India: down but not out

The economy is resilient and the future looks bright if decisive action is taken

By **TAN KHEE GIAP, LINDA LOW** and **KARTIK RAO**

AS INDIA faces significant uncertainty over its short and medium-term economic prospects, several predictions pronouncing the end of the Indian growth story are beginning to appear.

India's gross development product growth rate has slowed down to 4.4 per cent in the quarter ending June 2013, its lowest in the last four years. Moreover, there is an unmistakable sense of policy paralysis, with the impending 16th general election due in early 2014.

However, it would be unwise to ignore the tremendous resilience which was displayed by the Indian economy during the recent global downturn. The economy grew at an average annual growth rate of 8 per cent during the period 2000-2010. According to the latest data released by the World Bank, India is the 10th largest economy in the world by total nominal GDP (US$1.8 trillion) and third largest in the world (US$4.7 trillion) adjusted for purchasing power parity (PPP). Undoubtedly, the long-term prospects for the country remain positive.

With the Indian economy at this crucial juncture, the Asia Competitiveness Institute (ACI), Lee Kuan Yew School of Public Policy at the National University of Singapore, has recently concluded its latest study to analyse the competitiveness of the 35 states and federal territories of India. In this study, Maharashtra emerges as the top-ranked state, followed by Delhi, Tamil Nadu, Karnataka and Gujarat in the rest of the top five positions.

A distinct pattern is noticed as the western and southern states outperform the rest of the states in the country. The western states of Maharashtra and Gujarat, buoyed by their entrepreneurial and pro-business environment, have successfully developed niche industrial clusters aided by a strong institutional framework. It is no surprise that the two states account for almost half of the exports from the country.

The southern states of Tamil Nadu and Karnataka also register a strong performance with their highly skilled workforce, which is driving growth in knowledge-based industries such as information technology and biotechnology.

Paradoxically, the mineral-rich states in eastern India – Odisha (ranked 26th), Chhattisgarh (33rd) and Jharkhand (35th) – ranked among the bottom 10. Despite accounting for over 60 per cent of the coal and iron ore production in the country, these states have seen meagre investments for the development of downstream industries. These eastern states also experience frequent social unrest as their large tribal population has been unable to realise any benefit from India's socioeconomic development.

A similar geographic concentration emerges in the north-eastern states of Manipur (ranked 28th), Nagaland (30th), Meghalaya (31st), Assam (32nd) and Tripura (34th), which also appeared in the bottom 10 positions. Difficult topography, poor transport infrastructure and an unstable political environment have rendered the region backward. However, more recently, there have been new opportunities being presented, with nearby Myanmar opening up to the international community. Thus, India needs to explore the potential to renew and boost cross-border historical trade links with Myanmar and enhance India-Asean relations.

In the study, the overall socioeconomic development of states and federal territories of India was ranked by 77 unique indicators based on four broad environments: macroeconomic stability; finance, businesses and manpower conditions; government and institutional setting; and quality of life and infrastructure development.

India is clearly an agrarian economy with over half its population relying on agriculture for their livelihood. The primary sector is characterised by marginal land holdings, poor productivity, low coverage of irrigation and declining yields. With an ever growing population, it is imperative for the government to invest in research and development to improve yields. An equally crucial matter is the initiation of land reforms which could resolve the issue of marginal ownership and facilitate mechanisation for productivity improvement.

Infrastructure overhaul

Another challenge is to bring about institutional changes for an effective reorientation from a largely domestic-demand-driven economy to greater reliance on manufacturing and exports. Valuable foreign exchange from exports can help address the raging issue of India's current account deficit. It can also fund the much needed infrastructure overhaul to ease India's production bottlenecks.

The debate between "growing the economic pie first and dealing with distribution and sharing later" and "engaging on rules and regulations for sharing the economic pie first before growing it bigger" is also intensifying. While the latter as inclusive growth seems to be socially and politically correct, empirical evidence of successful economic growth and development is in favour of the former. Otherwise, it will remain an idealistic income distribution model, which is not quite enough to elevate the standard of living of the large population.

With a GDP per capita (PPP-adjusted) of US$3,876 in 2012, India ranks 115th in the world – compared to China's US$9,233, ranked 83rd. However, India's large proportion of a young population holds significant advantage, with the average age expected to be just 29 years by 2020 compared to 37 years in China. Emphasis on generating employment opportunities and promoting suitable skills will be decisive factors to realise the benefits of this "demographic dividend".

Furthermore, investing in education, healthcare and public utilities is also particularly important, as it can alleviate India's poverty. However, the government needs to tread carefully, as directing investment into welfare schemes is not a panacea. The success of such measures will hinge on effective implementation and the political will to follow through on these reforms.

Dynastic politics is playing an increasingly dominant role in the Indian electoral process with a large proportion of leaders coming from political families. It tends to create an environment which could potentially value patronage over performance, and family connections over ability. However, notwithstanding this reality which is pervasive in Asian state political economies, the paramount issue is the ability to govern, formulate and execute public policies beneficial and inclusive to the majority of the citizens.

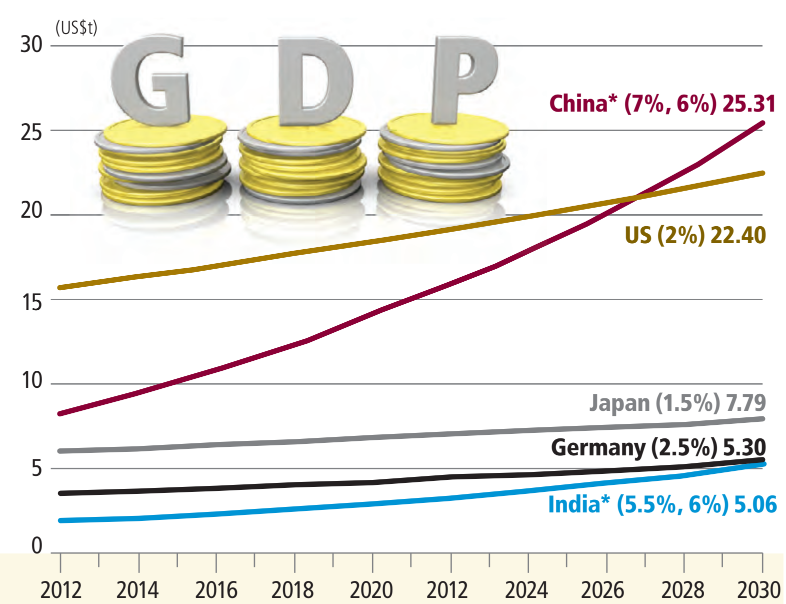
Discipline is the key before democracy, which will come in time even for China. As India stands at the crossroads of change, it needs to strike a fine balance between greater political unity and concrete economic reforms, with good governance and transparency deeply entrenched for public policy formulation.

Projected in the graph above are the total nominal GDPs of India and China with dynamic growth rates, between 2012 and 2030, compared alongside static growth rates for the developed economies of Germany, Japan and the US. India is seen catching up with Germany by 2030 and China surpassing the US by 2027, which highlights the growing significance of these two developing economies to the world.

The outcomes of the study serve as an important reminder to pursue economic policy planning which is more decisive and effective. As one of the largest economies in the world and with over a billion people, a stable and prosperous India is critical not just to Asia but to the whole world.

Rate of growth

India is expected to catch up with Germany by the year 2030



*For China 2012-2020, 7% p.a.; 2021-2030, 6% p.a. For India 2012-2020, 5.5% p.a.; 2021-2030, 6% p.a.

Graphics: Ludwig Ilio

Source for 2012 data: World Bank

This article is summarised from the forthcoming book, 'Annual Competitiveness Analysis, Simulation Studies and Development Strategies for 35 States and Federal Territories of India', to be launched on Nov 26. The writers are respectively co-director, senior research fellow and research associate at the Asia Competitiveness Institute, Lee Kuan Yew School of Public Policy, National University of Singapore.