BLOG

India climbs the welfare ladder

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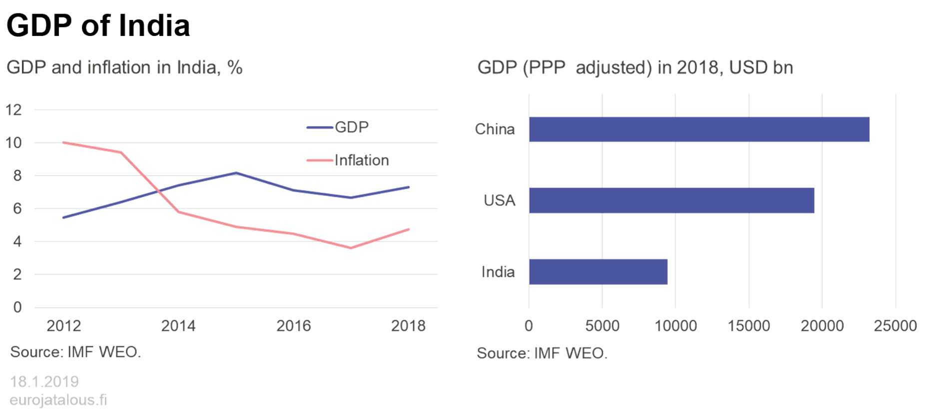
India's on a roll. Agreed, there are the usual complaints from its detractors about rampant corruption, slow progress in structural reforms, red tape and a lack of fiscal discipline, but it's hard to argue with India's macroeconomic performance – a booming economy with modest inflation. More importantly, India's recipe for growth delivers strong performance year in and year out. GDP growth has averaged over 7% per annum over the past two decades, translating into almost six percent more income for its young, expanding population every year.

India's rapid phase of economic development has elevated it from the low-income rungs well into lower-middle income status. It is already the third largest country in the world in terms of purchasing-power-adjusted GDP, and if growth continues on the present trajectory, India will surpass the current PPP-adjusted GDP levels of China and the US within the coming decade.

Chart 1



It's hard to avoid comparisons with China. When its historic growth spurt began forty years ago, China was dirt poor. Yet it surpassed India in terms of economic welfare by the 1990s and now leads India by over a decade in terms of economic development. Taking into account India's population growth rate of just over 1 % a year, living standards are presently growing at an equally rapid pace in both of the Asian giants. Given India's relatively closed, but vibrant, economy, and China's ongoing troubles, India is on track to start catching up with its big neighbor.

While China is often described as a unique case, the basic growth formula used by both is essentially the same. The roots of China's fast economic growth lie in Deng Xiaoping's reform-and-opening program that unleashed private enterprise and opened the economy to influences from the rest of the world. India's economic miracle commenced in the early 1990s with the far-reaching market reforms introduced by prime minister P. V. Narasimha Rao and finance minister Manmohan Singh.

From the standpoint of macroeconomic development, the greatest difference between the two countries is the political system. The highly authoritarian Chinese state, which incentivizes the political elite to support the central government's economic growth targets, has contributed to its remarkably high and stable economic growth over the decades. Under India's democratic political system, macroeconomic policies have been much less consistent and reform efforts much less dynamic.

However, as witnessed by China's ongoing struggles to maintain growth and gain acceptance for its high- tech products in Western markets, India may yet reap the benefits of its pluralistic approach in the coming decades. As its economy matures, it is plausible that India's individualistic political approach may turn out to be more conducive to fostering the innovation and trust-building countries need to graduate from middle-income to wealthy status.

Tags

economic reforms, BOFIT, Indian economy