THE BANK OF NEW YORK MELLON

Chindia: The Emerging and Merging of Two Asian Giants

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As the world's largest developing nations, China and India continue to fuel Asia's economic growth, which the Asia Development Bank estimates at 7.6 percent for 2008. The rise of these two giants within the global economy has led to healthy competition between the two countries. But as their economies emerge, they also are finding common ground from which to cooperate.

Increasingly, regional, political, economic, and business leaders are pointing out that Sino-India relations are at their best and getting even better. The extent to which China and India can strengthen and expand cooperation will be a key factor in their ability to succeed in the global marketplace.

Aneish Kumar and S.W. Chu, Bank of New York Mellon experts based in India and China respectively, have long been watching the changing dynamic towards cooperation from on the ground. They offer their perspectives on where cooperation is taking place, the implications of these developments, and what the future might hold.

Q&A with Aneish Kumar and S.W. Chu

Why is cooperation beneficial to China and India?

Kumar: What makes cooperation powerful is that each country complements the other's strengths. Collaborating in areas of complementary strength mutually enhances competitiveness.

Chu: We see this pattern of complementing strengths emerge on multiple levels in the areas of sourcing, selling, and investing. The information technology (IT) industry is one area where we've been witnessing it. The Chinese excel at hardware manufacturing, while India's strength is software development. The two countries have been working together to build synergies.

Bilateral Trade

India-China bilateral trade crossed US$ 38.6 billion by December 2007, surpassing the US$ 20 billion target for 2008 set a year before. Most recently, the two governments have set a target for 2010 of US$ 60 billion, a figure that could easily be achieved much sooner.

Exports from India to China include cotton, organic chemicals, iron, steel, and inorganic chemicals. India imports from China are highest in electrical machinery and equipment, organic chemicals, mineral fuels, oil, and oil products.

Where is cooperation between India and China happening today?
Kumar: Among recent developments, the two countries have engaged in a rapid increase in bilateral trade. In the past, India feared being inundated with Chinese imports. Bilateral trade has grown from less than $1 billion ten years ago to $38.6 billion today and should more than double in the next five years. Most recently, the two governments have set a target for 2010 of $60 billion in bilateral trade. China would surpass the U.S. to become India's largest trading partner if the two countries were to reach this goal.

Chu: In bilateral trade, the countries complement each other where they have natural resource shortages. For example, China imports commodities such as iron ore and other mining products from India and exports coal-related products to India. Both trade flows support the iron and steel industries. There is also some import of raw materials to add value for re-export.

What are the near-term opportunities for expanding cooperation?
Kumar: There are opportunities not only to source and sell as trading partners, but also to leverage respective manufacturing strengths to jointly explore growing markets in the region. For example, India's comparative advantage lies in complex, integral manufacturing, whereas China has mastered standardized design and mass production.

Human resources is another area of opportunity. China's demand for software educational services represents a significant opportunity for Indian IT training companies. Sharing experience in vocational training at the university level also could be of mutual advantage.

Manufacturing

India has become known as the world's back office for information technology and business process outsourcing (BPO), but a report by Capgemini, a global consulting, technology and outsourcing services company, predicts that India could threaten China's leading position in the next 3-5 years. Capgemini qualified this, saying that, although the Indian government is eager to attract foreign manufacturing activities, it will need to make significant investments to harvest this potential.

Chu: We are witnessing an increase in infrastructural projects. China has spent 40% of its annual GDP on infrastructure compared to 19% by India resulting in a world-class system of roads, airports, ports, and urban development. Chinese companies have gained expertise that could be successfully applied to India.

More generally, a number of Chinese firms have established a physical presence in India over the last decade, as have Indian companies planted roots in China. These include companies operating in software development, telecommunications, pharmaceuticals, and banking.

What recent developments evidence the move towards expanded collaboration?

Kumar: Both countries agree that their relations have acquired strategic importance. China and India have agreed to promote cooperation in many disciplines, including education, science, technology, healthcare, dairy development, information, tourism, youth exchange, and sports.

A number of initiatives are building on this agreement. For example, a joint study group has recommended a regional trading arrangement for identified sectors. China and India also plan to enhance direct air and shipping links, as well as tourism. In the area of science and technology, a joint steering committee will be consulting on how to mutually recognize academic degrees and qualifications.

Indian and Chinese banks are also following their corporate customers across the border. Foreign banks, such as The Bank of New York Mellon, are advancing the process by providing information, financing, matchmaking and transactional services to companies interested in taking advantage of this trend.

Mergers and Acquisitions

PricewaterhouseCoopers's second Asia financial services mergers and acquisitions (M&As) survey predicted that China and India will account for 86 percent of mergers and acquisitions in the financial services space in the next five years. The growth rate of M&As in India increased from 36 percent in 2005 to 39 percent in 2007. In China, M&As in financial services came down from 52 percent in 2005 to 47 per cent in 2007, but the percentage remains large.

What are the challenges to furthering cooperation?

Chu: Of course there are challenges to broadening economic cooperation, including differences in business practices; market conditions; legal, regulatory, and tax environments; as well as language and cultural differences. India and China can overcome these concerns.

The private sector in both countries is actively pursuing business ventures, and both governments are establishing policies for tax, customs, border trade, and travel as well as investment guidance and incentives that facilitate further expansion of the relationship.

A key challenge has been mutual suspicion. As this dissolves, investment between the two countries can substantially increase. There is an effort underway for increased cultural exchange. China is establishing a Confucian College at a leading Indian university, and a similar center for Indian studies is intended for China.

Private Equity

At US$ 10 billion in 2007, India attracted the highest private equity investments in the emerging economies outpacing even China, which attracted US$ 8.3 billion during the same period, according to IndusView, an India-focused cross-border advisory firm. Their positions reversed from 2006, when China received US$ 13 billion in private equity investments compared to US$ 7 billion in India. Most notably, India attracted only US$ 2 billion as private equity in 2005.

What might the future hold?

Chu: In 2006, China and India reopened border trade at historic Nathu La after a 40-year hiatus. The route caters to trade between Sikkim, Tibet, and the rest of China and India. When it opened, all border trade between the countries was approximately $100 million per year. Predictions for 2015 are for an increase to $3 billion through Nathu La alone.

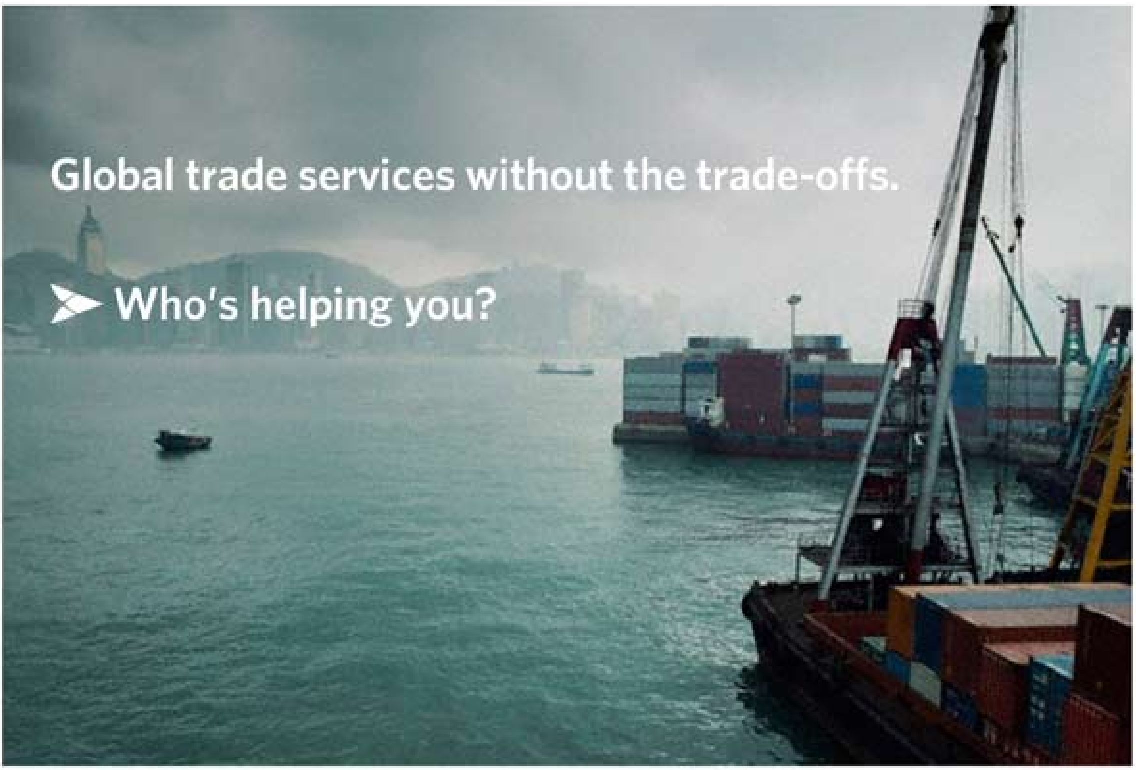
One might ask how the two countries will develop the infrastructure to facilitate expanded trade and investment. Perhaps the newly completed railroad between Beijing and Tibet will extend to India, or a highway could connect the countries. Will we see an oil pipeline from Russia or the Middle East that connects India and China? The reopening of the South Silk Road symbolizes the next phase of development.

Foreign Direct Investment

According to the world investment report issued by the United Nations Conference on Trade and Development, India was, after China, the second most-attractive location for global foreign direct investment in 2007, ahead of the US, Russia, and Brazil. China also led the 2007 Foreign Direct Investment Confidence Index by AT Kearney for the fifth consecutive year. India was second, a position it has held since displacing the United States in 2005.

Kumar: The concept of "Chindia" is emerging as an intriguing possibility. With 40% of the world's population, Chindia represents the world's second largest economy with an estimated 20% of global GDP. The two economies will account for up to 50% of global consumption of basic commodities including 35% of incremental global demand for energy. Combined, China and India will be the largest worldwide producers and consumers of coal, steel, cement, and non-ferrous materials. Technical and managerial skills in both countries are becoming more prized than cheap labor. Chindia will compete on a broad spectrum of low- and high-value-added goods and services.

The expanding cooperative relationship between China and India will be a defining trend in Asia for years to come.



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