



CHINA AND INDIA ARE RESHAPING GLOBAL TRADE, FINANCE AND INDUSTRY

India and China are emerging as giants in international trade and are reshaping the geography of industry. However, in some dimensions, for example, some areas of international finance, the Giants are not as dominant as many believe. Their growth presents other economies with many opportunities.

According to a recent World Bank report, *Dancing with Giants: China, India and the Global Economy*, the two countries account for about 37.5 percent of world population and 6.4 percent of the value of world output and income at current prices and exchange rates.

According to the report, the giants are growing very fast, and as their per capita production and consumption approach levels similar to those of today's developed economies, major effects on global markets and global commons are inevitable. *Dancing with Giants* considers whether such rapid growth through 2020 is feasible, whether there are any hints about the form it will take, and how such expansion could impinge on other countries.

Responding to the rise of India and China will require other countries to improve their investment climates and to invest soundly in infrastructure and human resources. According to the research, middle-income countries in Asia and Latin America are likely to face the biggest challenges. For example, producers in Thailand and Mexico are increasingly likely to see China move into their product spaces for items such as hard disk drives, auto parts, electronic components and apparel. Some of these countries are members of the production networks that may be threatened by China's move into component manufacture.

The direct challenge from China to Latin America is currently somewhat smaller, but it could increase unless Latin Americans boost the skills and technological capability of firms; diversify their product mixes, and upgrade the quality of products and expertise in design.

On the plus side, Chinese investment is expected to surge in resource-rich areas in Africa and Latin America, as well as into certain high-technology firms in North America and Europe.

To assess the effects of China and India's growth, the research assumes a future growth path for the Giants and asks what happens if they grow a bit faster. In the base view, China will grow at an annual average of 6.6 percent over the period 2005-20 (an aggregate increase in output of 162 percent), and India will grow at 5.5 percent a year. Even this conservative estimate implies an increase in their shares of the world economy from 4.7 percent in 2004 to 7.9 percent in 2020 for China, and from 1.7 percent to 2.4 percent for India. If China's and India's growth rates were raised to 8.6 percent and 7.3 percent, respectively, and if the world growth rate over the medium- to long-term were 3 percent, China's and India's shares of world GDP in 2020 would increase to 10.9 percent and 3.2 percent and their shares of the increase in output between 2005 and 2020 to 20.1 percent and 5.5 percent, respectively.

A key finding from the report is that China and India will become major players in the world economy, but certainly not the only ones.

Other key findings are:

- With annual growth at 15.1 percent over 1995-2004, China provided almost 9 percent of the increase in world exports of goods and services (second only to the United States), and 8 percent of the increase in imports (also second to the US). Both exports and imports are dominated by manufactures. India, accounted for about 2 percent in the growth of world exports and imports over the period 1995-2004, and its most dynamic export sector is information technology (IT)-enabled services. However, India's manufacturing exports are starting to grow strongly, particularly in the textiles and clothing as well as the pharmaceuticals sectors.
- With their growing incomes, the rise of the Giants offers most countries opportunities to gain economically. Many will face strong adjustment pressure in manufacturing, however, especially if, as seems possible, the Giants' technical advance is biased towards their current export sectors. For a few countries (i.e, the Philippines, Singapore, Thailand, other South Asian countries besides India) these pressures could outweigh the benefits of larger markets in, and cheaper imports from, the Giants and slightly curtail their growth rates.
- The Giants will contribute to the increase in world commodity and energy prices, but they are not the principal cause of higher oil prices. Although the Giants generated nearly half the oil use increase this century, their combined share of world oil consumption was still just 10.8 percent in 2003.
- India's and China's emissions of CO₂ will grow strongly if economic growth is not accompanied by steps to enhance energy efficiency. A one-time opportunity exists for achieving this if their ambitious current and future investment plans aim for appropriate standards. Doing so will not be unduly costly or curtail growth significantly.
- The Giants will become larger players in the world financial system as they grow and liberalize. They are likely to reduce the rates at which they are accumulating reserve assets and China may well reduce its current account surplus.
- Growing inequality could, especially in China, constrain growth potential since it implies a waste of talent and opportunity and makes efficiency-enhancing reform more difficult. Both Giants are aiming to address inequalities, however, and constraints are certainly not inevitable.
- Likewise, both Giants face challenges, but not insurmountable ones, in maintaining governance outcomes conducive to growth. Despite their very different institutions, both Giants have provided reasonable property rights and investment climates over the past decade or more.

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To download *Dancing with Giants* (DwG) and related materials, go to:
<http://econ.worldbank.org/dancingwithgiants>. For comparative facts and figures on India and China, see the attached one page fact sheet.

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FAST FACTS: Comparing the Giants:

Wealth and size: India is smaller and poorer than China [with a gross national income per capita of approximately \$620 (\$3,000 in PPP) to China's \$1,500 (\$5,000 PPP)].

Population growth: in both Giants, population growth has been slowing and is expected to continue to do so. China's population grew by only 0.6 percent a year during 2001-05, to reach 1.32 billion; it is expected to peak in 2032 and decline thereafter. India's population grew by 1.4 percent in 2001-05, reaching 1.1 billion, and its growth is expected to slow to 0.7 percent a year between 2030 and 2040 (by which time it will have overtaken China).

Growth of output and income: China accounted for 13 percent of the world growth in output over 1995-2004; India accounted for 3 percent, compared with the United States' 33 percent.

Domestic markets: The principal drivers in the Giants are their huge workforces, their ability to adapt technology and their large domestic middle-class markets (currently about \$1 trillion per year in China and \$250 billion in India).

The textile industry: In 2005, exports of textiles and garments amounted to \$9.5 billion and \$7.5 billion, respectively, versus China's respective \$77 billion and \$40 billion. Textiles and clothing account for 7 percent of world exports. China is the leading producer, followed by India. In 2004, Wal-Mart purchased \$18 billion worth of goods from China.

Pharmaceuticals: Developing a drug in India can cost as little as \$100 million, compared with a cost of \$1 billion or more in the United States.

Electronics: China has doubled the scale of the electronics industry, which now accounts for more than 8 percent of industrial output. In India the electronics sub-sector accounts for less than 3 percent of a much smaller industrial sector.

Services sector: Services account for 41 percent of GDP in China versus 51 percent in India.

International balance sheets: In terms of their underlying equity positions (portfolio and FDI holdings), China and India are quite different. In China, equity liabilities primarily take the form of foreign direct investment -- FDI liabilities were equivalent to 25.7 percent of China's GDP in 2004 versus 6.4 percent for India. Meanwhile, portfolio equity liabilities matter more in India -- equal to 9.1 percent of GDP in 2004, while they were just 2.9 percent of China's GDP.

Naturally available water: Water is scarce in both of the Giants. In 2004, China's naturally available water flow was 2,206 m³/person, and India's was 1,754 m³/person, compared with an average of 7,762 m³ for developing countries and a world average of 8,549 m³/person.

Energy efficiency: China's energy use per unit of GDP at market prices and actual exchange rates is 3.5 times that of the US. India's is 2.7 times larger.

Global carbon emissions: China and India currently contribute 17 percent and 5 percent of global carbon emissions, respectively.