

# Economics in Brief



No. 91, 2 November 2015

## Strong growth makes India shine but its policy lags behind

Author: Dr Martin Raschen, phone +49 69 7431-2434, research@kfw.de

While many emerging markets currently appear very weak, India boasts impressively high growth of more than 7% (see Figure). This makes India the clear leader among emerging markets and, notably, also ahead of China. So is everything rosy on the subcontinent? Not at all! Strong current economic data hides the fact that India is not living up to its potential and that the new Modi government has not been overly successful to date.

### (Un)favourable conditions for reforms

Since the election in the spring of 2014, Narendra Modi has governed with an absolute majority of the Hindu nationalist BJP. Modi promised that the period of extensive economic policy paralysis during the previous government would be followed by sweeping reforms. Several reforms were enacted quite quickly (more openness to foreign investors, licensing for the mining of raw materials, diesel price floating). However, recent massive nationwide strikes have proven to be as much of a hindrance as the fact that the government does not have a majority in the second parliamentary chamber and that, while BJP is in principle pro-business, its mission statement is not consistently market-oriented.

### Revision of statistics as “optical” brightener

At the beginning of 2015, the national account system (NAS) was completely and systematically overhauled, resulting in significantly higher GDP growth rates being reported since 2012. Although critics were scornful of this increase in Indian wealth, the soundness of the new NAS is not really in doubt. However, the country's actual circumstances had of course not changed.

### Strengths and weaknesses

India's economic advantages include a vast domestic market, the development of a middle class with strong purchasing power, a still favourable demographic situation (unlike China, for example, India is not yet an ageing society) and the currently low prices of oil and other imported raw materials. However, India has only partially earned the label “rising emerging market”. This is illustrated by, among other things, the fact that half of the Indian labour force works in agriculture, which is not very productive, 30% of the adult population is illiterate and 250 million Indians live below the poverty line.

### Three major topics on the economic policy reform agenda

Firstly, the federal budget has traditionally run a deficit. Although there has recently been some consolidation, the budget deficit of 7% / GDP (including the states) is still high, only 3% of the population pays income tax and one-third of government spending is consumed by

debt service. Secondly, there are substantial deficiencies in governance: governmental administration is cumbersome, is not particularly open to reform and is corrupt, and the legal system can be arbitrary. Thirdly, infrastructure (transport, energy) is a serious bottleneck for growth. The country must invest significantly more here. It is obvious that these problem areas are closely related. Promising initiatives of the Modi government encounter resistance and go nowhere, such as nationwide standardisation of VAT, which would allow reductions in bureaucracy and costs, or land acquisition reform.

### Economic relations with Germany

German exports to India have recently been trending upwards again (see Figure). Germany is India's most important trading partner within the EU. German exporters and direct investors regard the Indian market positively but hope that general conditions will improve. ■

Figure: India: GDP growth and German exports



Sources: OECD, Federal Statistical Office (*Statistisches Bundesamt*)