ANALYSIS ECONOMY

Can India Become a Developed Economy and Catch Up with China? Three Scenarios

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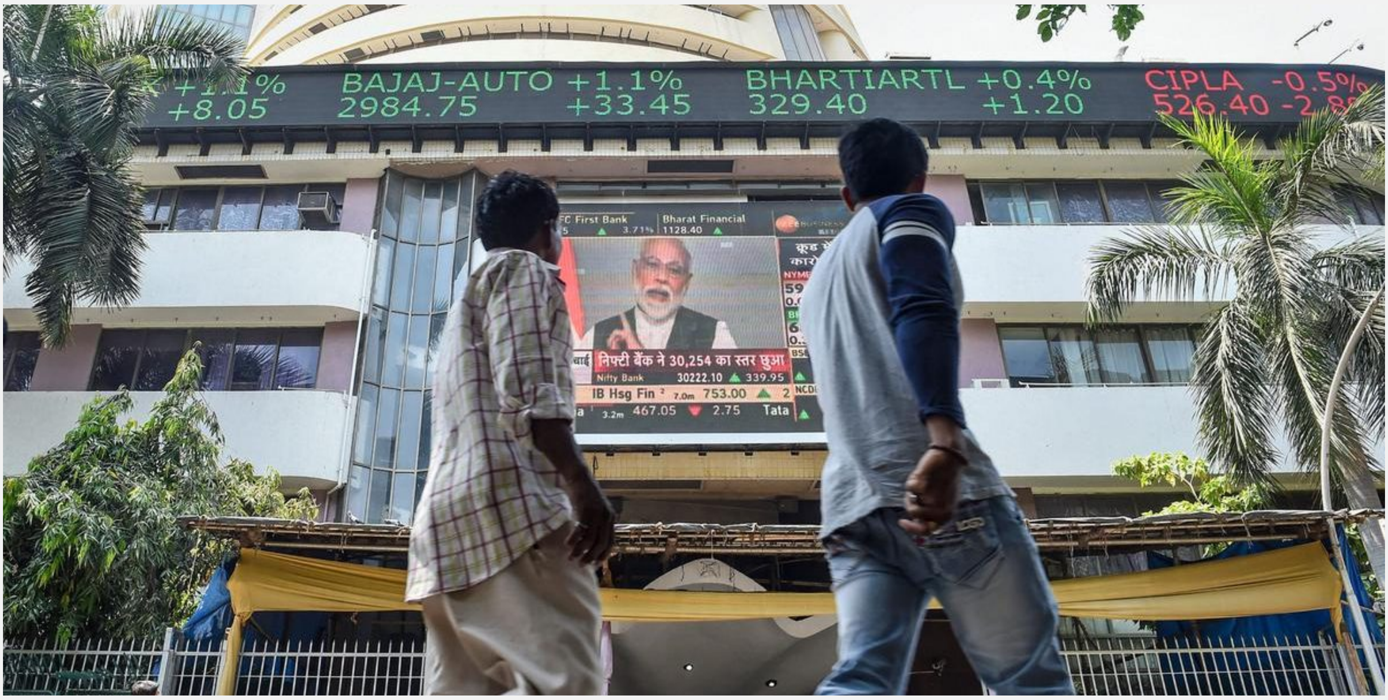

Representative image. Photo: PTI/Files

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ECONOMY 04/MAR/2023

India, like Brazil, has long been a rising power, a country of the future. Its growth accelerated after 1990, along with that of China. China has, however, left India far behind. Going forward, can India shed its perpetual 'country of the future' image and become a developed economy? How might it be expected to grow relative to China?

The article makes forward-looking projections of three possible trajectories based on different assumptions – baseline, higher growth and optimism. It concludes that this is possible only well after this mid-century and is contingent on decisive and determined policy interventions and good leadership, and ruminates on four caveats regarding its overall growth environment.

Also read: Mainstream Interpretation of India's GDP Growth Data Misses the Woods for the Trees

One can conceive of three possible scenarios. There is, firstly, the default business as usual scenario, where the economy trudges along on its present growth path. Secondly, there is a higher growth trajectory that might be achieved through good policy, leadership and institutional integrity. Finally, there is what might be called the optimal growth trajectory that the Indian economy has achieved in the past, but might find it difficult to sustain over an extended period going forward. This is the optimal growth scenario with which comparisons with China could possibly be made.

Baseline and higher growth scenarios

These forward-looking trajectories are derived from Excel Spreadsheet simulations using the last decadal (2011/12 to 2021/22) observed data as the baseline. The baseline growth rate is the last decadal average (2011/12 to 2021-22) which is 5.9 % in current international dollars according to the IMF World Economic Outlook database.

The Central Statistics Office (CSO) data shows that average nominal GDP growth over this period was 10.6%, with the average GDP deflator at 5.1%, yielding a real average growth rate of 5.5% which is slightly lower than the GDP growth in current US dollars. These are the observed GDP trends. The higher growth rate of 5.9% is used for the baseline projections. Some other analysts also see India growing at this rate. The current World

Bank thresholds for Upper Middle and High income ($ 4255 and $ 13205 per capita) have been used for comparisons. For the forward-looking projections the current thresholds are inflated by 2% annually, the target inflation rate of the US Federal Reserve.

Representational image. Photo: PTI/Files

The Excel spreadsheet simulations indicate that at the current rate of growth (5.9%) India would become a $ 5 trillion (in current dollars; India is already a $ 10 trillion economy measured in PPP, or Purchasing Power Parity) economy by 2029-30, and a 10 trillion economy and upper middle-income country by 2041-42. It will however still remain very far from entering the ranks of high-income countries at mid-century under the World Bank per capita income classification bands.

C. Rangarajan, former governor of the Reserve Bank of India (RBI) and former chairman of the PM's economic advisory council, recently observed that if India grew continuously at 7% over the next 20 years it might become a developed economy. According to him, this is eminently feasible in view of our current investment rate, and the average incremental capital output ratio of 4 that the Indian economy has achieved in the past.

Dr. Rangarajan did not specify what he meant by developed. If by this he meant joining the ranks of countries in the World Bank's classification of upper middle-income countries, this should be possible by 2036-37 at this growth rate. However, India would still be very far from transiting to the high-income bracket by mid-century at this growth rate, well beyond this writer's lifetime!

Sustaining a 7% growth rate in the current growth environment will however not be easy as India would need to grow on average over 1% higher in subsequent decades. India's recent growth deceleration has been sharp relative to its trend. Its growth rate fell year on year from 2016-17 to below 4% in 2019-20, followed by one of the sharpest declines in GDP amongst major economies during the Covid year of 2020-21. After factoring in the steep recovery over the next two years, the average growth during the last four years ending 2022-23 is just 3.2 %, registering one of the highest output losses relative to its trend growth globally.

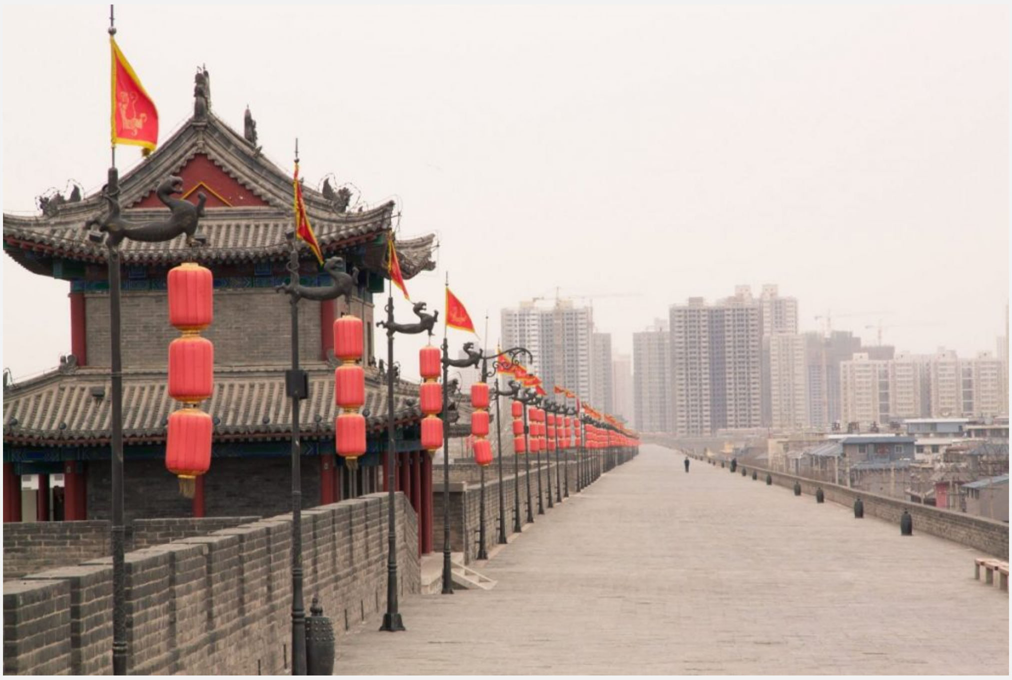
Also read: India Slips to 7th in Market Capitalisation Rankings, Worst Performer in 2023 Among Top 10

Even as global attention is focussed on the decline in Chinese growth, the data shows that the output loss is significantly higher than that of China and even that of its South Asian neighbours who appear to have weathered the Covid crisis better economically, and grown faster over these years. It would appear that demographic differences notwithstanding, similar factors are at work in India to slow down economic growth, and these stem not only from global economic and geopolitical factors.

The political economy of autocracy – hubris and unpredictability in decision-making, circumscribed consultative mechanisms, accounting and transparency issues, and excessive reliance on loyal favourites who tend not to tender honest, fearless advice — has thrown cold water on the China story, with its forward-looking growth projections being marked down. This should be a cautionary tale for India. In China, the hubris stemming from the growing one-man rule is tempered by the Confucian ethic with its emphasis on meritocracy. India does not have a comparable cushion.

Forward-looking growth trajectories: Comparisons and China

Comparisons between China and India are often made because their population size is roughly similar, because they were prosperous civilisational peers through much of history, economically on par till around 1990. For geopolitical reasons, India is seen as the only possible counterbalance to a rising China. But China has moved so far ahead during the last three decades that the geopolitical question of whether India can ever catch up with its civilisational peer is up in the air. Economic growth accelerated in both countries after 1990, but China accelerated much faster and for a longer period.



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Comparisons at baseline and higher growth

Consider that India's national income is currently where China was in 2006-07 whereas China is on the verge of becoming a high-income country. In 2006-07 India's per capita income was about 38% of China's; today it is just 18%. If India were to grow at the average of 2011/12 to 2021/22, it will reach China's current level of $ 17 trillion only around mid-century. In other words, during the last three decades beginning from a position of rough parity, China has moved ahead of India by about three decades. How far ahead might China move during the next three?

The past is however not always a good guide for the future. Could the gap actually narrow by then as China is slowing down, inter alia because its demographic profile and the geopolitical environment are turning adverse, with growing one-man rule leading to more policy errors? If China's growth were to slow to 4%, and India continued to grow at its current rate of 5.9%, India's economic weight relative to China's would increase from 18% % to 40% by mid-century. This would increase to a little over 50% were India to grow at 7%.

Optimistic scenario

In view of India's low base relative to China India needs to grow consistently at 8-9% over two to three decades if it is to become geopolitically significant and become at least a rook (and for longer, or at an even higher rate, if it aspires to pawn and become a queen like China) on the geopolitical chessboard and go beyond its current status of knight or bishop.

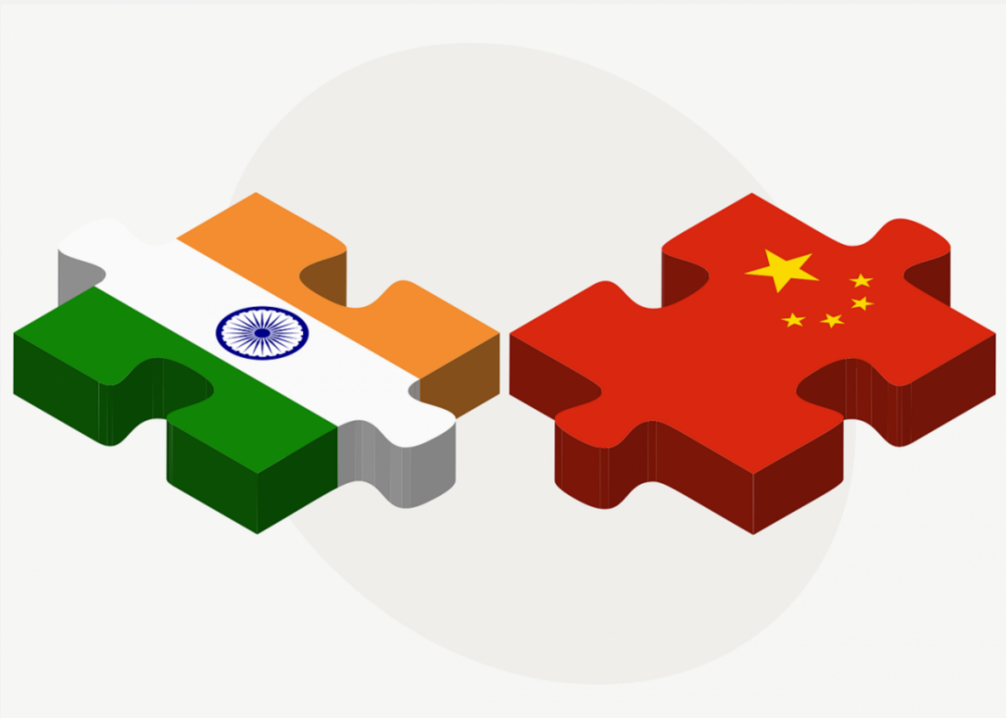

Photo: Public domain

At 8% growth India would become an upper middle-income country by 2033-34, and reach China's current economic size by 2043-44, but would still not join the ranks of developed countries by mid-century. In a recent report, Ernst and Young has projected that the size Indian economy would be $ 25 trillion by 2047. Spreadsheet simulations indicate that India would need to grow at 8.4% in current dollars to reach this level, compared to 5.9% achieved over the past decade.

India grew at this level briefly during the first decade of this century, but has been nowhere near this since. During the episode of hyper-growth all three engines of growth – consumption, investment and exports – were firing strongly. Its growth stalled as the investment and export engines stalled. While consumption is currently seeing a revival, both private investment and the export engine remain weak. India's Gross Capital Formation as a share of the National income has declined by about 30% from over the past decade. What is even more worrisome is that private investment has declined by 40%. The exports/GDP ratio is still about 3.5 % lower. India has also turned increasingly inward-looking focussing on self-reliant 'atma nirbhar' growth. The prospect of returning to the former high export trajectory has also diminished with countries turning inwards and globalisation stalling.

India's growth environment: Four caveats

Forward-looking projections are both interesting and useful for geopolitical analysis. In hindsight, the relative movement in income throws some light on why China appears to be no longer willing to accept the geographical boundaries agreed with India in the nineties when the two economies were roughly on par. It needs to be kept in mind, however, that forward-looking trend line projections often prove wrong as many non-trend line factors play into the equation.

There are alternate scenarios and caveats to the above projections, and even the baseline scenario is by no means guaranteed. Recent growth trends indicate that India's former growth potential may be seriously damaged at least over the medium term. In particular, four caveats need to be kept in mind.

First, by global benchmarks, India's growth rate remains high. Its growth rate however needs to be evaluated according to its potential and developmental stage. India is located in Asia where savings rates are high and which has had the fastest growing economies over the last few decades that have exploited external demand facilitated by the expansion of international trade in the post-war era. It is also currently in a demographic sweet spot during which growth accelerates. Recent IMF research suggests that its demographic dividend could add 1.5 – 2% to trend growth (the 8% scenario discussed above) if it plays its cards right, both domestically (expand and improve education and health) and geopolitically (closer alignment with American interests).

India undoubtedly has the potential to grow at a high growth rate for the above reasons, and indeed it did so for some time during the opening years of this century. The time horizon of demographic transition has however shortened sharply since the heydays of the Industrial Revolution, when western economies could grow at high rates over several decades before the labour force and savings started declining.

Also read: **Is India Serious About its Plans to Galvanise the Global South?**

East Asia invested heavily in both physical and social capital to harvest the demographic dividend and mostly transitioned to high-income status. India's relatively high rates of growth are on a low base (It only recently transitioned out of low income to low middle income) and derive from structural factors, such as a young labour force and high savings that in turn are indicative of the fact that India is presently in a demographic sweet spot. As a reality check, India's per capita income currently is only about 50% of the next poorest G20 country.

Representational image. Credit: PTI

But, as the East Asian, and now Chinese (accelerated by its strictly enforced one-child norm), experience shows, the time horizons of demographic transition have shortened considerably. This is now measured in decades rather than centuries as in the heydays of the Industrial Revolution that enabled the West to grow at significantly above pre-industrial levels for an extended period.

Even so, Europe might not have done so without free trade imperialism which gave it enforced access to external demand and also resources. America also had a huge and growing market in its own backyard reinforced through waves of migration. Small East Asian countries and China (reminiscent of small European countries) were able to leverage the more even-handed globalisation of the post-war era to grow at much faster rates to transit to high income before they were hit by the shortened demographic transition.

This window will close much sooner for both China and India. It consequently needs to get its act together quickly as it can ill-afford lost decades like the most recent as this might mire India in the middle-income trap like Latin American countries that aged before they could grow rich. While it is investing in physical capital it has done little to develop its human resources by investing in social capital. The central budgetary expenditure on health and education, which was already at a very low level of 0.8% of GDP has shrunk further to 0.6% of GDP over the past five years.

Second, India also has a historic opportunity with several countries seeking out alternative low-wage cost countries for fresh investment to reduce their exposure to China. This has already started happening in countries like Vietnam and Bangladesh. These are however relatively small economies with limited labour supply. India on the other hand is a large populous country with an almost unlimited supply. It also has a large and growing domestic market which is a critical asset at a time that countries are turning increasingly inwards.

Third, India has so far been a challenging environment for manufacturing, and addressing this weakness remains a continuing policy and administrative challenge. This weakness is also hobbling India's ability to leverage an advantage that only big countries possess, namely a large domestic market to fuel its growth. This advantage is magnified at a time major economies are turning inwards and deglobalising.

If India is unable to become a major manufacturing nation this opens up the possibility of an alternative scenario that the huge and growing Indian domestic market could cushion the decline in China's growth that is currently running into demographic, anti-globalisation, and geopolitical headwinds (growing confrontation with the US, its biggest trading partner). China's current account surpluses could mirror India's current account deficits just like the US-China co-dependency, as China appears to be the lowest cost option with the requisite scale to fulfil India's huge and growing appetite for consumer goods. The direction of India's growth model going forward is still unclear.

Unlike China, which has a national strategy of building world-class expertise and dominance in industry sunrise sectors such as Artificial Intelligence (AI), India does not have a clear strategic plan backed by budgets and organisation as this is left to private enterprise, as in western countries.

India's traditional area of strength appears to be presently locked into low end services and would need to move up the value chain in the manner

China is doing in manufacturing, and also develop a vibrant manufacturing sector as a large economy cannot run on a single-engine of growth to sustain high levels of growth over an extended period. Unlike China, India is dependent on global technology companies for the growth of its vibrant social media platforms. How they might respond to increasing State control and censorship of these platforms in a large market without risking reputational damage remains moot.

Fourth, the baseline scenario is by no means guaranteed. As things stand, India's former growth potential may be seriously damaged over the medium term with a sharp decline in private investment.

Ceteris paribus, it might be difficult to sustain a growth rate above 5-6 % over the long term without major policy initiatives, and avoiding unpredictability and hubris in policymaking, such as economic policy reform rollback and unpredictability, demonetisation, sudden lockdown, moving away from a level playing field for investors and regulatory transparency, hasty reforms without broad-based consultation and social and political extremism that queers the pitch for private investors. India is also dependent on foreign capital which is very sensitive to issues relating to institutional and regulatory integrity, both of which have been damaged by the ongoing controversy following the Hindenburg disclosures that have given bad press to the Indian story.

Way forward

India has a fair chance of growing faster than China (6.5 to 7 %), due to the demographic dividend and geopolitical opportunities opening up, which raises the possibility of eventual catch up, but obviously over a long-time frame, well beyond this mid-century. Decisive and determined policy interventions would be required for this. If India were to grow at the very optimistic, and currently unlikely, rate of 9% going forward, and China were to slow down to 4%, the Indian economy would be 70% of China's size by mid-century.

Indian Growth Trajectory Baseline Scenario: Based on IMF, United Nations and World Bank Data

N_gr	10.6%	Nominal Growth Rate					World Bank Data		2023	GDP_chn	0.04			
GDP_def	5.1%	GDP Deflator					Low income		Below 1085	Pop_chn_	-0.005			
$_curr_gr	5.9%	Growth Rate Current $					Lower Middle Income		1085+					
Pop_Gr_UN	0.645%	UN Population projections					Upper Middle Income		4255+					
Inf_R	2.0%	$ Inflation Rate					High Income		13205+					
	IMF WEO_Curr $		CSO nominal Prices		CSO Constant Prices						China			
Year	$ Mn	Growth Rate	Rs Bn	Growth	Rs_Bn	Growth	Def_GDP	Pop. Bn	GDP_PC_$_Curr	GDP	Pop.	GDP_PC_$	UMI	HI
2011-12	1823		87363		87363			1.23428	1477					
2012-13	1828	0.3%	99440	13.8%	92130	5.5%	0.0837	1.25029	1462					
2013-14	1857	1.6%	112335	13.0%	98014	6.4%	0.0658	1.26578	1467					
2014-15	2039	9.8%	124680	11.0%	105277	7.4%	0.0358	1.28084	1592					
2015-16	2104	3.2%	137719	10.5%	113695	8.0%	0.0246	1.29560	1624					
2016-17	2295	9.1%	153624	11.5%	123082	8.3%	0.0329	1.31015	1752					
2017-18	2651	15.5%	170983	11.3%	131446	6.8%	0.0450	1.32452	2002					
2018-19	2703	1.9%	189712	11.0%	140033	6.5%	0.0442	1.33868	2019					
2019-20	2832	4.8%	200749	5.8%	145160	3.7%	0.0216	1.35264	2093					
2020-21	2668	-5.8%	198009	-1.4%	135585	-6.6%	0.0523	1.36642	1952					
2021-22	3176	19.1%	236439	19.4%	147717	8.9%	0.1046	1.38000	2302	17745	1.5332	11574	4255	13205
2022-23	3365	5.9%	261478	10.6%	155819	5.5%	0.0511	1.39341	2415	18454	1.5252	12100	4340	13469
2023-24	3565	5.9%	289169	10.6%	164365	5.5%	0.0511	1.40240	2542	19193	1.5172	12650	4427	13738
2024-25	3777	5.9%	319793	10.6%	173379	5.5%	0.0511	1.41144	2676	19960	1.5093	13225	4515	14013
2025-26	4002	5.9%	353659	10.6%	182889	5.5%	0.0511	1.42055	2817	20759	1.5014	13826	4606	14294
2026-27	4239	5.9%	391112	10.6%	192919	5.5%	0.0511	1.42971	2965	21589	1.4936	14454	4698	14579
2027-28	4491	5.9%	432532	10.6%	203500	5.5%	0.0511	1.43893	3121	22453	1.4858	15111	4792	14871
2028-29	4758	5.9%	478338	10.6%	214662	5.5%	0.0511	1.44821	3286	23351	1.4780	15798	4888	15168
2029-30	5041	5.9%	528995	10.6%	226435	5.5%	0.0511	1.45755	3459	24285	1.4703	16517	4985	15472
2030-31	5341	5.9%	585016	10.6%	238854	5.5%	0.0511	1.46695	3641	25256	1.4627	17267	5085	15781
2031-32	5658	5.9%	646970	10.6%	251955	5.5%	0.0511	1.47642	3832	26266	1.4550	18052	5187	16097
2032-33	5995	5.9%	715486	10.6%	265773	5.5%	0.0511	1.48594	4034	27317	1.4474	18873	5291	16419
2033-34	6351	5.9%	791257	10.6%	280350	5.5%	0.0511	1.49552	4247	28410	1.4399	19731	5396	16747
2034-35	6728	5.9%	875052	10.6%	295726	5.5%	0.0511	1.50517	4470	29546	1.4324	20628	5504	17082
2035-36	7128	5.9%	967722	10.6%	311946	5.5%	0.0511	1.51488	4705	30728	1.4249	21565	5614	17424
2036-37	7552	5.9%	1070205	10.6%	329055	5.5%	0.0511	1.52465	4953	31957	1.4174	22546	5727	17772
2037-38	8001	5.9%	1183542	10.6%	347102	5.5%	0.0511	1.53448	5214	33235	1.4100	23571	5841	18128
2038-39	8476	5.9%	1308881	10.6%	366140	5.5%	0.0511	1.54438	5489	34565	1.4027	24642	5958	18490
2039-40	8980	5.9%	1447494	10.6%	386221	5.5%	0.0511	1.55434	5777	35947	1.3954	25762	6077	18860
2040-41	9514	5.9%	1600787	10.6%	407404	5.5%	0.0511	1.56437	6082	37385	1.3881	26933	6199	19237
2041-42	10079	5.9%	1770313	10.6%	429749	5.5%	0.0511	1.57446	6402	38881	1.3808	28158	6323	19622
2042-43	10679	5.9%	1957792	10.6%	453319	5.5%	0.0511	1.58461	6739	40436	1.3736	29437	6449	20014
2043-44	11313	5.9%	2165126	10.6%	478182	5.5%	0.0511	1.59483	7094	42053	1.3665	30776	6578	20415
2044-45	11986	5.9%	2394416	10.6%	504408	5.5%	0.0511	1.60512	7467	43735	1.3593	32175	6710	20823
2045-46	12698	5.9%	2647990	10.6%	532073	5.5%	0.0511	1.61547	7860	45485	1.3522	33637	6844	21239
2056-47	13453	5.9%	2928416	10.6%	561255	5.5%	0.0511	1.62589	8274	47304	1.3452	35166	6981	21664
2047-48	14252	5.9%	3238541	10.6%	592038	5.5%	0.0511	1.63638	8710	49196	1.3381	36765	7120	22097
2048-49	15100	5.9%	3581508	10.6%	624509	5.5%	0.0511	1.64693	9168	51164	1.3312	38436	7263	22539
2049-50	15997	5.9%	3960796	10.6%	658761	5.5%	0.0511	1.65756	9651	53211	1.3242	40183	7408	22990
2050-51	16948	5.9%	4380252	10.6%	694892	5.5%	0.0511	1.66825	10159	55339	1.3173	42010	7556	23450

While India's domestic market-led growth model is a distinct advantage as the global economy runs into deglobalization headwinds, in these changed circumstances, without the boost from external demand its growth potential is limited, especially since its per capita income is only low middle-income.

India cannot afford lost decades, like the one it is presently experiencing with trend growth falling sharply. This will not only push it further behind China, but it might also age before it grows rich. This would scuttle its geopolitical ambitions and lock it into a middle-income trap as it transits out of the demographic sweet spot and trend growth rates fall.

India needs to get its economic act together quickly if it wishes to narrow the wide gap that has opened up with its civilisational peer. Unlike Europe and East Asia, it has some strategic advantages as a large country, in particular a large domestic market. But it has so far been unable to leverage this effectively. Indeed it seems to be presently handing this advantage over to China on a platter to cushion the decline in its growth as it runs into deglobalising, demographic and geopolitical headwinds.

Alok Sheel served as secretary in the Prime Minister's Economic Advisory Council.