Sluggish Growth or Premature Decline? A Comparative Study of Indian Industrialization with China

Executive Summary

India's manufacturing sector has remained stagnant in terms of value-added and employment, in sharp contrast to China's rapid industrialization. While both countries embarked on their growth journeys at roughly the same time, India's trajectory has been services-led, whereas China's has been driven by manufacturing.

Most of the literature in this field has been using static models where the same problem is repeated every period, while exogenous processes drive the dynamics. This study develops a dynamic open economy general equilibrium model with endogenous capital accumulation, productivity growth, and trade effects to examine and compare the structural transformations of India and China. This is also one of the few studies that uses the comparative study of manufacturing vs. services-led structural change patterns.

The analysis reveals three core insights. Firstly, China's structural transformation has been powered largely by rapid TFP growth (accounting for about 80% of its economic shift) and high investment rates, with trade playing a complementary role. In contrast, India's transformation has been shaped more evenly by TFP and trade, but slow productivity growth and low investment have constrained its manufacturing sector.

Secondly, the counterfactual exercises show that if India's sectoral TFP growth had matched China's, its manufacturing share would have been 1.5 times higher, and per capita income would have more than doubled (by 137%). Even with modest assumptions, the manufacturing sector shows growth in the projections as well. This indicates that Indian manufacturing has not prematurely declined but has yet to fully take off, given the right productivity and policy environment.

Lastly, trade and timings matter. Economies like China and South Korea, which opened up to trade after productivity gains, benefited from export-led growth. In contrast, those that liberalized prematurely faced adverse import shocks that outweighed export benefits. The counterfactual of the shutdown of trade with China confirms that China's rise alone does not explain India's stagnation or deindustrialization elsewhere; instead, productivity remains the decisive factor.

The findings suggest that boosting productivity growth and investment, coupled with export-promoting industrial policies, is essential to unlock India's manufacturing potential. Going forward, even under conservative estimates, manufacturing remains central to accelerating India's economic growth.