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The rise of the affluent is the real India growth story

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The supply and demand game has to grow beyond this segment of the population so that the economy does not stagnate in the near future

India's Gross Domestic Product (GDP) now ranks fifth in the world. And it is expected to reach the third place by 2030. In the early 1990s, India ranked 17th in terms of GDP — there is no doubt that its relative position has improved significantly in this regard. However, on the basis of per capita income, India was ranked 161st in the early 1990s and is now 159th. That is, India's relative position in terms of per capita income has hardly changed during the period in which it rose from the 17th to the 5th place in terms of GDP. Why?

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The combination of a large population and a high rate of growth of per capita GDP consistently over several decades is behind India's improvement in the GDP ranking(Representative image)

One might think that this is due to population growth, which would mechanically push up GDP without increasing per capita income. But it is not. In fact, India's relative position in terms of population remained the second largest (after China) in the world throughout this period. Not only that, India did not significantly differ from the world average in terms of population growth rate during the period under discussion. Moreover, over time, its population growth rate has decreased.

A part of the answer lies in the fact that, between 1991 and 2021, per capita GDP increased more than seven times. If we exclude the effect of inflation, it can be seen that real GDP per capita has increased almost four times. Yet, why has the GDP ranking improved so much while the per capita GDP has stagnated? The other part of the answer lies in India's population size.

Let me give an example. Suppose the per capita GDP of a country doubles in a decade. There may not be much difference in its relative position compared to other countries if those countries already have a much higher average per capita GDP, or if they are also growing at reasonably high rates. But, the larger the population of that country, the higher the total GDP value will be proportionally. For example, if its population were to double, the total GDP would increase four times. We can call this the population multiplier effect. It is likely that the relative position of the country with a large population will increase in terms of GDP compared to other countries. It is because of this large population multiplier that India has been able to rise to the top of the GDP rankings from the early 1990s to the present. However, the average growth rate would have to be even higher to pull up India's per capita GDP ranking.

The combination of a large population and a high rate of growth of per capita GDP consistently over several decades is behind India's improvement in the GDP ranking. Let us compare it with China. Between 1991 and 2021, China's rank rose from 11th to 2nd in GDP, and its position in average per capita income rose from 158 to 75. Its GDP per capita grew 38 times during this period, while India's GDP per capita grew only seven times. Because China has a larger population, the effect of the population multiplier is greater, but they have been able to increase average per capita income many times more, so their relative position in both total income and per capita income has improved much more.

Now, it is well known that in the presence of inequality, GDP or national income is not a reliable measure of the quality of life of the average person. If the income of the richest 10% increases by 10% and the income of the rest remains the same, national income would register a growth of 10%. Per capita GDP is a slightly more reliable indicator of the standard of living of ordinary people in this respect. In this example, per capita income will only increase by 1%.

The real question in terms of development is to what extent the total or average national growth rate reflects the increase in the standard of living of the general population. Now, if a populous country can raise its per capita income over a long period, it deserves some credit since the presence of the poor always drags down the average. The reason why the world is paying attention to India as a rising economic power, despite its per capita income being low, is something else that these statistics indicate but do not fully capture — market size and the rising prosperity of a small fraction of the population who have cornered the lion's share of gains in growth of GDP. Multinational corporations with a keen eye on markets or footloose global capital seeking the highest rate of return do not care about either aggregate or per capita GDP: They care about a small segment of the economy that has prospered over the last three decades.

The bulk of the growth gains of the past three decades have been concentrated among a small segment of the population. Even though small with respect to India's population, the size of that group as a market is not insignificant — the entire population of Britain or France is close to 4-5% of India's total population. Smaller countries may have higher per capita incomes or may grow at a faster rate, but India is important simply because of the size of the market. So even if the value of total GDP or its growth rate is weak as a measure of development or a large part of the population is poor, it is an indicator of the purchasing power of a well-to-do and affluent group. This segment of the economy can rival many rich countries in terms of volume as the market for luxury cars or fancy smartphones. This class's affluence and demand patterns are symbolised by the glittering shopping malls and the rise in the consumption of luxury goods and services which might create the illusion of India shining.

Why does market size matter? First, large-scale manufacturing industries require a certain size market in terms of potential buyers. Otherwise, investing is not profitable. Second, regardless of what happens to per capita income, if a large country has even a small portion of its population whose income exceeds a certain threshold, its demands shift from necessities to luxuries.

So, if one thinks that India's rise in terms of GDP is purely a statistical construct, which does not reflect the standard of living of the common man, or that the average per capita income has not increased, he or she is missing the real story. That is, the increasing affluence of a certain segment of the population whose purchasing power has exceeded a threshold. The problem is that if the supply and demand game is confined to a small segment of the population, growth is bound to stagnate unless it spreads and brings a larger fraction of the population into its orbit. The signs of deceleration in growth that became visible before the pandemic could well be a reflection of that.

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