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Enter India, Exit China

India’s growth rate is suddenly rivaling, even outpacing, China’s. Can it sustain the momentum?

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The progress of Asia’s two giants, China and India, can be neatly encapsulated by the imagery used to portray them. China is usually characterized as a dragon, aggressive and slightly frightening. India, on the other hand, is often described as an elephant—big and powerful, but also lumbering and slightly ungainly.

Unfortunately for India, the caricatures are all too accurate. For the past three decades, China has reigned as the world’s premier emerging economy; India always plodded behind, stumbling in China’s formidable wake. As China raced with fiery purpose from a poor, isolated nation into the world’s second-largest economy, India’s boundless potential remained mostly untapped, its people mired in poverty and its footprint on the global stage barely perceptible.

Mention China to an international executive and watch him salivate over 1.3 billion increasingly wealthy consumers. Mention India and listen to complaints about a bureaucracy that tramples free enterprise. That’s why foreign investors plowed $124 billion into China in 2013, according to the United Nations Conference on Trade and Development, but only $28 billion into India.

All that’s about to change. The Indian elephant is set to outpace the Chinese dragon to become the world’s fastest-growing major emerging economy. According to official data released on Feb. 9, India’s gross domestic product in the last two quarters of 2014 surged 8.2 percent and 7.5 percent, topping China’s performance. For the current fiscal year, India’s government expects GDP to grow 7.4 percent, a hefty jump from 6.9 percent the previous year. “The stars do seem to be aligning in India’s favor,” says Cornell

University economist Eswar Prasad. “Among the large emerging-market economies, India stands out.”

Granted, these eye-popping growth rates are the product of a controversial and confusing revision by India’s statisticians of how they calculate GDP. But even before this, some economists had been predicting that India would start to grow more quickly than China over the next two years. That’s because dramatic changes are afoot in both countries.

China’s era of supercharged expansion looks to be coming to an end. In 2014 the economy sank to its slowest growth in almost a quarter century, and many economists anticipate its pace will decline even further. The International Monetary Fund expects growth to fall from 7.4 percent in 2014 to 6.3 percent in 2016. To return to health, Beijing’s policymakers are trying to engineer a critical rebalancing from investment-led to consumption-driven growth—a tricky transition that’s proving much harder than it sounds.

India, on the other hand, is still sitting on the launchpad, waiting for true economic liftoff. Even after two decades of solid if not spectacular growth, it’s at an early stage of development compared with China. India’s GDP is a fifth of China’s. Nearly one out of four Indians remains trapped in absolute poverty, according to the World Bank, compared with only 6 percent of Chinese. Corporate India has scored a few impressive successes—most notably in IT services—but hasn’t left as deep a mark on the global economy as Chinese industry.

Politics hamstrung India’s economy in the past and may still provide major stumbling blocks

That gap is, to a great degree, a creation of politics. After China cracked open its Soviet-style economy to private enterprise and foreign investment in the early 1980s, India began liberalizing its state-dominated economy in 1991 by dismantling what was called the License Raj, an impenetrable web of regulations that allowed the government to control business. But the reforms didn’t go far enough. Many of India’s squabbling politicians continued to distrust the free market and foreign companies and held up reform in interminable debates and protests.

That set the two economies on very different courses. In China, factories and skyscrapers rose with authoritarian efficiency; in India, major investment projects were stalled by the bureaucracy. While China became the Workshop of the World, India missed out on the mass manufacturing that generates jobs and exports. As reform in India faltered earlier this decade, growth slumped, and confidence in the economy deteriorated. India’s policymakers, meanwhile, were often too politically paralyzed to repair the problems.

Now, however, a fresh, can-do spirit has captivated New Delhi. In May voters kicked out the ineffective Indian National Congress-led coalition and ushered the Bharatiya Janata Party into power in an overwhelming landslide. Prime Minister Narendra Modi has restarted India’s free-market reform program with the aim of spurring a China-like investment surge. In September he launched a "Make in India" campaign, with a roaring lion as its logo, intending to turn the country into a manufacturing powerhouse to rival China. To get there he loosened convoluted land acquisition laws that held back big projects and streamlined the cumbersome process of obtaining government approvals. He increased the limit on foreign ownership in the insurance sector and other industries. India under Modi "has already seen a move towards kick-starting the investment cycle, and we think reforms to boost investments can continue," economists at Goldman Sachs wrote optimistically in a recent report.

India is also catching on to long-term trends that helped boost growth in China. Its Internet and computer usage is low compared with much of the rest of Asia, but new technologies are penetrating deeper and deeper into Indian society, which will provide a much-needed jolt to productivity. Goldman expects the number of Indian Netizens to rise almost two-thirds by 2018, to 410 million. India also possesses a demographic edge over China. Thanks to China's one-child policy, its labor force is shrinking, which should drag down growth. India's working-age population is expanding rapidly, which will give the economy a lift.

Modi's reforms, combined with the new GDP revisions, could push growth to China-like rates. In a preliminary estimate, HSBC figures India's growth in the next fiscal year could reach around 8 percent. Still, if India wants to sustain such superhigh growth, as China had for decades, much more has to be done. "Ultimately the question is if the reforms will be far-reaching enough," says Cornell's Prasad. "That is far from certain." Modi has barely gotten a start on some critical but politically sensitive reforms—most of all, overhauling archaic labor laws that discourage job creation and worker training and scare off manufacturers. To implement such controversial changes, he'll have to overcome persistent resistance from unions, civil servants, and recalcitrant politicians. Although Modi and his allies command a majority in Parliament's lower house, the upper chamber is still controlled by the opposition, which has foot-dragged on passing his reform measures. Modi's BJP also lost local elections in Delhi to a small, anti-corruption party, a reminder that his political position is far from unassailable. And there's always the risk that the Hindu nationalists, who form the backbone of the BJP, could stir up trouble. If Modi's reforms stumble, so could India's prospects.

Even with a sustained reform effort, India's growth spurt may not match China's past performance. With its more decentralized governing system and contentious political culture, India might not be equipped to marshal men and material in a China-like quest for industrial prowess. It's also so far behind China that it could take decades of high growth to truly catch up. Research firm Oxford Economics projects that India's per capita income will still be lower in 2030 than China's is today. That means India's rise may not have the globe-rattling impact of China's. "India may grow faster than China, but that's not to say that it will pack the same punch," notes Frederic Neumann, co-head of Asian economics research at HSBC.

That's not necessarily all bad. Perhaps India can develop in a more sustainable and balanced way than China, without the excessive waste and environment degradation that breakneck expansion spawned. At a time when China is slowing, Europe and Japan are flatlining, and other major emerging economies such as Russia and Brazil are struggling, the global economy needs a strengthening India to act as a reliable pillar of growth. We should all hope that the Indian elephant finally starts to charge.