Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Prelims and Mains focus: about Middle Income Trap; why is India facing it; about GNI

News: Many economists believe that countries that grow from low-income to middle-income levels tend to get stuck in a trap that prevents them from graduating to high-income status. India runs the risk of getting caught in that trap.

What is the middle-income trap?

World Bank defines a middle-income country as one with a gross national income (GNI) per capita of $1,000-12,000 in 2011 prices.

Those below the $4,000 mark are “lower middle-income” countries, and those above it “upper middle-income” ones. The middle-income trap refers to the phenomenon where rapidly growing economies graduate to the middle-income tier but then stagnate. They get squeezed from below by intense competition from lower-cost competitors while failing to transition to high-income levels for a variety of reasons—especially a failure to build institutional, human and technological capital.

Which countries have escaped it?

In the history of development, the success stories of transformation to high-income status include Japan, South Korea, Portugal, Poland and Latvia. Countries such as Brazil, South Africa, Egypt, Thailand and Turkey also tried to develop but could not transition to the high-income level. These countries failed to develop and remain stuck below their potential. Argentina, Mexico, and Russia, meanwhile, have been trapped in the upper middle-income category for a long time. China, with a GNI per capita of around $9,800, is most likely on its way out of the middle-income trap—unless it stumbles.
How has India moved up the development ranks?

In 1960, India had a per capita income of $1,033 (in 2011 purchasing power parity terms). This was equivalent to 6% of the per capita income of the US. India attained lower middle-income status in 2008. By 2017-18, the country’s per capita income was $6,538—or 12% of the per capita income of the US.

Is India caught in the middle income trap?

Rathin Roy, a former member of Prime Minister Narendra Modi’s economic advisory council, has cautioned that India runs the risk of getting caught in the middle-income trap. According to him, the country’s growth has mostly been driven by demand generated by the richest 100 million Indians. However, as this demand cannot keep growing infinitely, a failure to broaden the income base—and, therefore, the demand base or the market size—could act as a growth barrier, resulting in India slipping into a middle-income trap.

Is India’s market too small?

Inequality is a barrier to the broadening of the demand base in an economy. Even at $2.7 trillion, India’s GDP is relatively small—it’s about the size of California’s GDP. China’s is over 4 times as large. The 2017 Economic Survey warned that four factors could hurt India:

- hyper-globalization repudiation,
- thwarted/impeded structural transformation,
- human capital regression due to technological progress, and
- climate change-induced agricultural stress.

Following are the measures of National Income:

1. **Gross Domestic Product (GDP):**
   - GDP is the final value of the goods and services produced within the geographic boundaries of a country during a year.
   - GDP growth rate is an important indicator of the economic performance of a country.
   - The gross domestic product (GDP) is one of the primary indicators used to
gauge the health of a country’s economy
- In India, contributions to GDP are mainly divided into 3 broad sectors – agriculture and allied, industry and service sector.

2. **Net domestic product (NDP):**
   - The net domestic product (NDP) equals the gross domestic product (GDP) minus depreciation on country capital goods.
   - \( \text{NDP} = \text{GDP} - \text{Depreciation} \)

3. **Gross national product (GNP):**
   GNP is an estimate of the total value of all the final products and services produced in a given period by the means of production owned by a country’s residents.

4. **Gross National Income (GNI):**
   - Gross national income is a measurement of a country’s income. It includes all the income earned by a country’s residents and businesses, including those earned abroad.
   - GNI measures all income of a country’s residents and businesses, regardless of where it’s produced.
   - Gross domestic product (GDP), on the other hand, measures the income of anyone within a country’s boundaries, regardless of who produces it.

**Difference between GNI and GNP**
- GNI measures income earned, including that from investments that flow back into the country. Gross National Product (GNP) includes the earnings from all assets owned by residents.
- It even includes those that don’t flow back into the country.
- It then omits the earnings of all foreigners living in the country, even if they spend it within the country.

**Calculation of GNI and NNI:**

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\text{GNI (calculated from GDP)} = \text{GDP} + (\text{income from citizens and businesses earned abroad}) - (\text{income remitted by foreigners living in the country back to their home countries}).
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GNI (calculated from GNP) = GNP + (income spent by foreigners within the country) – (foreign income not remitted by citizens).

Net National Income (NNI) = GNI - Depreciation = NDP + (income from citizens and businesses earned abroad) – (income remitted by foreigners living in the country back to their home countries).