Seeing growth in a new light

*Growth narratives of China and India are important for knowing the future trajectory of global growth. But assessing growth by looking at investments in physical and human capital needs revision.*

By **DEEPANSHU MOHAN**, Nov 13, 2018

Where does the future trajectory of economic growth lie? How can developing nations (like China and India) in the future continue to raise their economic growth at a sustained level? Ever since the crisis of 2008, with the slowing of economic productivity, lowering of real wages and deepening income inequality, these questions have continued to perplex economists around the world.

In the field of development economics, most literature over the past 50 years has continued to rely on producing modelled examinations of cross-country growth patterns, predominantly, to ascertain universal solutions for achieving sustained growth. The idea was that such universally applicable growth models would allow most developing nations to somehow “catch-up” with developed economies.

However, most of such evidence drawn from cross-country-based regression models seemed to have offered limited assistance to the developing nation’s quest for sustainable economic growth. It is important to first explain why has this been the case?

For nations, in initial stages of industrialisation (or those with a long colonial history of deindustrialisation), there is strong emphasis laid today on the need to expand the perspective on drivers of economic growth.

Economic growth must simply not be seen as a product of investments in physical capital (buildings, machinery, infrastructure) and human capital (in education, skilling, etc.), that was the case up until the early 1980s. Mainstream growth diagnosis still involves judging an economy’s productivity, or output per capita, as a function of capital stock, labour (number of workers working in the organised sector), and a residual factor called total factor productivity (TFP)—analysed for measuring the technical and allocative efficiency of “factors of production”. The justifiable reason to add an abstruse measure like TFP here was to somewhere understand and account for the growing impact of technology on existing factors of production while measuring for growth.
However, recent evidence suggests that this approach, which uses the aforementioned “proximate” determinants, is not enough. A more accurate way to look at economic growth, as Turkish economist Dani Rodrik argues here, involves a close, inter-dependent analysis of a nation’s own ‘institutions’; ‘policies of integration’ (measurable in terms of trade and capital mobility); ‘geographical endowments’—called deeper determinants—with proximate determinants (investments in physical and human capital).

Thus, over time, a nation can simply tailor or customise its growth strategy for a high growth trajectory by focusing on the robustness of inter-relationships between these proximate and deeper determinants of economic growth. The strength of this inter-relationship will simply allow a nation to produce its own growth narrative that is both, unique and independent of any other country’s growth path, nullifying cross-country convergence theories and hypotheses.

A closer look at the growth paths of China and India over the past three decades can validate this besides revealing the inadequacies of cross-country growth convergence theories. China’s and India’s growth stories not only make their experiences quite unique (not similar to any rich nation like the U.S., Germany or Japan) but also compatible with higher growth standards (reflected by rising per capita incomes and production capacity).

Having said that, there is a critical way to reflect on questions about the future of growth in developing nations by closely monitoring the economic growth of ‘elites’ (highest income earning groups across sectors) within each nation to understand: a) the source of growth (where it is originating from); and b) trace the future possibilities of improving standards of growth (by increasing wages, reducing income inequality, checking corruption, etc.) through effective policies, requiring laws and incentives to be redesigned accordingly.

As a case in point here, if we take China’s own growth narrative (since early 1980s), it is one where, Chinese elites (with closer ties to the state) allowed growth reforms to be undertaken in a consistent manner while keeping the interests of those in power (i.e. the central party command). There is a good reason why China could sustain a 7% growth trajectory for more than three decades while maintaining economic and political stability. Going forward too, the economic and political actions of the same group of elites will necessarily shape the Chinese growth narrative, subsequently affecting both, the deeper and proximate determinants.

A similar observation can be made for understanding India’s own growth trajectory by tracing the performance of the elites in India. As the recent Credit Suisse report says: “While wealth has been rising in India, not everyone has shared in this growth. There is still considerable wealth poverty, reflected in the fact that 91% of the adult population has
wealth below $10,000. At the other extreme, a small fraction of the population (0.6% of adults) has a net worth over $100,000.”

There is a reason why growth narratives of China and India are both important for the purpose of knowing the future trajectory of growth (and its evolving nature). By 2030, over 50% of the world GDP will be sourced from the production and/or distribution of economic goods and services in China and India. The sustainability of global economic performance critically depends on the degree to which each of these nations can establish a robust, interdependent relationship between their proximate and deeper determinants (for example say, on the relationship between private property rights and its crowding-in effect on private investment opportunities).

What this also means is that, while the source of economic growth will partly shift away from the U.S. to countries like China and India, the nature of growth will significantly alter as well. High growth rates driven by the elites in China and India will be accompanied with high socio-economic inequities in access to basic social and income opportunities.

Does this mean it is going to be quite improbable (if not impossible) for high growth in developing nations to not be accompanied by high socio-economic divergence? A more cautiously optimistic take to this is: It depends. It depends on the strength of a nation’s own institutions (rule of law, property rights, investor-state dispute settlement mechanisms, etc.), its policies of integration (in terms of trade and capital mobility) with its overall growth capacity. In China and India, the success of some elites may have allowed them to kick-start growth, but the future of these nations seem quite disorienting in spite of higher growth rates if existing levels of income and social inequality continue to rise.

(Views are personal)

The author is assistant professor and assistant director, Centre for New Economics Studies, O.P. Jindal Global University.

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