Chapter 1

Asia Rising: Emerging Themes and Trends

During the early years of the fifteenth century, the legendary Chinese admiral and navigator Zheng He led large armadas on voyages to the far reaches of Asia, eventually crossing the vast expanse of the Indian Ocean to reach the shores of Mogadishu in East Africa. These voyages—sometimes involving fleets of up to 300 ships—were an attempt by the prosperous and progressive Ming Dynasty to spread its influence in Asia and demonstrate its growing power. More than conquest, these voyages were meant to show off the tremendous achievements of the Chinese people. This age of Chinese expansion, however, was brief, lasting for only around three decades. The natural instinct to withdraw within the confines of its borders and its cultural embrace of modesty was too strong to resist, despite the tremendous domestic and international impact of a growing, prosperous, and increasingly powerful China. To compound the philosophical and cultural tendency to introvert, the Chinese expression of power came at a time of European renaissance and renewal that led to a European golden age that resulted in the colonization, subjugation, and eventual decline of China, India, and other Asian civilizations.

Well before the economic and political growth in the Ming Dynasty, though, China had already emerged as a world trading powerhouse during the Tang Dynasty (618–907 AD), with merchant ships trading at ports in India, Sri Lanka, Persia, and Mesopotamia (modern day Iraq), and in Egypt, Ethiopia, and Somalia in North and East Africa. Chinese trade with kingdoms in India was recorded as far back as 2,000 years ago.

Economists and historians have estimated that toward the middle of the second millennium, between one-quarter and one-third of total global output came from China and India. Interestingly enough, by the 1890s China's share of global trade had fallen to just 1.5 percent, while India's had declined to 3 percent. By 1920, India's share had picked up to 4 percent, while China's had increased to just 1.9 percent. But China has had the industrial, financial, and human capital to be a dominant economic story from antiquity right up to the modern age. Like India, it has fascinated the West for a long time given its wealth and manufacturing ability. However, it was China's huge population (numbering over 300 million a hundred years ago) that emerged as a key driving force for Western traders (or factors, as they were known) to set up trading establishments or "factories" in China in the late nineteenth century. Economic writers who chronicled the early age of Western engagement with China (in the eighteenth and nineteenth centuries) pointed out that the only barrier to trade with China was the Chinese themselves. They were so conservative, introverted, and content with their own domestic production that they saw no point in trading with the West.

In the current era, the rapid recent growth and development of China is a miracle, even by its own historical standards. The story of this economic miracle that has unfolded over the past three to four decades has been well documented but merits a retelling since it has become a symbol of how a nation can collectively amplify its strengths and overcome its weaknesses while creating endless possibilities for its people. And as economic momentum swings eastward, Chinese naval vessels are once again reaching out to Asian, African, and European shores and beyond, as China projects its growing political clout at a time of tremendous economic prosperity. With all the evidence before us it would not be far-fetched to say that we are likely witnessing a resurgent Asia, with China at its head.

China's path to economic growth commenced roughly a decade before the visionary reformist leader Deng Xiaoping began to formally push his country toward a more liberal economic agenda in 1978. As Figure 1.1 illustrates, China's growth rate over the past few decades has been by no means linear, with growth trends punctuated with sometimes extensive periods of deceleration followed by years of very significant acceleration. What is interesting is that, but for two years in the late 1980s, China has recorded annual growth of more than 8 percent for over 30 years. Even the United States, generally labeled as one of the world's first emerging markets, did not enjoy such sustained economic expansion during its early years. Over the past 15 years, China alone has accounted for 40 percent of the increase in the world's industrial output. India, which is now second only to China in economic growth and investment opportunity, will need to expand by 8 percent annually for 15 years before it reaches a size comparable with that of China today.

China's stock indexes have produced stunning results since stock trading was introduced on the mainland (through the Shanghai and

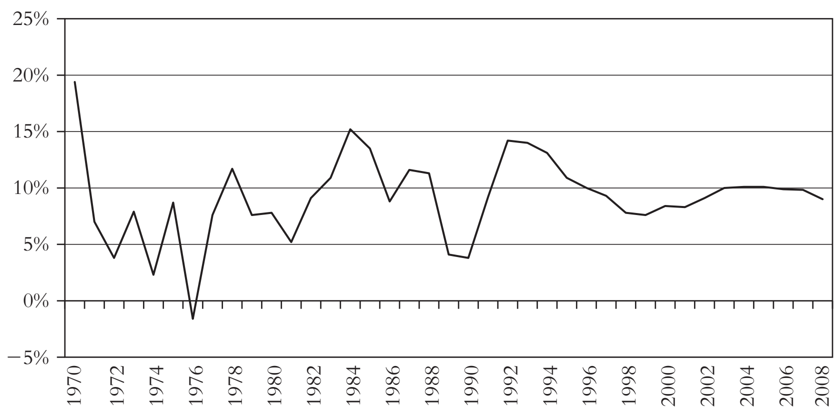

Figure 1.1 China's aggressive and remarkable 40-year GDP growth rate
Source: Bloomberg

Shenzen exchanges) in the early 1990s. For foreign investors, however, it is the China H-shares listed in Hong Kong (which are mainland companies with listings on either Shanghai or Shenzen as well) and the Red Chips (which are mainland companies incorporated in Hong Kong and traded only in Hong Kong) that are of interest. Here the returns from the Hang Seng China Enterprises Index (HSCEI), which represents both H-shares and Red Chips, have been spectacular too, as shown in Figure 1.2.

The average annual return on the HSCEI between 1996 and 2009 has been 9.8 percent, as compared to a 5.7 percent return for the S&P 500, an annual loss of 3.3 percent for Japan's TOPIX, and a 13.8 percent annual average gain for India's NIFTY Index.

India's equity returns have been among the best over different time periods from 1991 (the year that India's reforms process began in earnest), producing annual returns of nearly 14 percent, more than double that of the S&P. Even from 1993 onward, when the Hong Kong Exchange began to trade Chinese enterprises, the best total stock returns have come from Indian stocks, with an annual return of 13 percent over that 16-year period. While the risk perception of the markets in emerging Asia is certainly justified, the potential for returns remains undiminished for several good reasons, as we shall see later.

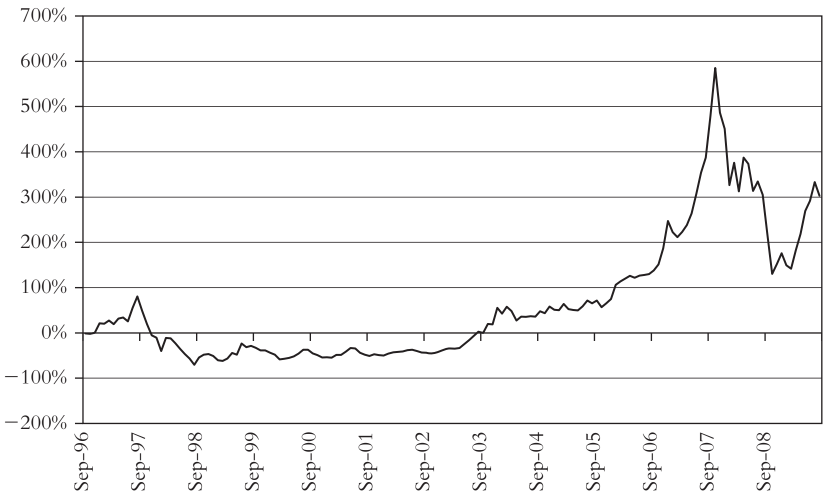

Figure 1.2 HSCEI returns, 1996–2009
SOURCE: Bloomberg

A New Economic Phase Begins for Asia

China's rise to prosperity in recent decades coincided with the surge in global trade and falling protectionism in major consuming regions. This trend led to extensive development of the coastal regions and cities that were the key to its economic strategy. But as the decade draws to a close, the economic structure that prevailed in the West for the previous five or six decades is beginning to look very different: the era of rapidly expanding global trade, open liberalism, and debt-funded consumerism is undergoing a drastic recalibration. Global economic relationships and national competitiveness are now being redefined in the wake of the global financial and trade crises that hit in 2007–08 as all nations seek to save more and protect their national economic interests by any means possible, giving rise to the specter of protectionism and reduced foreign trade.

Coincidentally, just as the developed economies face the prospect of years of slow growth and mediocre investment returns, East Asia—catalyzed by China—is entering the next phase of its modern economic era where the dominant themes will be linked to empowered domestic consumers and intra-regional trade. India for its part has long been focused on developing its domestic economy and has begun to accelerate that process. China has now begun to focus its collective energy on the development of its domestic market and its neglected hinterland. Given the lively pace of development and economic growth, Vietnam is being touted as the next Asian tiger and even Indonesia, East Asia's lumbering energy powerhouse always full of unrealized potential, is showing signs of breaking from the past and actually contributing to Asia's powerful growth story.

Significantly, the Chinese central government now sees the development of its domestic economy as a responsibility, not just to the Chinese people but to the rest of the world, and in keeping with its self-image as a "great and responsible" power. As China continues to open up its economy to competition through the slowdown it will become a powerful growth catalyst for a number of global economic sectors.

By Western standards the Asian consumer market has always been small, though growing rapidly for all that. Chinese growth has been driven by a high savings rate, a high investment rate, and low levels of domestic consumption. For China to supplant the US as a consumption-driven growth engine for the rest of the world then its historic trends must be reversed; consumption has to rise and savings fall. It seems as if a nation of frugal savers has now to turn into a nation of frantic shoppers. However, the unfortunate reality is that Chinese personal savings rates, especially in the more prosperous urban areas, had been falling long before the recent financial crises, and under the current economic circumstances, may not fall very much further. Chinese economists have been pointing out for some time now that individual Chinese savers are saving less than before and their place has gradually been taken by corporate and government consumption.

The Chinese government's understanding of this fact led to a swift and very aggressive direction to state-owned banks to step up lending to Chinese households at very low rates of interest. In addition, the Chinese government has implemented a corporate policy clearly designed to shore up domestic confidence (no pay cuts, no retrenchments, and no delays in payments to domestic suppliers) and one that quickly began to take effect in the second quarter of 2009, pushing domestic spending and raising global demand for metals, fuel, and other industrial commodities. India too unveiled a new economic policy, soon after national elections in May 2009 were convincingly won by incumbent reformist prime minister Dr. Manmohan Singh, that aggressively targets domestic growth, infrastructure spending, and increasing the government's financial flexibility. India is different from other Asian economies in that it has built an economy with a very strong domestic story and very low dependence on global trade and, despite the impact of contracting credit, it came into these crises very well positioned for growth.

Despite the forecast and expectation of strong growth rates for many Asian nations, how reasonable is the notion that these nations will move from being high savers to high spenders? Is there hope that the domestic markets in Asia and, especially, in China and India will provide the necessary growth momentum and a fillip to the global economy? And will Asian governments succeed with their plan to use their substantial financial flexibility (given that both households and most governments are underleveraged) and controlled banking systems to trigger a sharp but sustainable increase in credit and consumption?

These are questions that may appear hard to answer in the short term, but there are trends unfolding that make for some very powerful longer-term fundamental changes. Intra-Asian trade mechanisms are being strengthened in an unprecedented manner, with 35 bilateral and multilateral free-trade agreements (FTAs) negotiated between Asian countries in various stages of implementation. Second, almost every major nation in the world pulled out a stimulus package for their economies, together pumping between US$3–4 trillion into their recovery strategies. However, only India and China saw a powerful and quick resurgence in growth rates by the second quarter of 2009. While collectively the world economies—weighed down by the US, the Eurozone, and Japan—will experience a contraction for 2009 and small growth for 2010, only China and India among the major economies will push up toward their average growth rates. This is a powerful indicator of what the future might hold. It is almost certain that Japan's contribution to the Asian story will diminish over time. That role will be taken over by China, India, and the other large emerging economies of Indonesia and, possibly, Vietnam. Third, while the world has started wooing the Asian consumer, Asian companies are busy creating jobs across the world. Led once again by the indomitable Chinese, Asian companies are out there buying up corporate assets all over the place—from coal and iron-ore mines in Australia, auto-parts makers and auto plants in the US, equipment manufacturers and pharmaceutical plants in Europe, and oil projects in Canada, Africa, and Central America. According to an Ernst & Young study, between 2008 and 2009, some of the better-known Indian companies (including Reliance Communications, Wipro Technologies, and Tata Chemicals) made 143 acquisitions in the US alone, across a multitude of sectors including pharmaceuticals, IT, textiles, and manufacturing. One-third of these deals happened during the worst of the contraction in the US in 2009 and involved companies going bankrupt and about to close. In a similar vein, companies from other parts of Asia too have been buying up troubled companies in the US and elsewhere and essentially investing in those economies by saving jobs and keeping factories humming.

China's capital productivity has not compared well even with other fast-growing nations. China invests 40 percent of its GDP to produce a 9 percent growth rate; India on the other hand invests 30 percent of its GDP to produce an 8 percent growth rate. So unless there is an improvement in capital productivity, as the Chinese investment rate slows so will its GDP growth. In a sense there is a bit of a role reversal between India and China; where China drove its GDP growth through higher investments and lower consumption, India drove it through higher consumption and lower investments. Now India has been accelerating its investments just as China is accelerating its consumption. China has already built up very significant manufacturing capacities in a number of industries and will now have to spend locally to utilize that capacity. Indian companies have increasingly been driving investment spending in India and in general it would be reasonable to expect an upswing in corporate earnings growth following a period of sustained growth in capital expenditure.

Whether or not Asia actually delivers on the high expectations being placed on it, the world's reliance on the economic power of Asian nations to bring about a measure of stability is a remarkable turnaround from the situation a little over 10 years ago, when so much in rapidly growing Asian economies depended on the largesse of global multilateral financial institutions and the financial backing of the US and Japan. China's ability to influence the global economy is becoming more pronounced because of how it is using its wealth and knowledge in shaping a new pan-Asian economic framework focused on its domestic economy and inter-Asian trade. It is also triggering dramatic changes in North and Southeast Asia in particular and in the rest of the world in general. East Asian nations in particular are redefining their economic agenda and rapidly fine-tuning it to complement China's emerging domestic strategy.

Stock market returns from China, India, Japan, South Korea, Singapore, and Hong Kong have been superlative ever since Asian markets bottomed out in late October 2008 and have produced stunning absolute and relative returns (see Figure 1.3). As foreign investors became shaky participants during the global slowdown it was domestic investors that piled into mutual funds, especially in China where stocks have returned 25 percent. In India, the return has been 15 percent, as opposed to a –14 percent return in the US. It is very noteworthy that it

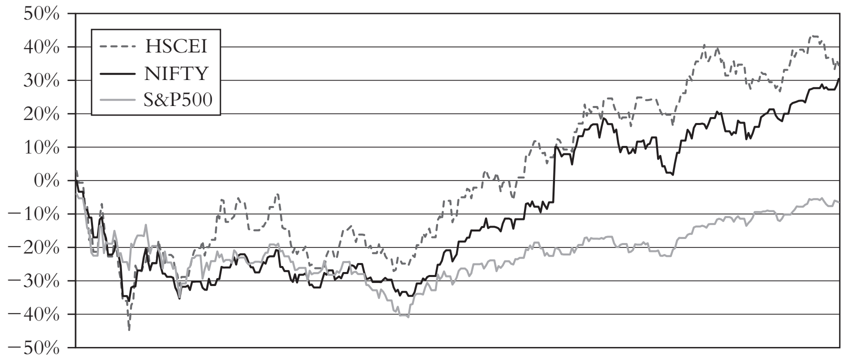

Figure 1.3 H-Shares (China), NIFTY Index (India) versus the S&P500 (October 08–September 09)

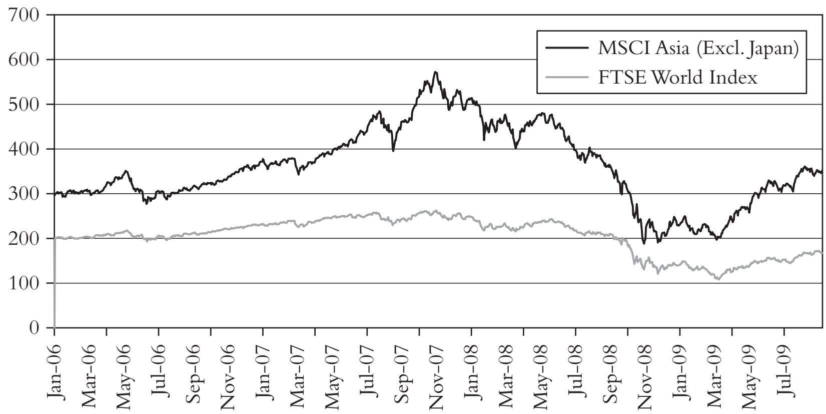

Figure 1.4 Emerging and developed-world markets compared

was the rally in China and key Asian markets that marked the bottom for global stock indices in October 2008.

The US markets followed five months later, in March 2009. This could signal the emergence of Asian markets as the trendsetters of the global economy and stock markets. It is also not surprising that declines or weakness in the leading Asian markets now tend to send ripples across global markets.

As Figure 1.4 makes clear, even when other Asian markets (with the exception of Japan) are included, the superior performance of emerging Asia against that of the developed world equity markets before and after the 2008 crash is evident.

While questions and doubts may persist about Asia's past performance and its future potential, and while debate may rage about whether Asia (especially China) can replace the US consumer and thus save the whole world, this really misses the point. Real development has occurred in Asia with some very profound and fundamental changes, some evident and some not so. The real story in Asia therefore is the mega-trends and themes that have begun to unfold across the continent, some recent and some that have been decades in the making, that are the real source of opportunity and value for global investors. These themes and trends are set out in brief in the following sections and are discussed in greater detail later in the book.

Emerging Investment Themes in Asia

A Rapidly Rising Standard of Living and a Large and Growing Middle Class Well Positioned on the Road to Prosperity Is a Powerful Growth Trigger

Asia is now home to the fastest-growing economies anywhere, and key Asian nations have experienced rapid growth in GDP and per-capita income, sustained increases in asset prices, and a rising standard of living for the last two decades. Asian GDP has increased from US$8 trillion in 1995 to US$14 trillion in 2008 (an annual growth rate of 5.7 percent) and according to IMF estimates will reach US$20 trillion by 2014 (with an even faster annual growth rate of 7.1 percent). Consumerism is the new economic mantra for a population that is younger, better educated than ever before, with a growing disposable income and the confidence to use it. Their desire for an upwardly mobile existence is proving to be the ultimate growth trigger. By 2020 half of all Chinese will belong to the middle classes, while India and China together will add 450 million people to the ranks of the middle class by 2030. The greatest impact will be felt in the real-estate market, since it is every person's dream to own their own home (followed by owning their personal transportation).

Asian households (barring Japan and South Korea) in general are underleveraged and have discovered the purchasing power of the credit card. Given that India's and China's household debt/GDP ratio is barely over 10 percent, over the next few years we are likely to see the emergence of a new and aggressive breed of Asian consumer. This is likely to drive the values of companies that cater to the local economy and depend on domestic consumers of all types of goods and services. Sectors and companies that are dependent on discretionary spending, whether on consumer durables (including electronics, TVs, and automobiles), real estate, travel and leisure, media, and consumer staples such as food and beverage producers to general and specialty retailers, look to be promising. Equally strong and almost recession-proof is the education sector. Financial services and asset managers will be big beneficiaries as disintermediation takes hold and Asian countries relax regulations on intra-regional trade in financial services. Already brokerages in the region, and especially in China, have reported an unprecedented increase in new retail brokerage accounts during the trough and rally in 2009.

Multinational corporations with strong brands have already made sizeable inroads into key Asian markets; companies such as YUM! Brands, Coca-Cola, Procter & Gamble, Kellogg's, Nestlé, and Unilever, for example, have very successful platforms in Asia, from which they will derive a growing portion of their future revenues. GM, a company synonymous with a sick manufacturing sector in the US, is the number-one foreign car maker in China, with a 13 percent market share in what is surely the world's most fragmented passenger-car market. GM reported nearly 40 percent volume growth in China during the first half of 2009, even as it emerged from bankruptcy in the US. GM expects to double its current volume in China alone to two million by 2014.

A key measure to look for will be per-capita income growth, and the disposable share of that income is expected to increase exponentially. In the last couple of decades China has increased its per-capita income several fold. If India invests heavily in infrastructure and carries out necessary structural reforms, it can easily be a US$55 trillion economy by 2050 and raise annual per-capita income from the US$1,200 reported in 2008 to US$36,500. Countries such as Vietnam too have

Table 1.1 Per-capita income growth for select Asian economies

Country	1987–1997	1997–2007	2006	2007	2007–2011
China	8.9%	8.7%	11.0%	11.2%	9.7%
India	5.5%	6.9%	8.2%	7.7%	7.2%
Indonesia	6.1%	2.3%	4.3%	5.1%	5.2%
Malaysia	6.5%	2.5%	4.0%	4.0%	4.3%
Vietnam	5.6%	5.9%	6.9%	7.2%	6.9%

SOURCE: World Bank

done an excellent job at pulling up living standards and are likely to accelerate that trend. The growth in per-capita incomes (actual and projected) for selected Asian economies is set out in Table 1.1.

Education is a booming business in China, India, Korea, and other parts of emerging Asia. For a continent with a young population, education is both a government priority and a multi-billion-dollar opportunity being quickly exploited by entrepreneurial and well-established companies alike, including the likes of Disney, Pearson Plc, and Linguaphone.

India has neglected its basic education system but has spent heavily on higher technical education, producing world-class institutes such as the six Indian Institutes of Technology (IITs) and thus preparing itself well for a service-oriented economy. India's development of the Tejas multi-role fighter aircraft showcased the depth of its scientific and engineering talent. Led by the public-sector aviation company Hindustan Aeronautics Ltd., more than 100 national research laboratories (including the Gas Turbine Research Establishment, National Aerospace Laboratories, private companies' research divisions, and engineering institutes) worked on cutting-edge technologies ranging from developing composite materials for the air frame, multi-mode radar, and a highly versatile jet engine. The Aeronautical Development Agency, which has oversight over the project, has licensed out some of the key technologies developed to global aircraft manufacturers and software companies.

China, on the other hand, prepared itself well for an industrial economy by focusing very zealously on primary education for all.

Though the emphasis on higher technical education is a newer phenomenon, China is not without its science-and-technology laboratories and its world-class companies that can now drive its industrial might. China too has a very long history of scientific innovation and technological progress. The Ming Dynasty voyages mentioned earlier are just one example of its demonstrated pursuit of technical prowess. The largest ships in those fleets, measuring roughly 500 feet in length and housing a thousand people, were considered to be the largest and most sophisticated sea-faring vessels of the time.

In comparing the development of the two nations, it may be easy to overlook the fact that in several ways India resembles a post-industrial society, with its advanced knowledge-based industries and remarkable technical prowess even in nascent areas such as nanotechnology and advanced aerospace technology. China has furiously pursued advanced scientific development and after two decades of effort has only just caught up with India in its annual output of scientific manpower.

Asia Is Urbanizing at an Unprecedented Pace

Asia is turning itself into an urbanized society, and several nations have begun to display the characteristics of post-industrial economies. This transformation is not simply a shift from a predominantly agrarian economic model to a predominantly industrial one but a shift of the labor force away from agriculture and into industrial and, more importantly, service sectors, thus significantly boosting overall wages and the standard of living.

Of all the major economies, India still has the largest proportion of its population in rural areas. China offers a good, large-scale model for India to follow in shifting its manpower away from agriculture into better-paying industrial jobs and from rural to urban areas. Despite the superior quality of its services sector, around 57 percent of the total Indian workforce is still engaged in agricultural and rural-based activities even though 75 percent of GDP is generated by the industrial and services sectors. India is now back-pedaling and creating the necessary economic environment to strengthen its industrial base like East Asia has done. The model that India has developed is built around the quality of its manpower and the high levels of technology absorption that will enable it to grow quickly into a post-industrial society. True prosperity will come when India is able to meaningfully employ its rural population and scale up its industrial base.

The 1990s was a period of change for most of Asia and its economic and social direction that has been driving rapid industrialization and the building of a strong and well-organized service economy. In 1991 India shed its socialist past and began reforms in earnest, while China's accelerated growth led to its accession to the WTO and the opening of its domestic economy. Following the Asian financial crisis of 1997–98 East Asia put in place numerous changes that transformed its economies; and a decade of weak oil prices prompted very significant change in thinking in the Middle East, where the move away from oil has begun in earnest, prompting the development of an urbanized service economy encompassing tourism and financial services.

To that end, growing urbanization in almost all Asian economies is a driver of economic growth, especially given all the ancillary trends that it triggers. The shift from rural to urban living results in more development initiatives that go beyond real estate and infrastructure and drive a number of other sectors. Social shift involves changes in how people choose to live, a reduction in average family size, a rise in incomes, and an increase in disposable surplus to spend on discretionary goods.

Growing Regional Cooperation and Economic Integration—A Mass Market Opens to Local Trade

The East Asian nations (Japan, South Korea, Taiwan, Singapore, and Thailand) that rose to prominence on their substantive trading volumes with the United States, now count China as their single biggest and most influential trading partner. Japan's foreign-trade statistics are the most telling symbol of this change. Up until 2008, the United States had always been Japan's largest trading partner, but then China claimed that title. China's total trade with Japan amounts to nearly US$260 billion per annum while Japan's total trade with the US is US$240 billion. Even China's trade with India has grown by 32 percent annually for the last 10 years. These trends become more significant when we consider that after being stung hard by the economic slump, US consumers have cut back on consumption rather drastically. A portion of this lost spending will be felt in global trade, with the biggest loser being China, which will need its trading partners in Asia like never before to help keep its factories humming. It will also be forced to open up its own economy to further competition. This unprecedented economic need is probably the best guarantee that China will do its utmost to promote economic stability in Asia and will seek further integration and cooperation among Asian economies, a process that has been under way for several years now. Essentially this process will provide preferred and less-cumbersome access for Asian companies to rapidly expanding Asian economies.

Asian regional cooperation and economic integration, which has become critical to global recovery, has been on the rise for several years and is now at an unprecedented level. It will rise to even greater heights in the years ahead. In 1980, a little over one-third of Asian trade was within Asia; at present this figure is approaching 60 percent. The activation of the ASEAN–China free trade area (FTA) in 2010 will create the world's largest trading bloc and will supersede the European Union in impact (if not in scale since the EU GDP is around US$18 trillion). It will encompass 1.7 billion people directly and nearly 3 billion people through linked agreements such as the ASEAN–India FTA, the China–India FTA, the India–Korea FTA, and the China–Korea–Japan economic framework and trade agreements—which will cover half the world's population, nearly a third of world GDP (at nearly US$13 trillion), and all the world's fastest-growing economies. The ASEAN–China FTA alone will have an annual GDP of nearly US$5 trillion and well over a trillion dollars of intra-regional trade. India too has put into effect its "look East" policy through which it intends to foster very close links with East Asia. All of these changes to how the most powerful Asian nations now interact and trade with each other will, through sheer dynamism and accelerating growth, shift the levers of economic power to the Asia-Pacific region. However, given other competing national priorities, a single standardized economic union along the lines of the EU may be much further off since it is a little difficult to envisage Asian collaboration on important issues such as defense and foreign policy.

While the ASEAN nations (10 Southeast Asian nations), South Korea, Greater China (China, Taiwan, Singapore, and Hong Kong), Japan, and India are looking at lifting all barriers to intra-regional trade, it is the movement of people between these nations for leisure rather than work that will likely be an enduring investment theme for a long time to come. The Japanese and South Koreans have long been the region's most avid travelers, especially to each other's countries and to the West. But now a new force has emerged on the Asian tourist scene; the Chinese traveler. Chinese global tourism is only a recent phenomenon and for a while people could travel freely only to those countries that had been approved by the Chinese government. But this is no longer an issue, and most nations have now been approved and the rush to East Asia is well under way.

On the western fringe of Asia lie the desert kingdoms of the Gulf Cooperation Council (GCC) nations (Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Oman, and Bahrain). These nations have functioned as a trading bloc since 1981 and are now pursuing the creation of a common currency, already a much-delayed event but likely to take effect within the next five years following the launch of their common market in January 2008. These are all probable precursors to eventual economic union. These six nations are also looking toward a future when their economic reliance on oil revenues will reduce, and today are looking to develop the region into a services and hospitality hub, with tourism as a cornerstone of their new investment strategy. These two broad economic trends unfolding in East and West Asia are likely to see the emergence of two very dynamic economic and consumer blocs in Asia that will drive growth and create interesting investment opportunities across a wide swathe of the continent.

It has almost become economic dogma in the Western investment world to believe in the BRIC (Brazil, Russia, India, and China) economic mantra and that China will be the world's largest economy by 2050 and India the second-largest. The probability of that actually happening is not very relevant in gauging where the investment opportunity lies in these economies and which investment is likely to endure over the long term. The fact of the matter is that these two countries currently define and envelop a lot of the economic and investment transformation in Asia and the world since the 1990s. But while these two giant economies contribute to Asian growth and political stability, they also benefit from the tremendous strides taken by several other Asian economies since the economic shock of the debt and currency crisis in 1997–98. A development not recognized in the BRIC argument, but one that is a distinct reality today, is the heightened economic integration and cooperation between various blocs of Asian nations. This process of integration builds on the region's competitive advantages, thus making the entire region, and not just one or two countries within it, a very compelling investment story. As economic integration becomes more robust and financial integration becomes an important element, the depth, sophistication, and opportunities within these economies will also grow.

Evolution of a Robust Pan-Asian Financial Infrastructure

Without discounting the seriousness of the economic pain felt in Asia as a result of the global financial crisis in 2008–09, the defining crisis for many emerging Asian nations was the 1997 currency and debt crisis. That crisis quickly turned into a severe economic contraction for several Southeast and North Asian nations. East Asian nations suffered dramatic economic collapse, including a run on their currencies. Aided and supported largely by Japan, the US, and an emerging China, the crisis drove the resurgence of a new Asian economic system based less on state direction and more on free-market economics and competition. The focus was on economic management and on building a more robust economic model capable of withstanding economic shocks. As a result, several of these countries emerged stronger, with more versatile and flexible domestic economies. Accumulating foreign-currency reserves has been the unrelenting focus of Asian governments, and their economic policies have evolved to sustain that objective. Asian nations today control the largest accumulation of dollar reserves anywhere in the world, with the bulk (a cumulative total of US$5–6 trillion) being concentrated in China, Japan, India, Singapore, and the GCC nations, and have the best-capitalized banks anywhere.

One very significant reason why Asia has escaped the worst of the 2008 financial crisis is that, with the exception of Japan and to some degree South Korea, the financial sector, which is deeply embedded in the fabric of more-developed societies, has not yet become a significant part of the economy, and the impact of economic contraction is thus not carried as far. India is one of the best-placed countries in respect of household debt and corporate leverage. Indian households have one of the lowest mortgage penetration rates among any major global economy—roughly 4–5 percent of GDP, where the average for major Asian economies including Japan is around 28 percent. China's is a little less than half of that. Indian companies too de-leveraged early on, and, with the resulting reduction in the risk premium demanded, Indian companies have considerably strengthened their balance sheets with equity capital. Low leverage is one of the most significant reasons why growth in Asia has already restarted (Japan being a notable exception) and why the more developed world will find it hard to keep pace (as reducing its considerable debt will take a very long time).

Further, contrast the cohesive response from governments in Asia to the economic and financial crisis with that in emerging Europe and Latin America. Government or, for that matter, any institutional intervention has largely been bilateral or through the Asian Development Bank or other regional structures. There has been no recourse to the International Monetary Fund (IMF) and, for the first time, Asian nations other than Japan have actually been contributing to the IMF capital base. This means that Asian governments today have the financial flexibility needed to spur growth with a further dose of stimulus spending if needed. China in particular enjoys a high proportion of tax receipts to GDP and low fiscal deficits as well as public debt.

Along with these changes, also emerging is a shift in financial centers. London rose to become the world's financial capital in the eighteenth and nineteenth centuries, replacing Amsterdam and Lisbon. New York was propelled into the same role in the twentieth century and remains the leader today. But, increasingly, Shanghai is being positioned as one the world's great emerging financial centers, along with Seoul, Singapore, and Abu Dhabi. Shanghai is already at the center of Asia's very significant and growing corporate-bond market, valued at some US$43 trillion.

An even more important and symbiotic development is the push to reduce barriers to intra-Asian trade in financial services. There is a growing awareness of this need for further Asian integration among Asian central bankers and financial institutions. Though still in its early stages, this could be one very exciting trend which, as it unfolds, adds further depth to the Asian financial system in general and capital markets in particular. India and China are today considered to be the world's foremost emerging markets for financial services. The prospects for the insurance sector are very strong, with most nations reporting very low levels of insurance penetration but strong potential given a better appreciation of risk and the growing sophistication of products offered, especially in retirement and healthcare segments.

Today with the Western world's financial system and once-vaunted banks in shambles, the most valuable banks by market capitalization are now Chinese banks. At the time of writing, the International Commercial Bank of China (ICBC) is the world's most valuable bank, with a market capitalization of US$175 billion. Before the start of the crisis in late 2007, Citigroup alone was worth US$250 billion, before losing 95 percent of its value. It therefore came as no surprise when the governor of the Chinese central bank made an uncharacteristically bold statement that China was better poised to lead the global recovery since its financial system and institutions were stronger than most.

Development of a Strong and Growing Private Sector

Unlike most other Asian nations, with the possible exception of Indonesia, India has single-mindedly focused on developing its domestic economy for decades. While India and China had similar backgrounds and economic and political conditions in the 1950s when they began their respective socialist and communist journeys, their paths began to diverge almost immediately. India stayed true to its commitment to build a hybrid economic model of private and state enterprise, where the state undertook the arduous task of building heavy industry, education, and infrastructure and the private sector did everything else. However, the Indian government began to make its overbearing presence felt on the private sector's turf by the 1970s, when the nationalization of banks and other industries reached a higher pitch, culminating with the forced departure of foreign companies such as Coca-Cola and others. Those companies that did not leave had to dilute equity in favor of domestic retail investors and list on Indian exchanges. Even during the darkest days of state control, the Indian private sector continued to grow even as companies sought government patronage and entrenched players succeeded in keeping out competition. This phenomenon allowed the blossoming of several private conglomerates and turned them into industrial behemoths. Indian managers, companies, and brands continued to develop and, more importantly, the institutional infrastructure also developed, thus aiding the development of the private sector. So when India's experiment with socialism and nationalization ended in 1991 and the economy was re-opened to foreign competition in 1993, the stage was set for a tremendous release of entrepreneurial energy and a ramping up of the institutional infrastructure.

In contrast, China grew only state-owned corporations and thus lacked a history of strong private-sector growth. Everything remained in the hands of the government until recently and even now the bulk of industry is state controlled or state driven. China remained mired in the communist dogma of central planning and state ownership and control of all economic levers until the late 1970s, and for a long time even after liberalization the state maintained control of nearly the entire economy. However, from the mid-1990s there began to emerge a growing entrepreneurial layer within the domestic economy that is beginning to transform the state-dominated economic model into a hybrid economy, more like India's. Recent surveys of the Chinese job market have shown that one in four Chinese intend to be self-employed. As recently as 2003 China did not have a single billionaire on the Forbes list; by 2009 it had 28, edging India (with 24) into second place on the Asian billionaires list.

The reason why until recently India had had a larger number of billionaires despite China's economy being three times larger is that India's private sector represents a much larger percentage of its economy. Indian private industry has been around since the early 1900s, and well before independence from Britain in 1947 the Indian private sector controlled steel and cement plants, airlines, hotels, insurance companies, and banks. By 2009, the Indian private sector was contributing more than US$800 billion to GDP as compared to the US$600 billion contribution from the Chinese private sector, despite being one-third the size of China's GDP. The Indian planning commission has said that for India's 11th Five Year Plan (2007–12), the private sector's investment share will be 80 percent. The Indian market capitalization also is largely dominated by privately run firms (67 percent of a US$1 trillion market cap) and currently has some 7,000 listed companies, as compared to 1,500 listings on Shenzen and Shanghai combined (though when Chinese companies in Hong Kong, Singapore, Toronto, and the American Depository Reciepts [ADRs] in NYSE and NASDAQ are taken into account this will be a larger number).

In addition, Indian public-equities markets provide investors with the option of buying into local listings of global corporations. For example, GlaxoSmithKline, Siemens, ABB, Unilever, Proctor & Gamble, Nestlé, Ingersoll Rand, Bosch, ITW, and a large number of other global corporations have listed their subsidiaries in India and offer a serious alternative to global investors looking for high-quality exposure to India. China still has to go beyond the heft of government companies and needs to make its markets more conducive to foreign companies listing subsidiary companies in China.

While India has had a head start in building world-class companies, the Chinese have learned very quickly and now have some dynamic companies with few ties to the state that are able to hold their own in a domestic economy that is increasingly competitive. Taiwan is a good example of the interplay between the state and the businesses it spawns. While promoting industries such as semiconductors over the past three decades, the Taiwanese also created an environment for a thriving private sector and built strong institutional frameworks to enable interplay between the government, the private sector, and Taiwan's strong technical universities. The government also fostered the spirit of competition and cooperation with the Taiwanese private sector. As a result of its very forward-looking economic policies and early development of its human capital (which, incidentally, was a function of Japanese government policy during its occupation of Taiwan during the Second World War), Taiwan has reported one of the most phenomenal per-capita GDP growth rates (12 percent annually from 1962 to 2008), with per-capita GDP (adjusted for purchasing power parity) increasing from US$170 to US$33,000. Its level of development and economic growth has put Taiwan on par with developed nations.

Privatization, the New Growth Engine

For any economy to prosper, it has to be driven by private enterprise and by entrepreneurs seeking a profit, surviving competition, and innovating. Russia is a good example of a state that has not been able to let go of its control over the economy and one that keeps muddying the playing field for private enterprise. By contrast, the relatively recent hybrid Chinese model of state-directed capitalism has proven to be a good incubator of entrepreneurship. Most Chinese enterprises begin with state support, including ample, low-cost credit, and are allowed to grow before being turned over to private hands. Carefully nurtured entrepreneurship in combination with financial stability, labor flexibility, and consistent economic and monetary policies have become the foundations of a successful economic system. Added to this, there has been a recognition of the need for independent regulatory bodies. The successful creation of such bodies in the securities industry (for example, the China Securities Regulatory Commission, the China Banking Regulatory Commission, and the China Insurance Regulatory Commission) makes the case for investors all the more compelling.

The extent of private ownership of the Chinese economy will increase as state-owned enterprises privatize and new enterprises are spawned or IPOs are launched by the private sector. In India, too, privatization is expected to pick up. Expectations among global investors are running high in the aftermath of the 2009 national elections that the Indian government will aggressively privatize state-owned companies. The fact that several such companies have come forward with plans to raise equity from domestic and overseas capital markets provides a basis for investor optimism. In the five-year period before the 2009 elections, the Indian government was hampered by its leftist coalition partners who blocked any talk of privatization and was thus not able to build on the significant momentum given to privatization by the previous government led by Atal Behari Vajpayee (1999–2004). (Even highly developed Asian economies such as Taiwan still have a very significant proportion of state-owned enterprises, though the Taiwanese government has said very clearly that it intends to privatize most of these.)

In India's case, the companies that are most in need of growth capital are the state-owned banks, oil companies, and power companies, which should be among the enterprises most likely to reduce the government's stake as they raise capital. There are 48 government-owned companies listed on the Indian exchanges, with a current market value exceeding US$400 billion. Speculation that the new Indian government will move quickly to privatize or further reduce its stake in listed non-bank companies has driven returns from the beginning of 2009, though it is likely that some outperforming banks (such as Corporation Bank) will be candidates for disinvestment.

The decision by various Middle East governments to privatize state-owned assets and allow foreign investors to participate has already created a sizeable securities market for their assets, both in GDP and absolute terms. The GCC nations now command a market capitalization of nearly US$600 billion, over 50 percent of which is Saudi Arabian and nearly one-quarter Kuwaiti. However, the investible universe for foreign investors is small in these markets and there are a number of restrictions, especially in Saudi Arabia, which has little foreign-investor participation. The most investor-friendly markets are the UAE, Kuwait, and Qatar, which between them have more than half the region's investible total. The privatization trend is expected to continue in the Gulf Arab nations and will form the basis for long-term institutional-investor interest and eventual participation in their economies.

Increased privatization and increased private-sector activity that, in turn, engenders competition will be among the great drivers for much of the region, especially China and India. China's acknowledgment of the need for competition, especially foreign competition on the mainland, began to accelerate after it joined the WTO in 2001. According to Chinese government statistics, nearly 15,000 new entities, both domestic and foreign, are registered every year. As more foreign companies set up operations in China, not just to export overseas but to service and sell to the domestic economy, the relative importance of China to the rest of the world will only increase. Besides offering the world a greater stake in its growth story, more economic openness is a terrific tool with which to build strong and resilient domestic companies, as India's experience has shown. If India today is able to boast companies that can compete with the best in the world in diverse industries such as steel, automobiles, pharmaceuticals, chemicals, telecommunications, and IT, this is largely due to the brutal competition that these and other sectors were subjected to both from imports (lower tariff barriers) and from foreign companies that invested in India from the early 1990s as a result of the government's economic liberalization program. And this has been the case across Asia, where foreign direct investment (FDI) and less-restrictive import regimes have become enablers of economic prosperity.

Infrastructure Development and Energy Security as Mega-Economic Drivers

Asia's hunger for energy is common knowledge. Decades of rapid development regardless of the impact on the environment is evident across the continent but especially in China. Asia is faced with the unpalatable task of maintaining the pace of its development while acknowledging that it has to contribute to mitigating the effects of global warming. There is no easy answer but both the scale of its energy requirements and the problem it faces have become a huge investment catalyst for both conventional and renewable energy.

Asian nations led by China and India have already commenced plans to invest well over a trillion dollars into power, roads, ports, airports, telecom, water, sanitation, and other physical infrastructure projects to be put into place across the continent over the next few years. The focus of these projects will be determined by their respective national priorities. China's focus is on water management and supply, power, and expanding its railway network; Indonesia's is on transportation infrastructure; in the GCC countries it's tourist infrastructure; while in India it is still core infrastructure of roads, ports, railways, and power. Given the large number of projects already announced or in the planning stages, Asia is emerging as one of the biggest customers of the global renewable energy and nuclear industries.

Vast sums are being poured into energy infrastructure whether it be gas pipelines in the central Asian republics, liquefied natural gas terminals, or cryogenic carriers to refineries (the largest of which is now in Asia). Currently there are 37 re-gasification terminals in Asia (28 of which are in Japan, three in India, and one in China), with 40 more being built in the Asia-Pacific region with Japan, India, and China dominating the demand. China, India, Korea, and Japan are major emerging markets for nuclear power and there are a number of global companies in the engineering, construction, mining, and fuel-supply businesses that will benefit from Asia's unprecedented plans to invest in nuclear energy.

Asian Economies and Corporations Are an Integral Part of Global Industrial and Services Networks

Given the powerful development trends seen within Asian economies, most Asian companies are less likely to be hurt by global disruptions and more likely to contribute to the recovery. For most global corporations too, China and India have become pivotal to their growth strategies, and establishing business relationships and lucrative supply contracts is now essential. Today it is unthinkable for the global IT industry to contemplate growing its business without being integrated with India's software companies or its vast software talent pool. Similarly, for hardware manufacturers integration with the Taiwanese semiconductor industry is critical. Taiwan's evolution as a hardware manufacturer began in the 1980s, when it acted as an outsourcer for American and Japanese technology companies. Taiwanese companies, backed by the government, focused on semiconductor technologies. Companies such as UMC and Taiwan Semiconductor Manufacturing Company, which began with technology transfer to set up chip foundries, have now grown into technology leaders and created entire industry and sub-industry clusters including chip-design houses, a whole slew of semiconductor device manufacturers, and device assemblers. Intense competition within the Taiwanese semiconductor and hardware clusters and very strong linkages between companies and technical universities have resulted in an entire innovation-support infrastructure that includes funding for start-ups. Today, Taiwanese companies are leading the global drive in optoelectronics. Touch-screen technologies, the kind that made the iPhone all the rage, owe their success in part to the development efforts and innovation of several Taiwanese companies.

This is true for a host of other industries that have integrated actively with Asian companies and sectors—including consumer goods, electronics, auto assembly, heavy industrial equipment, chemicals, and pharmaceuticals, to name but a few.

Being a critical part of the supply chain is one part of the story; the other is being integral to the future growth path of global companies. For example, Linde, a large European industrial-gases company, revealed that almost all its growth now comes from emerging Europe and Asia, and the scale of its involvement with Asia—especially India, China, and emerging industrial centers such as Abu Dhabi—is now unprecedented, with long-term contracts from core industries in metals, oil, and gas running into the billions of dollars. For industries ranging from footwear manufacturing to high-end electronics and from pharmaceuticals to integrated circuits, Asian companies are at the center of it all.

Reaping the Benefits of Political Stability, Improving Regulatory Infrastructure, and Corporate-Governance Practices

To complement their growing incomes and favorable demographics, most Asian societies (including China) now have greater social, economic, and political freedoms than ever before to enjoy their new-found wealth. Democracy today is certainly far more widespread in Asia than ever before, even though autocratic and single-party rule still remains even within nominally democratic frameworks. Despite the presence of all types of regimes, Asia is more politically stable and peaceful than it has been for many years. At the same time, we are witnessing a rapid development of institutional frameworks in politics, trade, finance, and investments, which are essential elements for regional stability.

The change in regulatory environment has been felt most in China, especially in civil jurisprudence, where until recently there was a complete absence of legal infrastructure that was acceptable by any global standard. Contrary to popular opinion outside of China, Chinese citizens have more social and economic freedoms today that ever before; it is hard to forget that China before communism was a feudal society that parlayed the labor of many into riches for a few. In 1970, 64 percent of the Chinese population lived below the poverty line (defined by the World Bank as an income of less than a dollar a day). Today that figure is less than 10 percent of the population.

Even though income inequality remains very high, China has done a remarkable job in providing for its people.

The Chinese are empowered to bring lawsuits against their government and have been doing so with varying degrees of success for almost two decades. The degree of social and economic freedoms in China is of great importance simply because of its growing presence in the world and how it engages not only with developed nations such as the US but also with regional rivals such as India and Japan.

Though India and Israel are at the other end of the political spectrum (with multi-party democracies that have strong grassroots traditions), they are proof that fractious politics and sometimes dysfunctional coalition governments need not be impediments to development and growth. Indonesia, the Philippines, Taiwan, and even the once war-torn Cambodia have seen a string of stabilizing national elections and have already begun to earn dividends from that stability.

Corporate-governance practices have taken giant strides, which should greatly influence the way Asian stocks are valued in the future. Historically, equity risk premiums demanded of Asian markets were significantly high. Now the factors that drove those premiums are being addressed. Liquidity is improving as companies raise capital and dilute the shareholdings of founding families. The number of individual companies listed and traded will continue to increase as privatization gathers momentum and markets become accessible to a larger number of companies. There is a growing awareness of corporate-governance practices, and a better understanding of investor expectations and the link to value creation, all of which will eventually lead to a reduced risk premium demanded from the larger Asian economies.

Asia Rising: The Complete Picture

While the Asian giants, China, Korea, Japan, and India, are focused on their domestic economies and the race for growth is on in earnest, there are fundamental changes happening in other regions and nations on the continent that need to be understood. Despite the Middle East producing 40 percent of the world's oil and sitting on a large portion of the world's known oil and gas reserves, that region is often thought of as an investment backwater. Now its leading cities like Dubai (despite severe financial problems), Abu Dhabi, Manama, and Doha are positioning themselves as international financial, trade, and tourist centers, and are attracting not only investments in real estate but also establishing more demanding and transparent corporate-governance, legal, and financial systems.

The stunning rise and fall of the leveraged real-estate market there does not help dispel the perception of an immature and untested economic system. But the collapse of the real-estate market in "glitter cities" such as Dubai will only strengthen the determination of governments to de-couple their economic fortunes from oil. For example, the real-estate boom in Dubai took off largely as a result of a relaxation in the investment policies that were designed to promote the development of the financial sector as well as promote tourism as the new investment mantra. Those efforts are likely to outlast the real-estate bubble and the current contraction in tourist traffic in those regions. The emirate of Abu Dhabi is undergoing the greatest transformation. Backed by vast oil wealth and the world's largest pool of investment funds this city is being positioned as the world's premier cultural and financial center.

Reverberations from the global economic crisis are also forcing once-insular capital-exporting nations such as Kuwait to become picky about where they put their money. Bowing to political pressure at home, Kuwait has stopped investing overseas altogether and is focusing on national priorities. It has, for example, recently backed out of commitments to purchase the polymers business from Dow and to increase its stake in German car maker Daimler. This thinking could become more mainstream among the GCC capital exporters as the opportunities within their own borders exceed opportunities elsewhere.

While there is no real depth to the equity markets in the Middle East, there is a growing choice of investment names available for consideration by investors. These are largely concentrated in industries such as petrochemicals (with a huge competitive advantage in feedstock), banking and insurance, fertilizers (where a significant competitive advantage is the cost of feedstock), and telecommunications. Even though the restrictions on foreign investors are more than a little onerous right now, the Middle East could throw up some interesting investment opportunities a few years down the line.

That the Middle East countries can embark on these ambitious new economic plans and invest heavily within their borders is the result of the unprecedented political stability that many of them now enjoy. With the exception of Saudi Arabia, which is racked by domestic violence and a huge wealth gap, the Arabian Peninsula as a whole enjoys greater political cohesion and loyalty to their respective monarchs.

The Sun Rises in East Asia

The economic development in China over the past three decades is something of a double-edged sword for much of East Asia. On the one hand, China's ascendancy and the shift of manufacturing to the Chinese mainland has begun the process of hollowing out Southeast Asian manufacturing, especially of the lower value-added kind that depends more on labor cost and productivity. At the same time, though, it has also offered new opportunities for those nations to sell to China, especially intermediate- and higher-value-added manufactured goods, services, and technology.

The growing Chinese influence over Asia's trade flows did not happen by chance. Japan was the first Asian nation to reach developed status by using lower labor costs and manufacturing efficiencies, since the 1960s to focus on exports. Manufacturing momentum then flowed to the four Asian Tigers—Singapore, Hong Kong, Taiwan, and South Korea—which followed the Japanese example and created solid trade links with the US and Europe largely in consumer electronics and other manufactured goods such as textiles, footwear, integrated circuits, and semiconductors. China in turn learned very quickly that exports was the way to go and built its model, buoyed less by productivity and more by its greater labor-cost advantage, on the products and strengths already created by Japan and the Asian Tigers and by the shift of manufacturing from Southeast Asia to the Chinese mainland. However, the breadth of products that China makes now far exceeds anything produced by the other East Asian economies, though electronics exports account for a little over one-fifth of Chinese total exports. This was both a threat and an opportunity for Japan and the Tiger economies: they quickly saw China's advantages and began to focus on China as the preferred destination for their exports, and imports of intermediate goods from China for their own manufacturing industry. Nearly half of Taiwanese exports to China, for example, comprise electromechanical or optoelectronic products.

Malaysia has demonstrated that such a shift away from a raw-material export-based economy to a modern industrial and service economy is well within the realm of possibility. The strategies that Malaysia used to effect this (improve education, infrastructure, political stability, and state sponsorship of industries) are being emulated by others. In the 20 years that have elapsed since Malaysia moved away from being a raw-material supplier to the world it has developed competitiveness in several industries and in not all of these does it possess a natural competitive advantage. The Malaysian economy is now readying itself for the next phase of development where it is looking to build its information technology and pharmaceutical sectors.

Cambodia is another example of emerging investment potential if the government and politicians can turn the hard-won peace and nearly two decades of a functioning democratic process into real economic gains. It has a fairly well-developed textile segment, dominated by overseas companies taking advantage of the country's cheap labor and abundant supply of raw materials, but also has tremendous potential in mining for both iron ore and precious stones. However, it remains daunting for individual investors to take advantage of the opportunity in Cambodia since there is no market for securities (unlike in the Middle East where, though opportunities will unfold over the next decade as they build up their internal governance systems, they still do have an existing public market for securities for those investors who wish to venture there).

Though there remains a long way to go, several significant lessons have been learned from past crises and much has already been achieved. High savings rates, strong GDP growth, the emphasis on domestic consumption, high investment rates, and capital formation are all the envy of the world. No wonder then that most people in Asia resent the fact that they too suffered the effects of financial troubles conceived elsewhere but that washed up on their shores nonetheless. Countries which, like Indonesia, are heavily dependent on the resource sector will probably be hard hit if commodity prices do not pick up. A recent survey of FDI flows throughout the world shows that nations with a large resource or financial exposure will suffer the worst in the case of a prolonged downturn. But, as we will see later, the crisis that unfolded globally is not a terrible tragedy for the continent and especially its stronger nations.

The objective of this book is to examine opportunities in Asia. Given the role that China is playing and its recent evolution and historical position, we will logically focus significantly on the opportunity there. But I will add one caveat to an unfolding Asian age of prosperity led by China. China has in the past rejected both its own prosperity and its leadership role in world political or economic spheres. Its history has shown that China alone can restrict China's ascendancy. While it is the likely super-heavyweight champion in our lifetime, India, too, is rising to a position of eminence, and Japan will retain its own sphere of influence. Add to this mix the growing dynamism in economies such as Indonesia, Vietnam, Malaysia, and the Philippines; re-calibrated growth in Israel; and unprecedented economic diversity emerging in a few of the Middle Eastern economies and we have the making of a truly Asian century, as opposed to the notion of a Chinese or Indo-Chinese century that has become commonplace in popular investment thinking.

Asian society has not progressed evenly since several nations began taking tentative steps to develop in the early 1980s. The disparity in approaches and growth among different Asian countries and the distribution and pace of prosperity within nations remain uneven at best. Asian poverty remains very significant despite huge gains made by China and India. So, by focusing all its energy on developing its domestic market and aiming for more equitable distribution of income and wealth, China is once again leading Asia by example. And the domestic-wealth effect too is not widespread even within those nations where reform has been heeded. Needless to say there are huge shortcomings in each of these economies and regions. It is precisely these shortcomings and the amount of developmental work that remains to be done that will provide investors in Asia and the rest of the world with great investment opportunities.

Despite the sense of optimism regarding the opportunities that Asia presents, there are risks to be considered too. Despite the fact that many Asian economies have managed themselves well in recent years, there remain considerable risks—political, regulatory, and operating—that have the potential to derail some of the expected returns from this market. Many of Asia's recent top performers such as India and Vietnam suffer from growing pains where the physical infrastructure is simply not able to keep pace with the changes taking place. China is facing a desperate water and environmental crisis that some observers believe could lead to political crises. Southeast Asia is seeing an increase in risk in its manufacturing industries, while Vietnam, in a rare departure from recent Asian stability, is facing a serious shortage of foreign exchange.

Where India still lags behind most of East and Southeast Asia, despite creating a successful and unique model of its own, is in creating a more business-friendly environment. Even in outsourcing, its core competency, it still takes innumerable permits from all levels of government to begin operations in an urban center. In trying to create a workers' utopia in its flawed experiment with socialism, it has made it expensive, if not outright impossible, for companies to fire workers in a cost-effective manner. In China, supposedly the world's bastion of communist ideology, it is a relatively trivial matter to let employees go or restructure enterprises. Despite India's inevitable and very significant rise, it may not be in a position to challenge China in too many spheres at the moment. This book examines the dynamics that drive the differences in these two countries: democratic but dysfunctional India; autocratic but very capable China.

For a rising power like India the continuing rise of China will be a wake-up call. While India can rise in a similar fashion, it needs to do more than it is doing at present. It has already achieved a great deal in a remarkably short time and, over time, it will become one of the more significant centers of power in the world. However, for the moment it needs to emulate China's speedy decision-making and still speedier implementation.