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CHINDIA - RE - AWAKENING OF CHINA AND INDIA AS ECONOMIC POWERHOUSES

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Abstract

As the Industrial Revolution dawned in 1770, India had the Second Largest Economy in the World and contributed 20% of the world economic output. However, after two centuries, due to economic stagnation and misguided economic and trade policies, India contributes only 3% of the world economic output. But since the dawn of the New Millennium, India has been one of the fastest growing major economies, with rapid increases in per capita income, demand and integration with the world economy. According to the economic forecasting by Goldman Sachs, if India can sustain growth rates in excess of 8% until 2020, India's GDP will exceed that of US before 2050, making it the second largest economy, behind China. This paper looks at the preconditions necessary to maintain and accelerate the growth trajectory for the economic development in India. The Author bases his observations and recommendations on the methodology of Opinion Research.

Key Words: *India's Economic Growth, Productivity Growth, Environmental Degradation, Rural-Urban Migration, Education, India's Employment Potential.*

Introduction

As we travel back in time to 1770, India had so much potential. It was the second largest economy in the world, behind China, and contributed about 20% of the world economic output. However, since that time, due to various factors such as instability in the political landscape, fractured princely states, and more recently since Independence, the misguided economic and trade policies had shackled the economy to such an extent that by the 1980's, India barely contributed about 3% of the world economic output **(see Figure- A).**

According to projections by Goldman Sachs in 2007, India can maintain growth rates of 8% until 2020, with an underlying assumption that the Central Government will promote economic policies that are supportive of growth. The projected growth rate of 8 % seems highly plausible in the light of similar growth spurts experienced by other Asian Tiger Economies. According to the same 2007 Goldman Sachs Report, by 2050 India will rank as the second largest economy in the world, behind China **(see Figure- B).** The dramatic opening of the economy to increased global competition has led to a rapid turnaround in manufacturing productivity. This has compelled the private sector to restructure their operations and become lean and mean in order to survive the global onslaught (CSRO 2002-09).

Growth Engines: Service and Industrial Sector

Global competition has spurred the industrial sector to improve its productivity which in turn has led to a distinct improvement in total factor productivity. There has been a mass migration of labor from agriculture to the industrial sector. Many States are increasingly wooing industries to locate their new factories in their States to provide meaningful employment to their citizens. However, there have been far

[1] This paper is an abridged text of the address delivered by the first author at the 2011 conference on 'Emerging Capital Markets: Issues and Challenges' held at Bharatidasan University on Jan 8, 2011. The author is thankful to Dr. M. Selvam for assistance and comments.

too many skirmishes between agricultural landowners and the States over acquisition of land for new factories. Recently, in the State of West Bengal, Tata Motors had to abandon its plans to build a new factory for its much touted "Nano" Car (New York Times, 2008). However, despite such hurdles, the industrial sector has been able to bounce back and put the economy on its growth trajectory.

Over the last two decades, the growth story in India has been primarily linked to the Services Sector. Once again, there has been a noticeable migration of labor from the agricultural sector to the services sector.

As the Indian Economy maintains its growth trajectory, the migration of labor from the agricultural sector to the industrial and services sector is expected to accelerate and it should provide further fillip to overall labor productivity as the labor employed in the agricultural sector suffers from negative marginal productivity.

Labor Productivity has accelerated, with the onset of reforms, under the leadership of Prime Minister Rajiv Gandhi in the early 1990's. Average trade tariffs have declined by almost 90% and exports have sky rocketed. Open Trade Policies have brought superior technologies and production inputs. This has forced indigenous firms to become Lean and Mean and focus more on increasing efficiency as the means to survival.

In 2010, the Indian Economy recorded a growth rate of 10% which surpassed the growth forecast of Goldman Sachs. How was this possible? In the last two years since the Global Financial Crisis of 2008, there has been an influx of Foreign Direct Investment. Coupled with an increasing savings rate, this has led to a growth rate higher than the forecasted 10% growth rate (Word Development Indicators, 2009). In fact, recently, the Oracle of Omaha, Mr. Warren Buffett himself was on a visit to India to explore investment opportunities in the Insurance Industry. He implored the Indian Government to relax the restriction on foreign investment in the Insurance Sector to 49% (Anand, 2011).

Role of Financial Sector

The precondition for rapid growth in any economy is the existence of an efficient and sophisticated financial sector. The floodgates to the financial sector have really opened up in the last five years. Increasingly, foreign money center and investment banks have set up operations in India to tap into its growth story. Credit to the private sector has burgeoned over a very short period. As the financial sector deepens, this should provide an immense boost to productivity and growth rates to the Indian Economy.

Role of Information Technology Sector

Over the last decade, the Information Technology Sector has been at the forefront driving the economic growth. Infosys, Tata Consultancy Services, and Wipro among others, have truly emerged as world class companies. Apart from contributing to the dramatic productivity gains across the globe, it has also led to the creation of growing pool of highly skilled labor that other industries can capitalize as they try to improve their efficiency and productivity.

Role of Transportation Sector

Lack of transportation infrastructure has always been the Achilles Heel of the Indian Economy. In comparison, China boasts of outstanding transportation infrastructure. It is also the reason that has enabled China to become the Manufacturing Hub of the World. The transportation costs as percentage of manufacturing cost is among the lowest in China. On the other hand, the poor state of Transportation Infrastructure in India has led to its inability to compete in the global stage in the manufacturing sector. If India truly wants to maintain its trajectory of higher economic growth, then it has to modernize its Transportation Infrastructure in a hurry. The Golden Quadrilateral Project to connect the four corners of the county is a good start in this direction. However, problems with land acquisition still continue to plague and hamper the development of the Transportation Infrastructure.

Rural-Urban Migration

The acceleration of recent economic growth had led to mass migration from rural to urban areas. India has ten of the fastest growing cities in the world. It is expected that around 700 million people will live in the urban areas in the next three decades. This rapid urbanization has major implications for the growth in labor productivity as labor moves from the agricultural sector with negative marginal productivity to the more productive Industrial and Service Sector. This will lead to a burst in demand for housing, education, healthcare etc. which should further sustain and boost economic growth rates.

The rapid urbanization will also inevitably lead to shift in land from agricultural use to urban use. This shift in use is needed as more land is needed for factories and housing colonies and thereby to provide employment to a vast multitude of the population. As land use moves from agriculture with low productivity to industrial use with higher productivity, this should once again lead to an increase in overall productivity.

Conclusion: Words of Caution

The scenario outlined above is fraught with some risks. The ballooning fiscal deficit and the tendency of the politicians to pander to the electorate and offer social programs that further exacerbate the fiscal deficit is a real threat to the aforementioned growth scenario. A growing income divide could lead to societal acrimony and force the politicians to slow the reform process. Already, there are calls for more "inclusive" growth where all sections of the society participate in the economic gains. However, such calls in the short run will only impede the growth trajectory.

Also there are various supply side constraints that may rein in the projected growth scenario. Bureaucratic red tape in getting clearances for new projects, lengthy legal process to enforce contracts and such will impede the ability of the economy to quickly absorb the labor force coming out of the agricultural sector.

Although India boasts of elite educational institutions that are capable of educating a highly skilled workforce, the majority, lacks quality education that is necessary to compete in the global marketplace. This has to be addressed so that it does not act as a major impediment to the envisioned growth.

Finally, rapid environmental degradation in the name of rapid industrialization poses a grave threat to economic growth (Sankar, 2008). China provides a clear example of such a case. Climate change, as a result of environmental degradation, will result in erratic monsoons which in turn will hurt agricultural and overall productivity.

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Figure-A
Share of World GDP

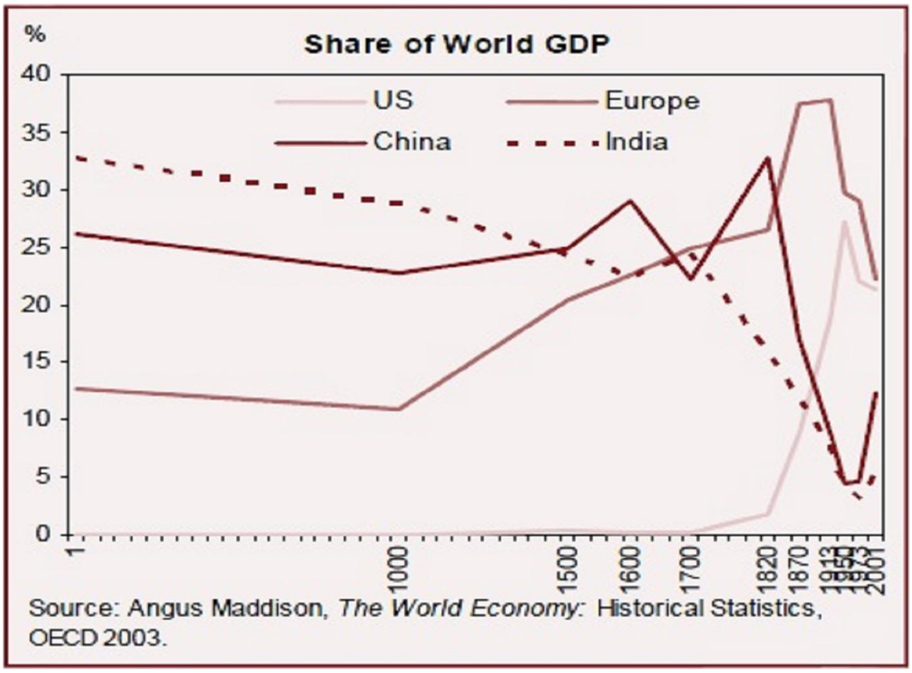

Figure-B
When will India's $ GDP Exceed that of the G6?