American Research Journal of Humanities and Social Sciences
ISSN (Online)- 2378-7031
DOI : 10.21694/2378-7031.26020

Review Article

How India Achieved Economic Growth through Economic Reform

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Publication Information: Accepted: July 13, 2026 **Published:** July 31, 2026

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Citation: : Kim D. How India Achieved Economic Growth through Economic Reform. American Research Journal of Humanities and Social Sciences, Vol 12, no. 3, 2026, pp. 5-15.

Abstract

This paper argues that India's transition from decades of stagnation to rapid growth was driven not by its demographic endowment but by economic reform. For more than four decades after independence, India combined a vast labor force and an immense domestic market with an inward-looking, state-controlled economic system—the License Raj, industrial nationalization, and restrictions on foreign investment—that held its potential captive at a per-capital income of under one hundred dollars. The 1991 liberalization of trade, foreign direct investment, and the License Raj, together with the Modi government's later institutional reforms (the Goods and Services Tax, Aadhaar, and the Unified Payments Interface), unblocked the flows of labor, capital, and finance and converted latent potential into growth. Drawing on macroeconomic, trade, capital-market, and demographic data, the paper traces the concrete channels of this conversion, compares India with China and other emerging economies, and evaluates the limits that remain. It concludes that India's growth reflects the quality and continuity of reform, and that sustaining growth depends on how deeply reform continues.

Keywords: India; Economic Reform; Liberalization; License Raj; Demographic Dividend, Economic Growth; Foreign Direct Investment; Emerging Economies.

Introduction

India is today counted among the fastest-growing major economies in the world. Yet this growth was never a foregone conclusion in India's history. For decades after independence, India possessed enormous potential—a vast territory, an abundant labor force, and an immense domestic market—and yet could not escape poverty and stagnation. In 1960, India's per-capital income was only about eighty-five dollars a year, life expectancy stood at roughly forty-five years, and the illiteracy rate exceeded seventy percent [1]. Despite its wealth of resources and people, India was long a byword for a country of great promise that remained perpetually poor.

A natural question follows. Why did a country that had stagnated for so long suddenly rise, after the turn of the millennium, to become one of the world's major growth stories? India's territory and workforce had always been enormous; those endowments alone cannot explain the dramatic contrast between an era of poverty and an era of rapid growth. If a country with the same resources turned from stagnation to growth, what changed in between was not the quantity of those resources but the environment that put them to use—that is, its institutions.

The question this paper poses is therefore the following: How did India, through economic reform, end its long stagnation and achieve growth? Between long-dormant potential and finally unleashed growth, some mechanism of conversion was required, and this paper aims to show, step by step, that the mechanism was reform and to trace the channels through which it worked. The paper begins with the reasons for India's pre-reform stagnation; it then examines the 1991 reforms and their concrete results, the cumulative changes from 1991 to 2014, the Modi government's policies of expanding participation, and the resulting transformation of the economy and capital markets. It closes by comparing rival explanations, asking why India's reforms succeeded where those of other emerging economies did not, and considering the limits and prospects of India's growth.

A Country of Untapped Potential

To understand India's growth, one fact must be established at the outset: India's potential—its vast territory, abundant labor, and enormous domestic market—was never small, nor is it a recent development. Indeed, the more fully one acknowledges the scale of that potential, the sharper the question becomes: why, then, did India stagnate for so long?

India has long been a country of abundant labor and a vast domestic market [2]. Such conditions can form a favorable foundation for economic growth: there are many people to work, many to buy goods, and ample scope for a society's savings to flow into investment [3]. But the crucial point is that such a foundation does not, by itself, guarantee growth. Favorable conditions lead to growth only when institutions exist to connect them to actual production and investment.

That a favorable foundation does not automatically yield growth is made plain by a comparison with China. The two countries began with comparable potential, yet the outcomes diverged sharply. Applying the same income thresholds used by the Pew Research Center—defining the middle class as those living on ten to twenty dollars a day in 2011 purchasing-power terms—China's middle class exploded from about thirty-nine million people (3.1 percent of the population) in 2000 to about seven hundred seven million (50.8 percent) in 2018, whereas over the same period India's middle-class share rose only from 1.2 to 5.7 percent. Two countries that started from similar conditions diverged so widely not because of the size of their potential but because of differences in the institutions that convert that potential into production and consumption.

The decisive fact this comparison reveals are that India's growth potential did not suddenly materialize in the 2020s. Its enormous labor force and vast domestic-market potential already existed in the 1980s. Had that potential alone been sufficient for growth, India should have grown rapidly then. The reality was the opposite. A favorable foundation was a necessary but not a sufficient condition for growth; what had been holding that potential captive is the subject of the next chapter.

Why India Stagnated for So Long

The stagnation of India's growth originates in choices rooted in independence and in the political convictions and economic ideas of its first leaders. The onset of stagnation, in particular, can be traced to India's adoption after independence in 1947 of a Soviet-style socialist model rather than a market economy. This choice rested on the following pressing reasons and convictions.

The largest factor was the experience of colonial rule. For Indians, "free trade" and "foreign business" were bound up with the memory of the plunder of the British East India Company and of British textiles that had destroyed India's indigenous industries. India's post-independence leaders were therefore wary of foreign capital and free markets, believing that the economy, at least, had to be kept under state control beyond the reach of foreign powers. The first prime minister, Jawaharlal Nehru, was especially influenced by British Fabian socialism and Soviet central planning. The Soviet Union's apparent rapid ascent from an agrarian country to an industrial power in the 1950s and 1960s made it an attractive model for a newly independent, poor, agrarian India. Rather than leaving matters to the disorder of the market, having the state build heavy and basic industries directly through five-year plans was seen as the path to escaping poverty quickly.

India's particular circumstances added to this. In a vast and poor country, there was deep concern that leaving everything on the market would concentrate wealth on a few large capitalists and worsen inequality; so, a "socialistic pattern of society" was adopted as an official national goal, foregrounding equality and self-reliance. And this model became more than mere policy—it became a national ideology. The Congress governments running from Nehru to his daughter, Indira Gandhi, made this line

Table 1: India and China Compared: A similar Endowment, Divergent Outcomes.

Indicator	India	China
Total population	1.46 billion (world's largest)	1.40 billion
Median age	29 years	38-40 years
Working-age population	1.0 billion (68% of total)	980 million (peaked 2015, declining)
Middle class (Pew definition)	over 500 million (share rising)	700 million (51%, 2018)
Growth contribution (if realized)	1.9 pp (1981-2021)	key driver in high-growth era; exhausted after 2010

Sources: [2]; EY; Hudson Institute; [3,4]; China Power (CSIS). Middle class uses Pew Research income bands (USD 10-20/ day, 2011 PPP) applied identically to both countries.

their political identity for decades, and nationalization and protectionism were packaged as "policies that protected the poor and national self-reliance," winning broad support. A thick layer of bureaucrats, politicians, and businessmen who profited from state enterprises and the licensing system also formed, resisting fiercely any attempt to change the system once it was entrenched. With convictions born of the colonial experience, the Soviet model as the exemplar of the age, the ideal of equality, and the interests of vested groups all interlocking, India maintained this economic system for forty-four years, until 1991, even as inefficiencies piled up.

The economic system that took hold against this backdrop, contrary to its intentions, actively suppressed rather than harnessed the country's potential. Three institutional barriers, specifically, blocked growth. The most important was the "License Raj." A firm needed government permission every time it wanted to build a factory, raise output, or make a new product. An automobile company, for instance, could not increase production without a government license, and obtaining one commonly took years. In the meantime, entrepreneurship was stifled, and no matter how many people were available to work, firms could not freely arise and grow to employ them.

The second barrier was the nationalization of key industries. As major industries—steel, telecommunications, insurance, banking—passed into state hands, competition disappeared, and with no competition there was no incentive to improve quality or cut costs. The anecdotes that symbolize this inefficiency are well known: installing a new telephone in India could take years, and one had no choice but to accept whatever products the state enterprises made.

The third barrier was the restriction on foreign investment. The Foreign Exchange Regulation Act (FERA), introduced in 1973, capped foreign firms' local equity stakes at 40 percent, cutting off the technology and managerial know-how that should have arrived with foreign capital. The emblematic episode was the departure of the global company Coca-Cola from India in 1977. India had, in effect, closed off its own channel for absorbing advanced foreign technology.

As a result of these three barriers combined, the Indian economy was trapped in what came to be called the "Hindu rate of growth"—overall GDP growth of around 3.5 percent a year from 1950 to 1980. Because the population grew by roughly 2 percent annually, per-capita income growth fell short of even 1 to 2 percent a year. Competition vanished, the industrial structure sank into inefficiency, and firms had neither reason nor capacity to grow. Abundant labor and resources, far from becoming an engine of growth, came to be seen as a burden to be supported. In short, India's problem was not a lack of potential but the limits of its institutions. The foundation—people to work and people to buy—was certainly there, but the economic system to convert it into production and investment did not exist. The bridge between potential and outcome had been severed. The event that rebuilt that severed bridge was the reform of 1991.

The 1991 Reforms: A Historic Turning Point

Why is 1991 the turning point in India's economic history? Because it was the event that fundamentally changed the very economic system that had been maintained for forty-four years. And the fact that this enormous change was not planned but forced by crisis paradoxically reveals how urgent it was.

The change began with a foreign-exchange crisis. When the Gulf War of 1990 sent international oil prices soaring, India—which imported 80 percent of the oil it consumed—was hit directly. The current and fiscal accounts deteriorated simultaneously, the rupee collapsed, and foreign-exchange reserves fell to a level insufficient to cover even two to three weeks of imports. In the end India had to pledge sixty-seven tones of gold held by its central bank as collateral abroad and receive emergency financing from the IMF [5]. That same year the collapse of the Soviet Union pulled away even the ideological ground beneath the socialist planned economy that India had taken as its model for more than four decades.

It was the government of P. V. Narasimha Rao and his finance minister, Manmohan Singh, that turned this desperate crisis into an opportunity. With nothing left to lose, reforms long blocked by the resistance of vested interests at last became possible. The reforms proceeded simultaneously along three fronts; each aimed squarely at one of the three barriers that had bound India for forty-four years.

The first front was trade liberalization. Before the reforms, India's average import tariffs ranged as high as 80 to 100 percent, with top rates exceeding 300 percent [6]. On top of this, an import-licensing system under which the government approved item by item what could be imported and in what quantity had effectively blocked the inflow of foreign goods. The 1991 reforms sharply lowered these tariffs in stages and abolished most import licensing. As a result, domestic firms could bring in cheaper and better raw materials and components, while domestic industries that had grown complacent behind protective walls were exposed to international competition and could not survive without raising efficiency. Competition, in effect, forced structural improvement.

The second front was the opening to foreign direct investment (FDI). Loosening the bar that had capped foreign firms' stakes at 40 percent, the reforms allowed automatic approval of foreign equity up to 51 percent in thirty-five priority industries [7]. Foreign firms could now invest in India and build factories without seeking government permission at every turn. This did more than draw in capital; it created a channel through which the advanced technology and managerial methods that foreign firms brought could be transplanted into the Indian economy. It was the decisive shift that opened India's closed market to global capital and technology.

The third front was the dismantling of the License Raj. Industrial licensing—required whenever a firm started a business, expanded, or made a new product—was abolished in nearly all sectors except eighteen industries related to security and the environment. At the same time, the state monopoly over key industries such as steel, telecommunications, and power was loosened to permit private entry. As firms could now judge for themselves, invest, and grow without government permission, entrepreneurship that had been suppressed for decades began to burst forth. The collapse of the Soviet Union that same year, which removed even the ideological rationale for the socialist planned economy India had taken as its model, added further legitimacy to these reforms.

As the bars were thus lifted simultaneously across the three domains of trade, capital, and enterprise, the three barriers that had bound India for forty-four years fell at once. The three fronts of reform worked in interlocking fashion: trade had to open for foreign firms to have a reason to do business in India; FDI had to open for those firms to be able to enter; and the License Raj had to be loosened for domestic and foreign firms alike to compete and grow freely.

It is worth noting here that what amplified the effect of these reforms was none other than India's population. When the reforms opened the market, the chief reason global firms took notice of India was precisely its vast market and abundant labor. Had the same reforms been undertaken in a small country, they would not have drawn nearly as much foreign capital. In the 1991 reforms, in other words, population acted as a powerful multiplier of the reforms' effect. The reforms opened the door, and because a vast population waited on the other side as an opportunity, foreign capital and firms poured in. Reform and population are not competing explanations but a mutually reinforcing pair.

But knowing "what" the reforms were is not enough. The more important question is how those reforms actually converted India's population into growth. The next chapter, the heart of this paper, traces that concrete mechanism.

How the Reforms Activated India's Potential

This chapter analyzes the concrete channels through which the 1991 reforms connected the potential of the Indian economy to actual growth. The effect of reform appeared not through a single channel but through three interlocking mechanisms, each of which activated, in turn, the flows of labor, capital, and finance that had been institutionally suppressed. What follows examines in sequence how three channels—trade liberalization, the opening to foreign direct investment, and financial-market reform—led to the expansion of production and investment.

The first is the channel through which trade liberalization converted population into labor. Once the market opened, the effects spread in a chain. As tariffs fell and import licensing was abolished, firms could operate more freely; as business activity grew, employment expanded; and as employment expanded, the vast young population that had lain dormant, underused, at last began to be converted into an actual labor force. The most dramatic example is the information-technology (IT) services industry. Before liberalization, India's excellent science and engineering graduates could not find suitable jobs and either went abroad or failed to realize their potential. After liberalization, however, firms such as Infosys, Tata Consultancy Services (TCS), and Wipro grew explosively by taking on software development and back-office work for American and European companies. India's IT-services exports swelled from under one hundred million dollars in 1991 to tens of billions by the mid-2000s, and Bengaluru rose as "India's Silicon Valley" [8]. As millions of young workers gained good jobs, an abstract number—population—turned into concrete agents participating in production.

The second is the channel through which the opening to foreign direct investment (FDI) converted capital into productivity. The change in scale alone was dramatic. India's average annual FDI inflow, only about four hundred seventy million dollars in 1991-94, rose to about 3.6 billion dollars in 1997, and from about 2.2 billion dollars in 1999-2000 it surpassed twenty-two billion dollars in 2006-07 [9]. India's share of global FDI likewise grew more than twentyfold, from 0.16 percent in 2000 to 3.25 percent in 2018. Yet the inflow of foreign capital meant more than money coming in. Foreign firms brought advanced technology and managerial know-how along with their capital. When South Korea's Hyundai Motor built a plant in Chennai in the late 1990s, for instance, it created not merely jobs but transplanted modern production-management techniques and an ecosystem of parts suppliers. In fact, about 83 percent of the FDI that entered India in 1995 was concentrated in manufacturing [9], so the technology-transfer effect was large. The same labor force, combined with better technology and management, generates higher value added. FDI, that is, did more than raise the "quantity" of jobs; it raised the "quality" of labor—its productivity. If trade liberalization turned population into labor, the opening to FDI raised that labor's productivity, moving from the quantitative use of population to qualitative improvement.

The third is the channel through which financial-market reform converted savings into investment. Harshad Mehta was the figure who, conspiring with corrupt bankers, siphoned off bank funds to invest heavily in select stocks, drove up their prices, took his profits, and pulled out—crashing the market in 1992 in what is regarded as the largest securities fraud in the history of India's capital markets. When the 1992 Harshad Mehta scandal exposed the opacity of the existing exchanges, the computerized and standardized National Stock Exchange (NSE) was established in 1993, and foreign portfolio investment was permitted in stages (NSE, n.d.). With a modernized capital market in place, firms could raise funds through the stock market; the resulting abundance of capital fed corporate growth, and corporate growth spread in turn to growth of the economy as a whole. The effect is visible in the indices: the benchmark Sensex quintupled in nine years, from about 1,000 points in 1991 to about 5,200 in 2000, showing that reform translated, through the capital market, into real growth in corporate value [10]. At the same time this process activated another of the population's resources—its savings. The savings accumulated by a young population flowed, through the channel of the capital market, into corporate investment. India's population thus came to perform three roles at once: labor force, consumer market, and source of capital supply. Before the reforms all three roles had remained merely potential.

The economic reforms transformed India's population from a mere number into agents of production, consumption, and investment. What the three mechanisms share is clear: the essence of reform lay not in creating new resources but in opening the "waterways" of economic activity that had been blocked. Once the channels of trade, investment, and finance were opened, production and growth at last began to flow.

The Results Of Reform: A Qualitative Transformation in the Numbers

If the three conversion mechanisms set out in the previous chapter actually worked, their effect ought to appear in the movement of macroeconomic indicators. This chapter compares key economic indicators before and after the 1991 reforms to examine empirically how the reforms changed the growth trajectory and structure of the Indian economy. In doing so, it seeks to confirm that the effect of reform went beyond a mere rise in the growth rate to a qualitative transformation of the economy.

The first thing that changed was the growth rate. India, whose per-capital income growth had fallen short of 2 percent a year in 1958-1991, recorded average annual growth of 6 to 7 percent after the reforms, rising to become one of the world's fastest-growing major economies [11]. The absolute level of the growth rate had more than tripled. This difference, accumulating over time, appeared in per-capital income. Per-capital income, only about three hundred dollars just before the reforms in 1991-92, rose to about 450-460 dollars by the early 2000s, a decade after the reforms, and then, as growth accelerated, climbed over the long run into the thousands [12]. This shows that the effect of reform appeared gradually, with a lag.

The more important change is the reduction of poverty—the most human evidence that reform converted the population into agents of production. Just before the reforms, India's poverty rate was very high; at one point nearly half the population lived below the poverty line. After the reforms the poverty rate fell steadily, to about 35 percent by the early 2000s, and continued to decline to about 22 percent by 2011-12 [13]. Hundreds of millions escaped absolute poverty. Notably, what led this reduction in poverty was chiefly the growth of the service sector. According to one study, the tertiary (service) sector accounted for more than 60 percent of the reduction in poverty after 1991—evidence that the IT and service sectors the reforms opened up led not merely to the enrichment of the well-off but to a broad escape from poverty. That agriculture's contribution, about 40 percent

Table 2: Key Economic Indicators Before and About a Decade After the 1991 Reforms.

Indicator	Just before reform (1991)	10 years after reform (c. 2000)
Per-capita income growth	under 2% per year	around 6% per year
Per-capita income	USD 300	USD 450
Population below poverty line	45%	35%
Average annual FDI inflow	USD 0.47 bn (1991-94)	USD 2.2 bn (1999-2000)
Sensex index	1,000	5,200
Imports (trade volume)	USD 27.1 bn (1990)	USD 65.1 bn (2000)

Sources: World Bank; European Commission (2024); CEPR; theIAShub; IMF Survey (2000); BSE. Compared about ten years after reform to account for the lag in reform effects.

of poverty reduction before the reforms, fell to under 10 percent afterward, its place taken by services, signifies that the very structure of the Indian economy had changed.

Taken together, these figures point to a clear conclusion. The 1991 reforms did not merely raise the growth rate by a few percentage points; they changed the very quality of the Indian economy. A stagnant agrarian economy was transformed into a dynamic service economy, and in the process a vast population shifted from being a burden of poverty to being agents of production and consumption. The population remained the same, but its standing within the economy had fundamentally changed.

From 1991 To 2014: An ERA of Gradual Accumulation

The effects of the 1991 reforms did not appear overnight. The two decades between the reforms and their full fruition were a period in which change accumulated quietly but steadily. Following how the Indian economy was transformed step by step over these two decades makes clear how reform converts into growth over time.

The 1990s were a period in which the effects of reform gradually seeped in. The IT services industry laid its foundations then. Infosys listed in 1993, and in the course of solving the millennium-bug (Y2K) problem that the whole world faced as 2000 approached, Indian IT firms raised their credibility and standing in the global market at a stroke. As American and European firms began entrusting work to India's cost-effective, English-capable workforce, Bengaluru rose as "India's Silicon Valley." Through the door reform had opened, the opportunities of globalization came rushing in.

As the 2000s arrived, the accumulated changes burst into full-fledged growth. From 2003 until just before the global financial crisis of 2008, India enjoyed high growth of 8 to 9 percent a year. A construction boom in this period brought jobs even to low-skilled workers, contributing greatly to reducing poverty. A telecommunications revolution also occurred: as mobile-phone adoption exploded, hundreds of millions were connected to a communications network for the first time, and infrastructure such as roads and airports was rapidly expanded [14].

Thus by 2014, just before the Modi government took office, India had already changed beyond recognition. GDP had reached about two trillion dollars, making it the world's tenth-largest economy, and foreign-exchange reserves had recovered from their nadir in the 1991 crisis to about three hundred billion dollars. The poverty rate had fallen from once over 70 percent to about 22 percent, diseases such as polio had been eradicated, and in 2013 India astonished the world by placing a Mars probe into orbit on its first attempt [1,15]. A country once called a "basket case" had transformed into a rising economic power.

Yet this period was not entirely rosy. In the early 2010s, at the end of the Congress-led UPA government, major corruption scandals, policy paralysis, and a growth slowdown coincided. As the momentum of reform weakened and bureaucracy again became a drag, India found itself in need of new institutional reforms to take a further leap. The arrival of the Modi government in 2014 began precisely from this point—inheriting an India that was "dynamic but also beset by problems." The Modi government's reforms, in other words, were a "second reform" that began on the foundation the 1991 reforms had built over two decades.

The two decades from 1991 to 2014 were a period in which the effects of reform accumulated bit by bit—through the growth of the IT industry, the high growth of the 2000s, the reduction of poverty, and the expansion of infrastructure. This gradual accumulation is precisely what the population hypothesis cannot explain. The population did not change abruptly over this period, yet as reform worked over time, growth accelerated in stages. And it was on this foundation that the Modi government's second reform began.

The Second Reform: The Modi Government and The Expansion of Economic Participation

If the 1991 reforms opened the door of the market and their effects accumulated through 2014, the reforms of the Modi government that took office in 2014 were reforms that "let more people into" that opened market. Where the 1991 reforms had chiefly expanded the freedom of firms and capital, the Modi government's reforms widened the path by which ordinary individuals could participate in the formal economy. Three policies drove this expansion of participation, each removing a different barrier that had blocked economic participation.

The first policy, the Goods and Services Tax (GST, 2017), tore down the barrier of a fragmented market. In a federal country like India, taxes differed from state to state, and inspections and levies imposed each time goods crossed a state border had effectively severed trade. Trucks were commonly held up for hours at state-border checkpoints, and so firms had to accept the inefficiency of keeping small separate factories in each state to avoid distribution costs. The GST unified these disparate taxes into a single nationwide system, making India one market. As a result, even small firms could grow their businesses on a nationwide stage, and the very stage of economic activity widened.

The second policy, Aadhaar, brought down the barrier of the absence of proof of identity. In the past, many in India could not even open a bank account for lack of official identification, and without an account one could not participate in the formal economy. Thanks to Aadhaar, which gave 1.4 billion people a fingerprint- and iris-based digital identity, about two hundred million people who had lacked bank accounts entered the formal financial system [16]. It was, in effect, the issuance of a credential to participate in the economy to virtually the entire population, and government subsidies could now be paid directly into people's own accounts without leakage along the way.

The third policy, the Unified Payments Interface (UPI, 2016), eliminated the barrier of transaction costs. Even with an identity and an account, economic activity shrinks if transactions are cumbersome and costly. UPI made it possible to transfer money instantly and almost free using only a smartphone, cutting transaction costs effectively to zero, so that everyone from street vendors to large firms came to transact within the same payments network. In 2023, UPI transaction value exceeded 60 percent of India's GDP [17]. As activity that had remained in the informal economy was absorbed into the formal economy, more people and transactions were captured in the statistics and became subject to taxation and credit.

Here too, population was a factor amplifying the reforms' effect. For the single market the GST created to have meaning, that market must contain vast numbers of consumers; for the digital financial network that Aadhaar and UPI created to display its power, many people must be connected to it. In a country with a small population, the same policies would not have had such reach. The 2014 reforms, like those of 1991, had their effects multiplied on the foundation of a vast population. In the end, the Modi government's reforms were not a mere growth policy but a policy of expanding economic participation. As the GST addressed the scope of the market, Aadhaar the credential for participation, and UPI the cost of participation, hundreds of millions who had lingered in the shadows of the informal economy stepped up onto the stage of the formal economy. If the 1991 reforms "opened the market," the Modi government's reforms "let the people into that market."

The Evidence of Change: The Economy at Large and The Capital Market

If reform converted the population into economic agents, where does the evidence appear? The evidence spans the economy as a whole. It can be confirmed in turn across five dimensions: the growth rate, foreign capital, exports, industrial structure, and the capital market. Comparing each indicator at three points in time—just before the reforms (1991), the 2000s when the reforms took full effect, and the most recent period (around 2025)—makes the trajectory of change clearly visible.

First, the leap in the growth rate and the size of the economy. India's GDP, only about two hundred seventy billion dollars in 1991, swelled rapidly as the reforms took full effect in the 2000s, surpassing about one trillion dollars around 2007 and reaching about four trillion dollars around 2025, making India the world's fourth- or fifth-largest economy [1]. Per-capital growth, too, jumped from around 2 percent a year before the reforms to 8-9 percent by the mid-2000s. An economy that had been trapped in slow growth had become one of the world's fastest-growing major economies.

Second, the rising inflow of foreign capital. Average annual FDI inflows, only about four hundred seventy million dollars in 1991-94, rose to about 2.2 billion dollars around 2000, surpassed twenty-two billion dollars in 2006-07, and reached an annual scale of seventy to eighty billion dollars around 2025 [5,18]. Cumulative inflows since April 2000 exceeded one trillion dollars. A country that foreign capital had shunned as a closed economy had become a market to which investors from around the world flocked.

Third, the expansion of exports and the scale of trade. India's imports (one measure of trade volume) surged from about 27.1 billion dollars in 1990 to about 65.1 billion in 2000 and about 450 billion in 2010, and around 2025 India's total trade in goods and services exceeded 1.5 trillion dollars [1]. Imports as a share of GDP nearly doubled, from 13.9 percent in 2000 to 29.3 percent in 2008. Software and IT-services exports in particular grew explosively, and India was transformed from a closed economy into a global IT-export power.

Fourth, the qualitative transformation of industrial structure—perhaps the most fundamental change. Around independence, India was an agrarian economy in which industry barely exceeded 10 percent of GDP, and even in 1991 agriculture remained a major pillar of the economy and of employment [19]. But over the course of the 2000s, India shifted rapidly toward high-value-added services such as IT, software, finance, and telecommunications, and toward advanced manufacturing such as pharmaceuticals and automobiles, so that by around 2025 services accounted for about 55 percent of India's GDP. India is now known to the world not as an exporter of farm goods but as an exporter of software. An economy in which a vast population had been tied to low-productivity agriculture had become one in which people work in high-productivity industries.

Fifth, and most emblematic, is the evidence of the capital market. The benchmark Sensex rose more than seventy-five-fold, from about 1,000 points in 1991 through about 5,200 in 2000 to about 77,000 in 2025, and in 2024 India became the world's number-one market by number of IPOs [20,21]. But more important from this paper's standpoint is the question of "who came to participate in the market." Demat (dematerialized securities) accounts—the accounts needed to trade shares—exploded more than fivefold, from about thirty-six million in 2019 to about one hundred ninety million in 2025, meaning that, on the digital financial infrastructure that Aadhaar and UPI created, hundreds of millions of ordinary people were converted into investors. That India's stock market, which once crashed whenever foreign capital withdrew, has become a market supported by domestic savings is the decisive scene in which digital financial reform connected the nation's savings to investment in the capital market.

A Comparison with Rival Explanations: Why India's Reforms Succeeded

The discussion so far has proposed that reform was the central engine of India's growth. To examine this conclusion more rigorously, however, two questions must be addressed together. The first is whether India's growth can be explained by factors other than reform; the second is why, if reform was decisive, other emerging economies did not achieve comparable results. This chapter examines the two questions in turn.

Consider first the alternative explanations. Population certainly mattered, but as chapter 1 showed, it existed before the reforms and so cannot explain the "timing" of growth. Globalization, too, offered opportunity, but it was an opportunity opened simultaneously to all developing countries. Why, then, did India in particular become a global hub for IT services, a pharmaceutical-industry hub centered on generic drugs, and, more recently, an emerging manufacturing base? Because, while the opportunity of globalization was open to many countries, India had opened its doors in 1991 and was in a position to actually seize it. In IT services, after liberalization India's excellent science and engineering workforce was connected to global outsourcing demand; in pharmaceuticals, through deregulation and reform of the patent system, India grew into the "pharmacy of the world," supplying a substantial share of the world's generic drugs; and in manufacturing, liberalization and subsequent policy reforms made it possible for global firms to relocate production bases. Before liberalization—as Coca-Cola's 1977 withdrawal showed—no matter what opportunity came, India could not seize it (Kaur, 2019). The same holds for technological advance. The explosion of digital payments in India came not merely because smartphones spread but because the government deliberately built the public infrastructure of Aadhaar and UPI. Population, globalization, and technology were all potential or external opportunities; what laid the channel to convert them into growth was reform.

A more interesting question arises from the comparative perspective. India was not the only country to possess both a vast population and reform. Why, then, were India's reforms so distinctively successful? Three comparisons are suggestive.

First, the comparison with China. China set out with its 1978 reform and opening, thirteen years ahead of India, and as a result surged well ahead of India in per-capita income, its middle class exploding from 3.1 percent in 2000 to 50.8 percent in 2018 [4]. This shows, in reverse, how important the "timing" of reform is. But China's growth relied chiefly on state-led manufacturing and exports, and as its demographic dividend was exhausted from around 2010 it ran up against the wall of aging. India, by contrast, is growing on the basis of private-led services and domestic demand, and a demographic dividend that is still open. Even with the same "reform," India walked a different path from China in drawing on its distinctive strengths of democratic institutions and English-language and IT capabilities.

Second, the comparison with other BRICS countries. Brazil and Russia, too, possessed reform, resources, and population, but Brazil was hobbled by chronic inflation and political instability and Russia by resource dependence and institutional backsliding. What set India apart was that, even as power changed hands repeatedly after the 1991 reforms—from Congress to the BJP and back—the broad direction of reform was not reversed but consistently maintained. A representative example is that the reform stance Manmohan Singh launched as finance minister in 1991 was carried forward in broad terms when he became prime minister in 2004-2014, and again under the Modi government after 2014. This continuity of policy gave foreign investors predictability.

Third, the dimension of the "inclusiveness" of reform. Unlike the reforms of many emerging economies, which concentrated benefits on a small elite and large corporations and thereby produced polarization and political backlash, India's second reforms (GST, Aadhaar, UPI) explicitly aimed at "expanding participation." Bringing two hundred million people without bank accounts into the financial system and connecting even street vendors to a digital payments network had the effect of distributing the fruits of reform broadly. This inclusiveness widened social support for reform and raised its sustainability.

Reform was not the sole factor in India's growth, but it was the foundation that allowed all the other factors to take effect. And that India's reforms were more successful than those of other emerging economies was due not to reform alone but to the combination of distinctive strengths—democratic institutions and IT capability—with a continuity of policy that transcended changes of government and an inclusiveness that expanded participation. The reason India pulled ahead, amid the same population and the same opportunities of globalization, lay in the end in the quality of its reforms.

The Limits of Reform and The Tasks That Remain

Even granting the conclusion that reform converted a demographic advantage into growth, that conversion is not yet complete. Indeed, an honest look at the tasks that remain reveals that even these tasks arose because "the conversion is unfinished." Five tasks are examined in detail.

First, the lack of manufacturing competitiveness. The 25 percent manufacturing-share target set by the "Make in India" policy remains unmet; if anything, the share retreated from 18.3 percent in 2020 to 16.9 percent in 2022 and stood at around 17.5 percent in 2024 [1,19]. The more fundamental problem is the "quality" of manufacturing. Raghuram Rajan, a former governor of India's central bank, points out that Indian manufacturing tilts toward assembly and adds little value. Even when a one-thousand-dollar iPhone is assembled in India, for instance, the value India actually adds is only fifty to sixty dollars, and core components still depend on imports [22]. Moreover, as modern manufacturing has become capital-intensive and automation-centered, there is a structural limit whereby manufacturing no longer creates large-scale employment as it once did.

Second, youth unemployment. The young labor force that is the core of the demographic advantage has paradoxically become a burden. Of India's total unemployed, those aged 15 to 29 make up about 83 percent, and while the youth unemployment rate fell from 17.5 percent in 2019 to around 10 percent in 2023, it remains high [14]. Unemployment among educated youth is especially serious: a phenomenon of "over-qualification" has emerged in which college graduates cannot find work. In 2022, one in three young people was in the so-called NEET state—not in education, employment, or training—and many of them were young women. The pace of creating good jobs, white-collar jobs in particular, cannot keep up with the pace at which educated youth pour out.

Third, the low female labor-force participation rate. Indian women's labor-force participation, at about 25 to 29 percent, is among the lowest in the world—half the emerging-economy average of over 50 percent [14]. This means that female labor, corresponding to half of the demographic potential, is scarcely being used. That women make up 76.7 percent of educated unemployed youth, higher than men's 62.2 percent, shows that India educates its women yet fails to draw them into the labor market. Many analyses hold that raising female participation merely to the emerging-economy average would substantially increase India's growth potential. This is the very example of a "demographic advantage not yet converted."

Fourth, the persistence of poverty and inequality. Although the poverty rate has fallen greatly, even in 2022 about 12 percent of Indians lived on less than 2.15 dollars a day—well over one hundred million people in absolute terms [1]. Moreover, the fruits of growth are not evenly distributed, and the gaps between city and countryside and between rich and poor states are large. Growth is rapid, but its benefits tend to concentrate at the top, and many who have only just crossed the poverty line still lead precarious economic lives. This shows that not only the "speed" of growth but its "inclusiveness" remains a task.

Fifth, the weak rupee and political uncertainty. The rupee has depreciated steadily over the long run, eroding foreign investors' dollar-denominated returns and raising import prices, thereby exerting inflationary pressure. And after the ruling BJP failed to win a single-party majority in the 2024 general election and shifted to a coalition government, concern has arisen that the momentum driving strong reform may weaken [20]. Reforms in sensitive areas such as land and labor have repeatedly been delayed by political resistance, and such difficult reforms may become still harder under a coalition government.

Reform built the foundation for growth but did not solve every problem. The issues of female participation and manufacturing jobs, in particular, show that "the demographic advantage has not yet been fully converted." Manufacturing that takes only fifty dollars from a thousand-dollar iPhone, youth who are educated yet cannot work, female labor that does not step out of the home—all of these are parts of a vast demographic potential that remains unconverted into growth. In other words, even the tasks that remain arose not from a lack of potential but because the conversion is unfinished, and their solution likewise lies in deeper reform—manufacturing policy, the expansion of female employment, and investment in education and skills.

Conclusion: Will the Conversion Continue?

India's demographic advantage has existed for a long time. A vast and young population, an abundant labor force, and an immense domestic market were things India already possessed in the 1960s and in the 1980s. Yet that advantage never automatically translated into economic growth, because the institutional walls of the License Raj, nationalization, and restrictions on foreign investment had severed the bridge between potential and outcome. The fact that the same population was, in those days, synonymous with the poverty of a three-hundred-dollar per-capital income proves the point.

The economic reforms after 1991 and the institutional reforms of the Modi government rebuilt precisely that severed bridge. Trade liberalization converted population into labor, the opening to FDI converted capital into productivity, and financial reform converted savings into investment; and their effects accumulated gradually over two decades, halving the poverty rate and greatly raising per-capital income. GST, Aadhaar, and UPI let hundreds of millions who had lingered in the informal economy into the formal economy, and the results appeared in a leap in the growth rate, cumulative FDI surpassing one trillion dollars, the shift from an agrarian economy to one of services and advanced manufacturing, and one hundred ninety million demat accounts alongside a seventy-five-fold rise in the Sensex. What all these changes share is that reform, by opening the blocked flows of the economy, changed the role the economy performs. India's growth was therefore not the mere result of population but the result of economic reforms that converted a demographic advantage into actual growth.

To be sure, India's vast market and labor force were favorable conditions that magnified the effect of reform. In the reforms of 1991 and 2014, they were the favorable backdrop that drew in foreign capital and firms and added to the power of digital policy. But such conditions did not become growth by themselves; they were realized as growth only through the institutional device of reform. That many countries with the same conditions failed at reform and stagnated bears this out. That India pulled ahead of other giant emerging economies such as China, Brazil, and Russia was, in the end, due to the quality of its reforms—democratic institutions, IT capability, continuity of policy, and inclusiveness.

What, then, of India's future? To answer this question, one must remember that the demographic dividend is a time-limited resource. India's demographic-dividend window is projected to peak around 2041 and then begin to close slowly, and if the young population is not converted into sufficient jobs and skills before then, India could fall into the risk—as China has already begun to face—of "growing old before growing rich." And converting that potential into growth is, as we have seen, a matter not of population itself but of reform. If reforms that build manufacturing, draw women into the labor market, and invest in education and skills continue, India will be able to convert its remaining demographic dividend into growth. If not, a vast young population will become not an opportunity but a burden.

In the end, what India has shown is that it was not resources or conditions in themselves but the institutional reform that converted them into growth that ended a long stagnation. The same logic applies to India's future. Whether India can overcome the remaining limits—the fragility of manufacturing, low female participation, youth unemployment—and sustain growth depends on how long and how deeply it carries forward the reforms undertaken so far. The key question in gauging India's future lies, in the end, in the sustainability of reform.

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