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China's Staying Power

Yasheng Huang and Tarun Khanna argue (“Can India Overtake China?” July/August 2003) that India may have a long-term advantage over China even though it receives far less foreign direct investment (FDI). Yet, by resting their case in part on the preponderance of domestic as opposed to foreign investment in India, the authors understate India’s attractiveness to foreign investors and overstate China’s.

This is in part because a considerable portion of Chinese FDI is not foreign in the strict sense, but rather domestic investment financed out of Chinese savings in the form of capital outflows, mainly to Hong Kong, Macao, and offshore tax havens. These funds are sent back to China in the form of FDI and recorded as such in official FDI statistics. This round-tripping is motivated by the more favorable treatment that the Chinese authorities confer upon FDI: According to the World Bank report “Global Development Finance 2002,” round-tripping may account for nearly half of recorded FDI inflows. Furthermore, while Chinese statistics overstate FDI, Indian statistics vastly understate it.

China’s GDP is more than 2.5 times larger than India’s. Taking this difference in economic size into account, it turns out, surprisingly, that the respective amounts of FDI flowing into the two giant economies are not all that different. FDI accounts for over 2 percent of China’s GDP and for about 1.7 percent of India’s GDP. While China’s flows are larger, and have become larger still since China’s entry into the World Trade Organization (WTO) in 2000, they are not 13 times larger, as stated in the article.

The smaller gap makes sense: Most surveys of the investment cli-

mate show conditions in China to be somewhat better than in India, but in global comparisons, the two are in roughly the same league. Some conditions are better in China (most notably, the quality of physical infrastructure). Others, which are important for long-run economic and social development (predictability of the judicial system, for example) are better in India.

—GUY PFEFFERMANN

Director
Global Business School Network
International Finance Corporation
World Bank
Washington, D.C.

Yasheng Huang and Tarun Khanna’s argument that India could soon overtake China because it relies less on FDI and has more world-class companies and deeper financial markets is flawed.

India and China account for FDI differently. Normalized figures reveal India’s annual FDI is \$8 billion, or 1.7 percent of GDP, and China’s FDI is \$20 billion, 2 percent of its GDP, which means China’s growth is as organic as India’s. Although China’s first mainland stock exchange opened 115 years after India’s, China’s market capitalization is, at least, equal to India’s. India has taken 126 years to have 13 companies on *Forbes*’s list of the world’s best small companies; China has taken 11 years to place four firms on the same list. If you count private manufacturers—which *Forbes* does not—China has more globally competitive companies in more industries than India. China’s top five brands are worth about \$18 billion; companies such as Haier appliances, Tsingtao beer, and Legend Computers compete globally.

The reason for all this lies in something Huang and Khanna celebrate—the cult of the Indian industrialist. Indian founders rarely take their companies completely public.



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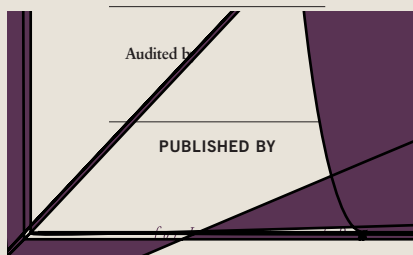
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Most companies remain family controlled and undercapitalized, with limited investment in research and development and marketing.

China's leaders may be more controlling, but they are also more competent. Even politically, given where both countries started, China has traveled further and faster toward democracy and good governance. Below the top 10 to 20 percent of India's population, hundreds of millions live in desperate poverty under a local tyranny worse than China's. The last time politics killed nigh on 2,000 people in China was at Tiananmen Square in 1989; in India, it was in Gujarat in 2002.

Perhaps India can take a page out of China's book—enact land reform, invest in primary education and research and development, give people basic human dignities, and more real economic and political freedoms.

—JEHANGIR POCHA
Beijing, China

Yasheng Huang and Tarun Khanna explain how India will beat China. Their argument that India's barriers to foreign investment ensure more genuine growth, and that China's dependence on FDI is somehow a liability, constitutes an odd residue of the old socialist ideas that China has repudiated and that India is slowly abandoning. In reality, foreign investment fosters domestic investment. It teaches management, familiarizes society with technology, builds global marketing networks, exposes industries to competition, provides capital, and maximizes modern jobs.

The authors exalt India over China partly through double standards. True, China did repress entrepreneurs. But Huang and Khanna gloss over India's repression of private business through the license raj and the continuing bureaucratic

antipathy to private and foreign companies. Today, large Indian companies enjoy more anti-competitive political power than China's state enterprises. The authors emphasize China's anti-capitalist history to suggest that it must still be more anti-capitalist than India, but they ignore the fact that today Chinese bureaucrats can only advance if they nurture investment. Therefore, they nurture it with an enthusiasm unimaginable in India.

They explain India's shunning of foreign investment by blaming democracy. Tell that to the Americans, British, and Taiwanese! In reality this rejection was imposed by a narrow elite informed by Harold Laski, the socialist British political scientist, and continues because of the political power of India's largest companies. Huang and Khanna explain away China's success at attracting investment by saying, "China's success in attracting FDI is partly a historical accident—it has a wealthy diaspora." Of course, India has an equally wealthy diaspora, but India only began to court its émigrés after China's success forced it to reconsider. Their assertion that "Indians abroad have substantially more intellectual capital to contribute" than the Chinese diaspora ignores the intellectual capital of Hong Kong and Taiwan, as well as China's vastly superior rate of investment in overseas education. They say India is held back by domestic and foreign conflicts, but don't mention that China had worse conflicts, both domestic and foreign, until the post-1978 policy changes that overcame them.

China's current FDI-led model of development emulates Taiwan's path several decades ago. In 1960, Taiwan was far poorer than India. By Huang and Khanna's logic, Taiwan should have fallen further behind. Today, however, Taiwan is an order of magnitude wealthier than India.

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Like Taiwan, China has superior potential because it builds infrastructure. For example, more expressways have been built in one year in China than India has built since its independence in 1947. China also educates its people better than India does, as shown by China's illiteracy rate of 14 percent, compared with India's 42 percent. By fostering competition more effectively and taking greater advantage of membership in the global economy, China has seen a 50 percent growth in vehicle sales in its first year of WTO membership. India's heartwarming recent success comes from modest moves in the Chinese direction.

—WILLIAM OVERHOLT
Asia Policy Chair
RAND
Santa Monica, Calif.

*Yasheng Huang and
Tarun Khanna Reply:*

Our claim is not that India is outperforming China overall, but that India has some underappreciated strengths and that these strengths—including better protection of property rights and a relatively better allocation of financial resources—constitute a long-term advantage.

Nowhere did we advocate restricting FDI. We do believe, however, that a superior strategy is to encourage both FDI and indigenous private entrepreneurship. As Yasheng Huang shows in his book, *Selling China: Foreign Direct Investment During the Reform Era* (New York: Cambridge University Press, 2003), the 1990s FDI flows into China surged in part because the government (motivated to protect state-owned enterprises) curtailed the investment potential of the domestic private sector. Greater protection of property rights and financing for private firms are not "old socialist ideas."

China has greater economic potential than India, as William Overholt and Jehangir Pocha state, but that is precisely our point: Despite its weaknesses, India's growth is approaching 80 percent of China's growth, with a substantially lower ratio of non-performing loans. Furthermore, India has more efficient domestic firms. The corporate heroes we celebrate today succeed by their capabilities, not by policy protection. We did not adopt a double standard. We simply deferred to the views of Chinese and Indian entrepreneurs. World Bank surveys suggest that Chinese entrepreneurs feel more financially and legally constrained than their Indian counterparts.

However, both China and India are far more "FDI-led" than Taiwan was. In the 1970s, FDI accounted for an average of only 1.2 percent of annual capital formation in Taiwan. By contrast, FDI accounted for nearly 15 percent in China during the 1990s and reached 2.3 percent in India in 2000. Taiwan's growth was led by domestic entrepreneurs. (Adjusting for round-trip FDI does not make a difference for our argument.)

Pocha's reference to Tsingtao beer is unfortunate. That firm was run to the ground and had to be rescued by Anheuser-Busch, precisely the FDI model we describe. Most Chinese entrepreneurs who succeed do so in places where local officials—ignoring central government prohibitions—have privatized state firms and financed private entrepreneurs. It would be strange for Pocha to praise those policies that, if fully implemented, would have killed off the entrepreneurial successes he so enthusiastically endorses.

We believe that China should seek to emulate India's institutional strength, and some Chinese officials agree. In 2002, a top Chinese legis-

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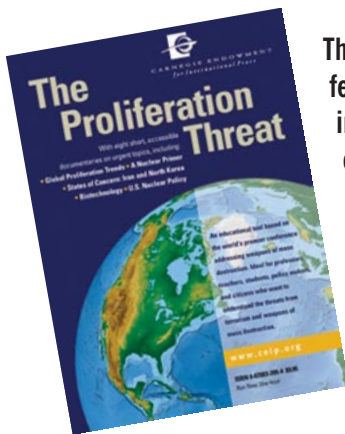
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lator, Tian Jiyun, criticized the government's policies to impose more restrictions on domestic private firms than on foreign ones. And now there is a proposal for a constitutional amendment to protect private property rights. Tellingly, the reaction to our article among Chinese officials has been less strident and more constructive than the reaction of observers like Overholt.

Terrorized Moderates

In her response to Michael Smith and David Martin Jones's letter ("Surprise Attack," July/August 2003), Dini Djalal writes that "those familiar with Indonesia's Byzantine politics, including [Dan] Murphy, would note that these [radical] groups flourish only when they are convenient to the ambitions of their military-linked patrons."

I would note nothing of the sort. While extremist groups such as Laskar Jihad and others have, at various times, had links to the military, it is foolish to believe that radical organizations do not have lives of their own. Indeed, Djalal's mention of Laskar Jihad brings to mind how many of us (myself included) failed to recognize the emergence of a smaller, more dangerous group: Jemaah Islamiyah (JI). In 2000, Laskar Jihad received lots of attention as the principal driver of the religious wars in the Maluku Islands of Indonesia. But JI, which organized the Bali blasts that killed 202 people last October and the attack that killed 12 at Jakarta's Marriott Hotel in August, was also at work there, using the conflict to recruit operatives.

The surprising emergence of this group supports Smith and Jones's argument that Southeast Asia has been ill-served by the conventional wisdom that the region's "moderate" Muslims would provide an

effective shield against extremism. Islam is of course heterogeneous, and there has always been something different about the faith in Southeast Asia. Yet Smith and Jones are right to point out that the academic and journalistic faith in “moderation” has caused many of us to miss the trend toward a more homogenous, radical Islam, fanned by bushels of Saudi money.

The majority of Southeast Asia’s Muslims are clearly not extremists. The problem is that the moderate majority has been steadily losing ground—despite whatever Djalal would have us believe. To dismiss these moderates as “still” being in the minority is to accomplish nothing. Small, committed groups have often changed the course of history. The challenge, especially for Southeast Asia’s moderate Muslim leaders, remains how to contain the extremists.

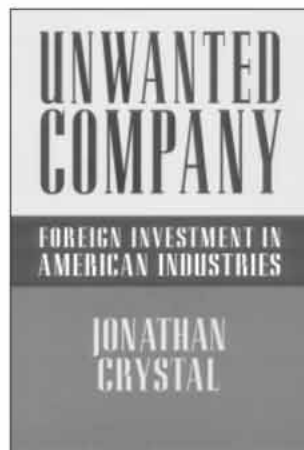
—DAN MURPHY
Jakarta, Indonesia

Dini Djalal Replies:

I have known Dan Murphy since the start of our journalism careers and value his work and opinions.

I also value the work of other colleagues who report on Indonesia and on “terror hotspots” around the world, without downplaying or exaggerating the threat. They are not to blame for failing to predict the actions of terrorists—groups that, by necessity, operate under extreme secrecy.

We reported what we saw, which was that the radicals were out of step with the general public. We were not, however, oblivious to subtle undercurrents in society. Michael Vatikiotis, now chief editor of the *Far Eastern Economic Review*, wrote in 1996 that “(a) potent challenge to established authority could stem from a revival of traditional

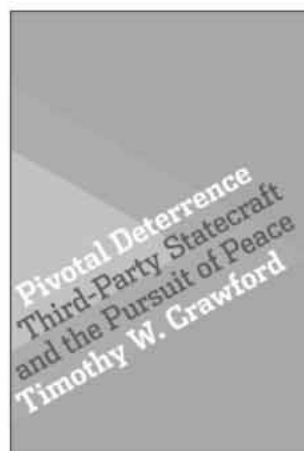


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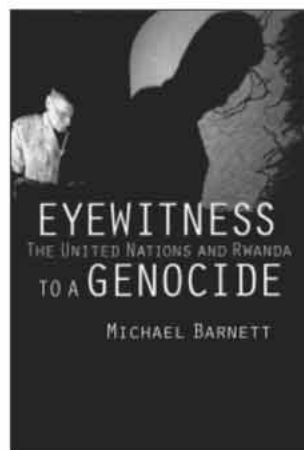


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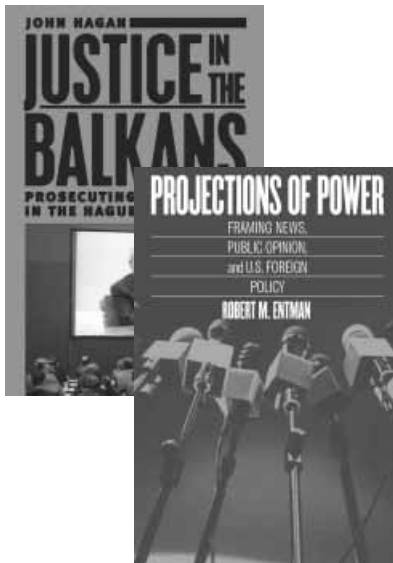
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religious and moral values."

There are, though, as many ways of looking at Islam in Indonesia as there are strains of the religion. One can choose to focus on the few thousand radicals shouting amongst 200 million moderates. Or, one can remember the report by Jakarta's CNN correspondent Atika Shubert that revealed the two best-selling T-shirts in Jakarta's markets feature Osama bin Laden and Britney Spears, respectively.

Dueling Nationalisms

Minxin Pei's "The Paradoxes of American Nationalism" (May/June 2003) illustrates American chauvinism and ignorance plus the peril of not defining one's terms. Pei cavalierly dismisses the distinction between nationalism and patriotism, implicitly presents U.S. foreign policy as a manifestation of alleged popular feelings of "national pride," ignores heterogeneity and fragmentation in U.S. society, and illogically equates community-based voluntarism with national integration.

Most egregiously, Pei characterizes nationalism in other countries as what he says Americans (which Americans?) regard as outmoded, destructive ethnonational superiority. According to Pei, U.S. nationalism is purer and more altruistic, at least to those who formulate U.S. foreign policy.

Emblematic of Pei's biases is the table showing "Different Visions" of nationalism. U.S. nationalism, Pei claims, is based on universal ideals and on such institutions as separation of powers. Other nationalisms are instead based on ethnicity, religion, language, and geography. So a parliamentary system is somehow inferior to the U.S. system? And, Pei argues, U.S. nationalism is unrelated to such primordial forces as

language and geography. Remember the debate about making English the official language? How about "fifty-four forty or fight," the expansionist slogan from the 1844 U.S. presidential election?

The next section of the table likewise attributes U.S. nationalism to grass-roots voluntarism. Is saying the Pledge of Allegiance really voluntary for schoolchildren? In contrast to the alleged voluntary basis of U.S. nationalism, Pei writes that other nationalisms are fostered and promoted by agencies such as the military, police, and state-controlled media. Precisely how do the military and police engender nationalism, except by perhaps controlling expression of ideas deemed nonnational? Could state-run media (the BBC and the Australian Broadcasting Corporation, for instance) conceivably do a better job in this regard than the Fox News Channel or even CNN in their coverage of Operation Iraqi Freedom?

Pei unwittingly demonstrates that the dangers of U.S. nationalism may be even more pernicious than imagined.

—STANLEY J. MORSE

Collegiate Professor

University of Maryland University College
Naples, It.

Minxin Pei Replies:

Professor Morse seems to have misunderstood, or distorted, some of the key points of my article. He accuses me of ignoring the "heterogeneity and fragmentation" in American society, for example. But he seems to forget that Americans are united by their belief in American political ideals, which, as I try to argue, form the basis of American nationalism. Also, I did not "equate community-based voluntarism with national integration." What I noted was the key role played by civic vol-

untarism in the promotion and maintenance of the symbols of nationalism in American society. That is quite different from saying that civic voluntarism contributes to national integration. Morse also believes that I regard American nationalism as "purer and more altruistic." He is again reading too much into my original text. All I was trying to demonstrate was that American nationalism is of a different kind.

The last point made by Professor Morse, about the behavior of the private American media during the Iraq War, does not contradict my main argument about the key role played by private efforts in promoting American nationalism. Indeed, it only reinforces it. The American media gave a nationalistic spin to Operation Iraqi Freedom out of the political convictions of the individuals who control the media. No state coercion or direction was needed.

Correction:

In the 2003 A.T. Kearney/ FOREIGN POLICY Magazine Globalization Index, the numbers that form the basis for Turkey's political ranking are incorrect. The correct scores are: embassies in country (Rank: 31), membership in international organizations (Rank: 25), and participation in U.N. Security Council missions (Rank: 31). FOREIGN POLICY and A.T. Kearney regret the error.

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