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India – A Race Against Time

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ABSTRACT

The demographics and growth of India have made it an epicentre in emerging world economics. In the face of prevailing geopolitics and the struggle to resuscitate growth in most of the post-pandemic world, India's trajectory has a meaningful impact. We retrace India's journey from the liberalization in the 1980s to the current scenario of stuttering growth, high inflation, and burgeoning. We assess the policies that led to the current quagmire - against those of its larger competitors and debate the prudent path ahead to break out of the lower middle-income trap.

Keywords: India; inequality; economy; economic policy; emerging economy

INTRODUCTION

We are witnessing a global economic system that is attempting to reduce its interdependence in trade, technology, and operations. Geopolitical ambitions, geoeconomic fragmentations and rise of right-wing nationalism across continents is inciting distrust, conflicts and de-globalization. This has exacerbated downside risks on trade, supply chains, immigration and growth. Realigning global commerce toward a strong multipolar world is essential to sharpen competition and efficiency, spur productivity and innovation, reduce inequalities, and create potential opportunities and demand. As the world's most populous country with a large young demography and the fourth largest consumer market in the world, India's economic well-being and partnerships will have a big bearing on the above.

METHODOLOGY

This study is based on the secondary data published in the public domain by responsible, recognized authorities in the field. All data, tables, and figures presented to support the inferences and observations have been labelled with the source (in references) and appropriate captions.

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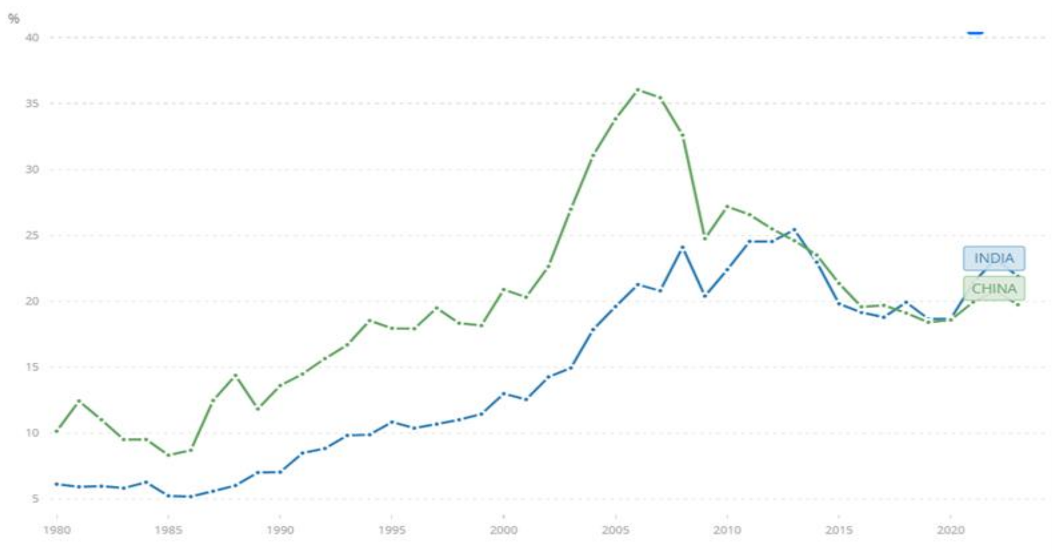
RESULTS AND DISCUSSION

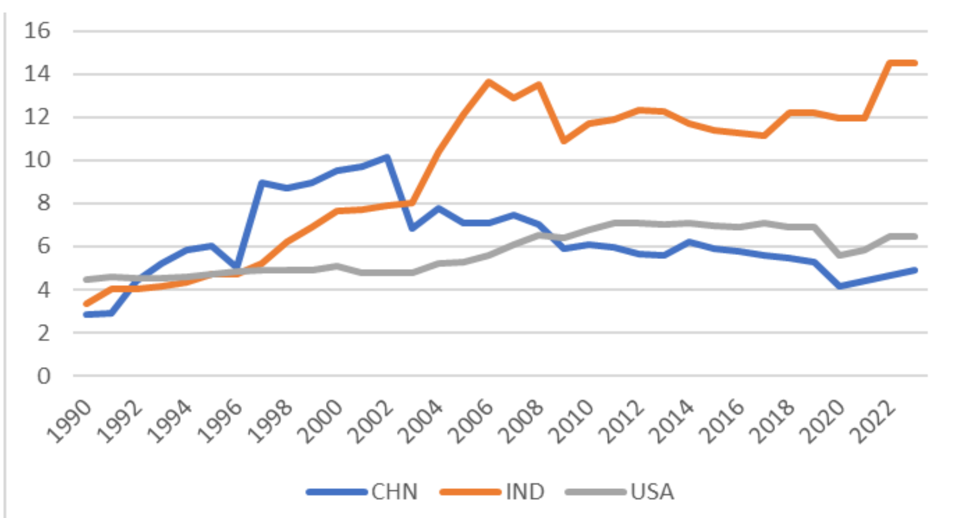
In the mid-1980s, India veered away from self-sufficiency-seeking import-substitution policies to an increasing liberal trade, taxation, FDI, privatization, and exchange rate management policies, causing a big spurt in the goods and services trade that lasted till the global financial crisis in 2008.

Fig 1. Export of Goods and services (% of GDP)



India leapfrogged even richer developing countries as a services exporter.

Fig 2. Trade in services (% of GDP) in China, India, and USA



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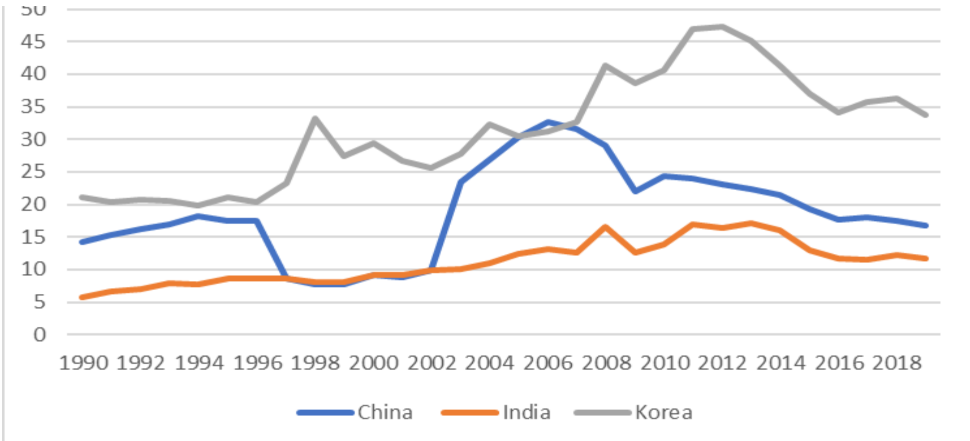
However, draconian labor laws, small-scale industry reservations, and large fiscal deficits held back industry growth vis-a-vis China (and Korea).

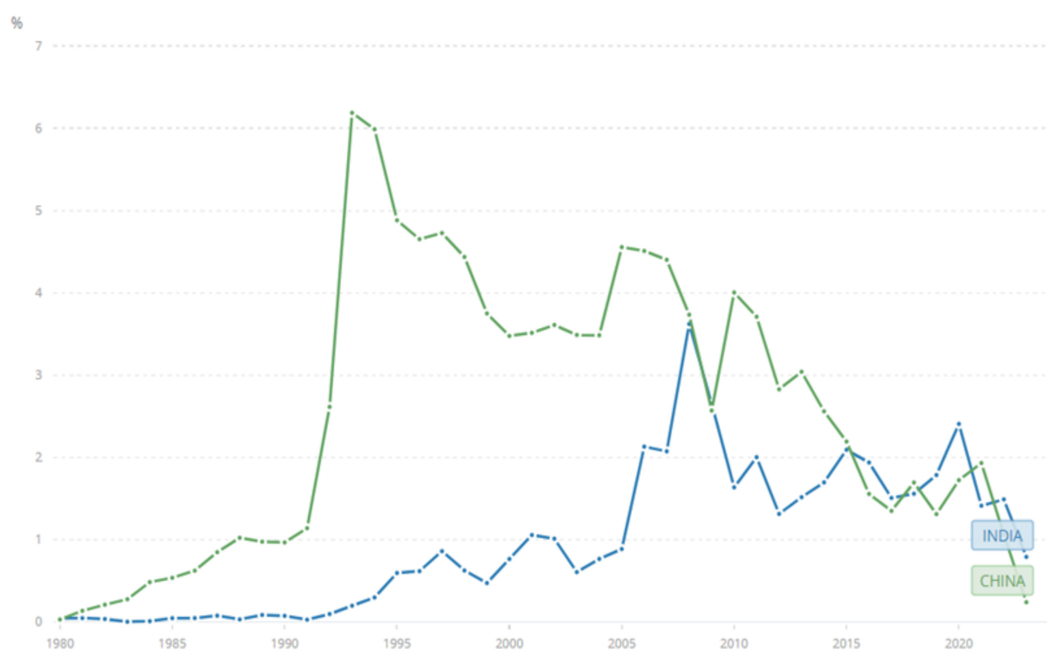
Fig 3. Value of exported goods (% of GDP) in China, India and Korea



Historically, countries started as exporters of commodities, graduated to manufacturers, and ultimately achieved service exports.

On the FDI net inflows (% of GDP), differences are even starker.

Fig 4. FDI net inflows (% of GDP)



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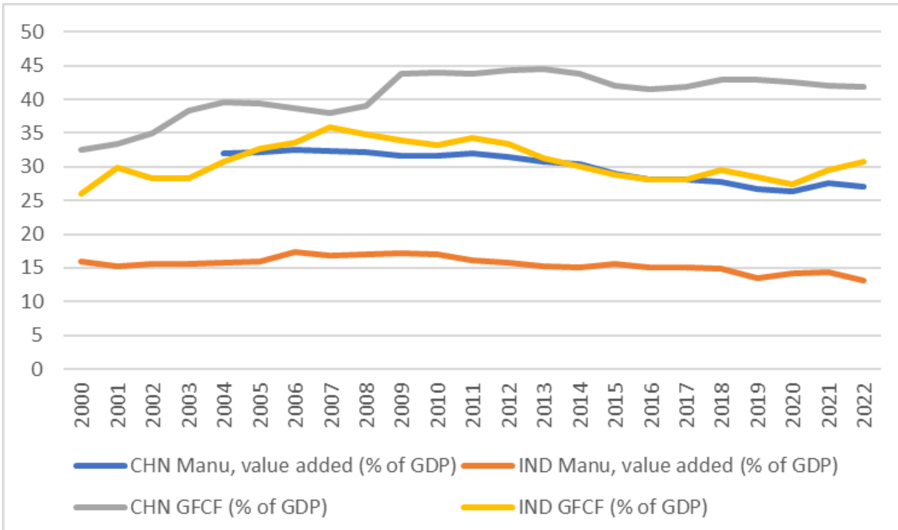
However, the growth momentum petered out in the 2010s, owing to premature deindustrialisation.

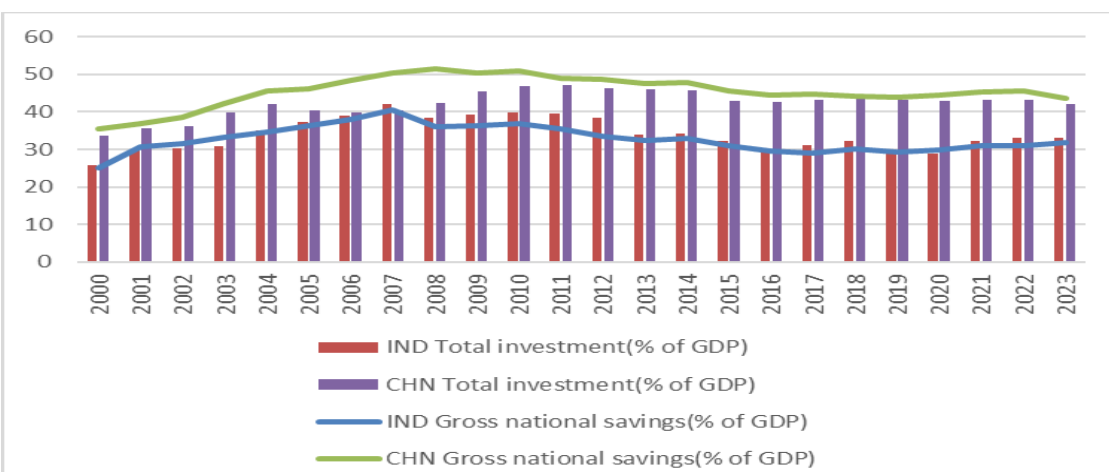
Fig 5. Industrial value addition (% of GDP)



The aggregate investment rates on manufacturing started shrinking well before attaining close to 40% of GDP which China needed to sustain 7–8% annual output growth for a decade.

China's rapid economic transformation was driven by highly-subsidised investments into infrastructure, manufacturing, and real estate investment, on the back of high levels of domestic savings.

Fig 6. Investment and savings (% of GDP)



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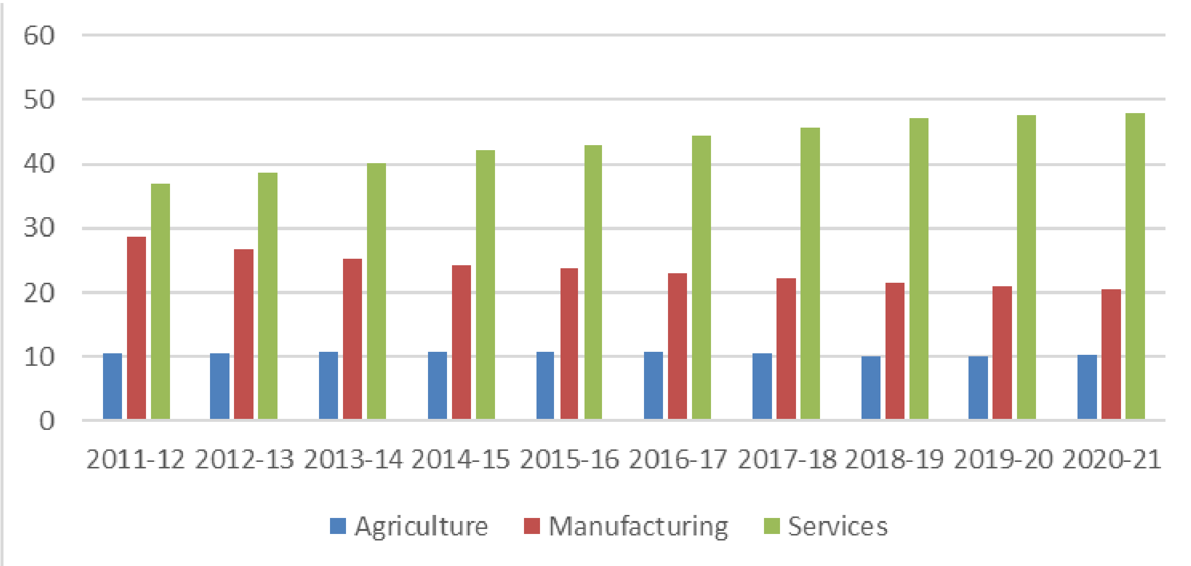
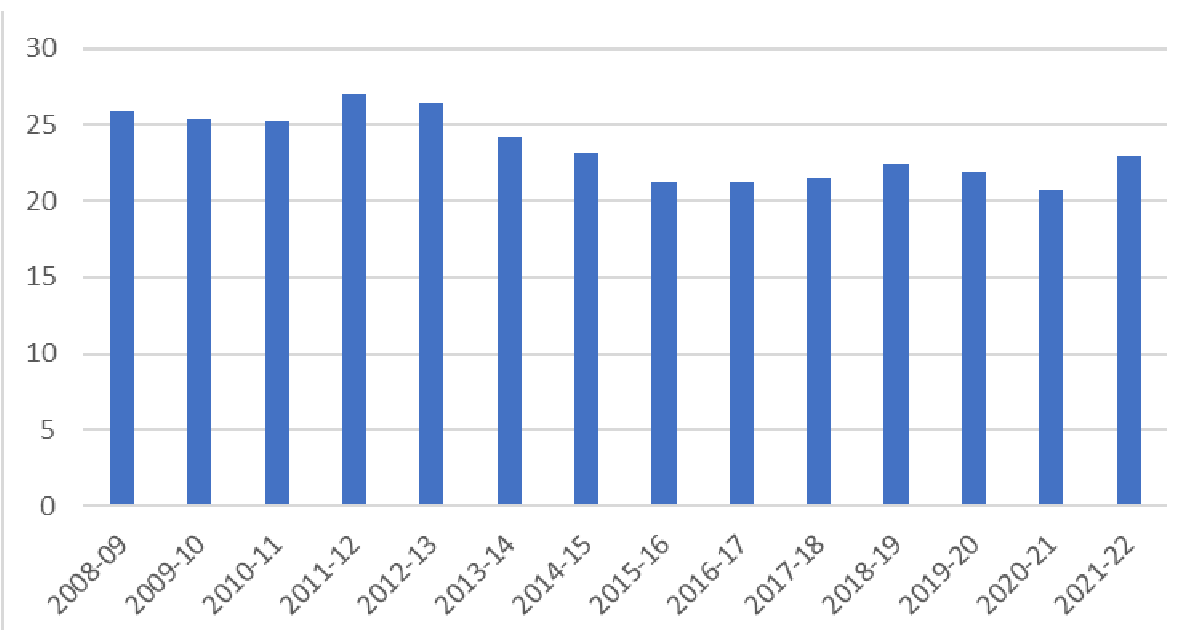
In the distribution of fixed income by major sectors. the shares of agriculture and industry – and manufacturing within the industry declined, while the share of services gained.

Fig 7. Consumption of Fixed Capital by economic activity at current prices (% of total)



Household and private sector investment in the economy also started shrinking post 2011-12.

Fig 8. Private Sector GFCF (% of GDP)



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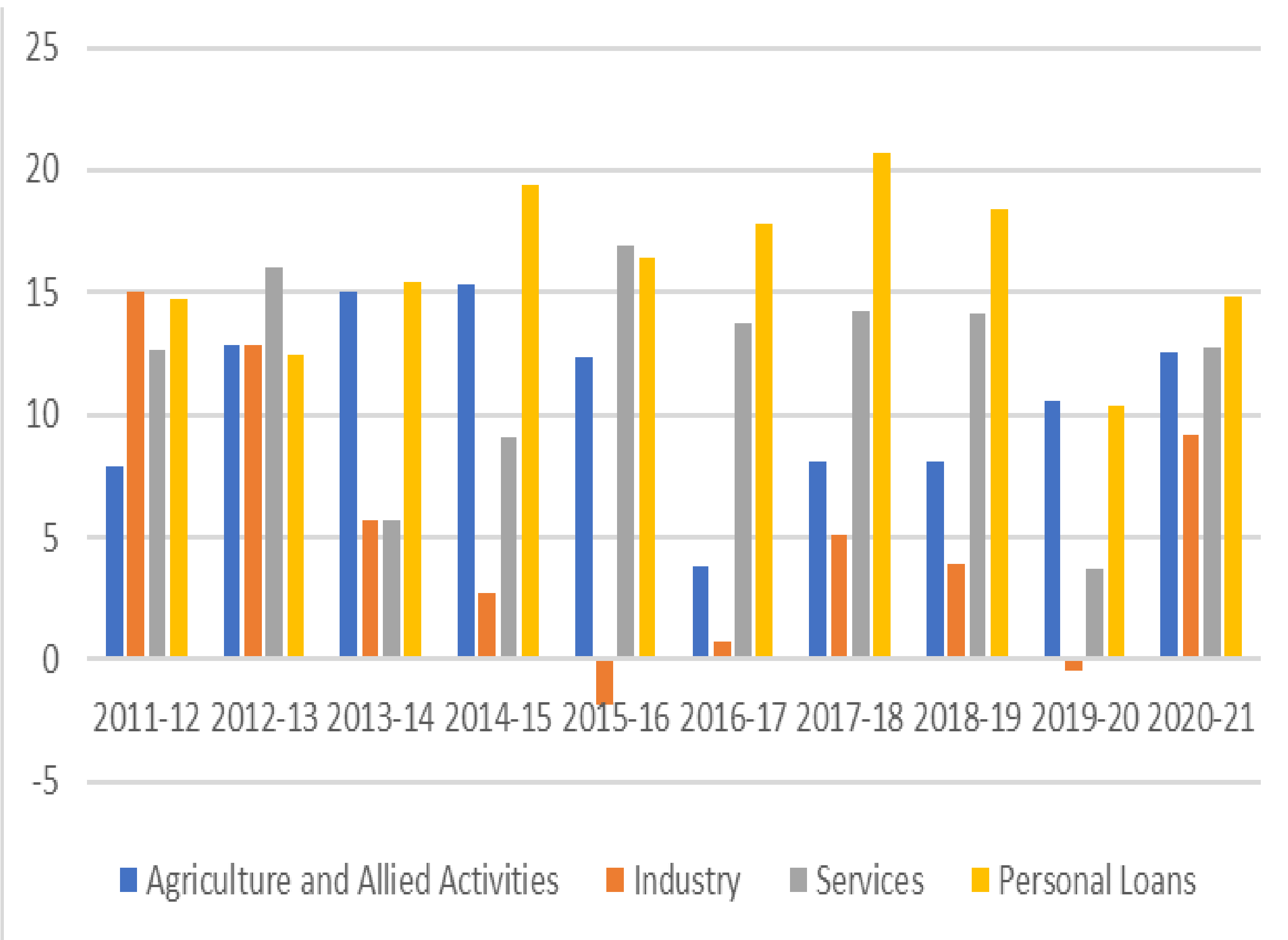
After the extraordinary credit expansion in the boom of the 2000s, India's exports and growth collapsed, interest rates elevated, and the exchange rate depreciated after the Global Financial Crisis of 2008, wreaking havoc on corporate India's finances - leading to banking sector NPAs reaching double-digits.

Not surprisingly, bank loans to industry faltered by more than 10% of GDP in the decade starting in 2010. Underutilized production capacity further depressed private-sector credit demand.

Banks responded by redirecting their incremental lending to consumers and NBFCs.

Fig 9. Sectoral Credit Growth (YoY)



NBFCs became a source of credit for the MSMEs that were shunned by banks. Post the IL&FS liquidation owing to the real-estate bust, credit froze there too.

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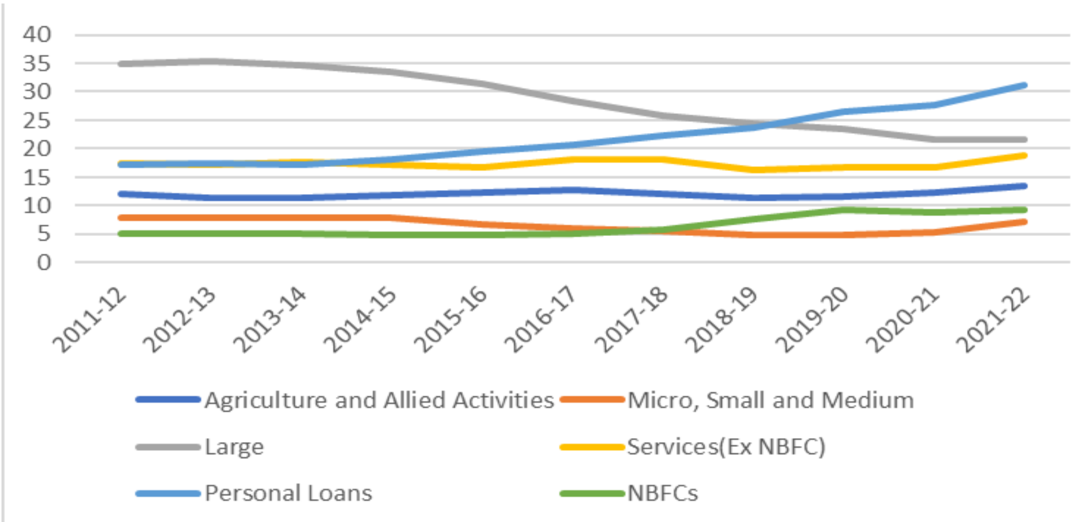
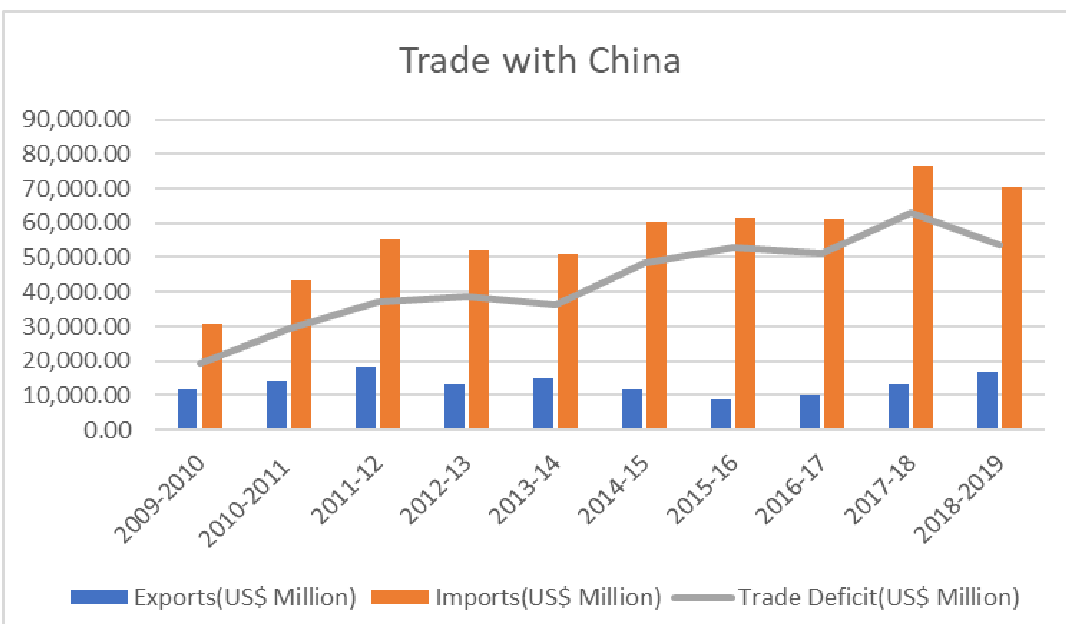
Fig 10. Sectoral Allocation (% of food credit)



Net FDI in India too has stagnated between 1.5% to 2.1% of GDP since 2010–11.

Deindustrialization has also been accompanied by India turning into an import-dependent economy. "Heavy reliance" on Chinese imports is eroding the market share and survival of Indian MSMEs in several sectors.

Fig 11. Trade with China



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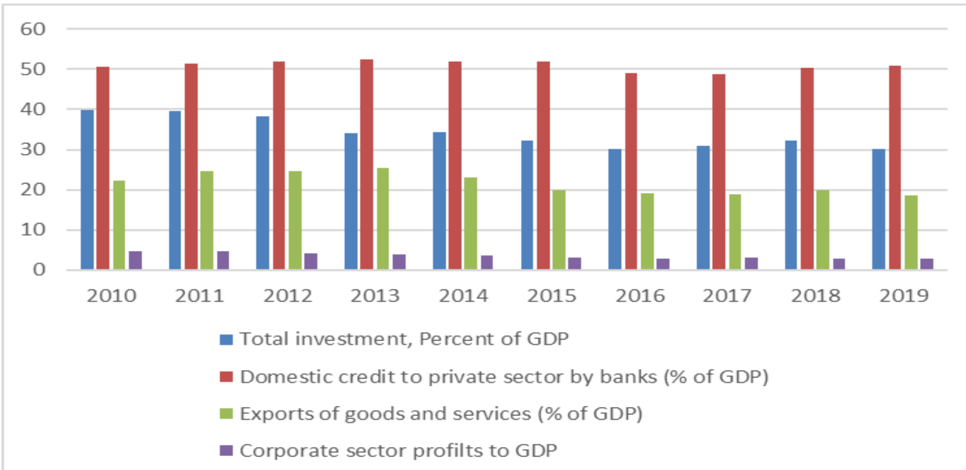
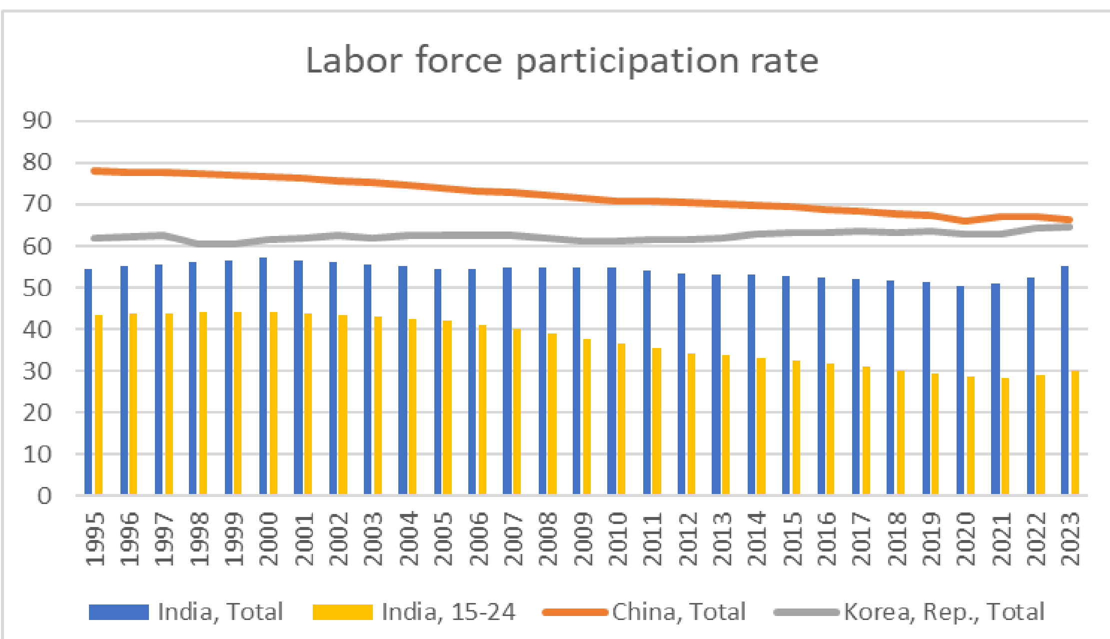
Since the boom of 2002-11, all the pillars of the economy have stuttered. The annual average growth of investment, credit to industry, profits, real exports, and imports have faltered or remained stagnant.

Fig 12. Economy Snapshot



Expectedly, the deterioration impacted employment levels too (with adverse changes in its composition).

Fig 13. Labour force participation rate



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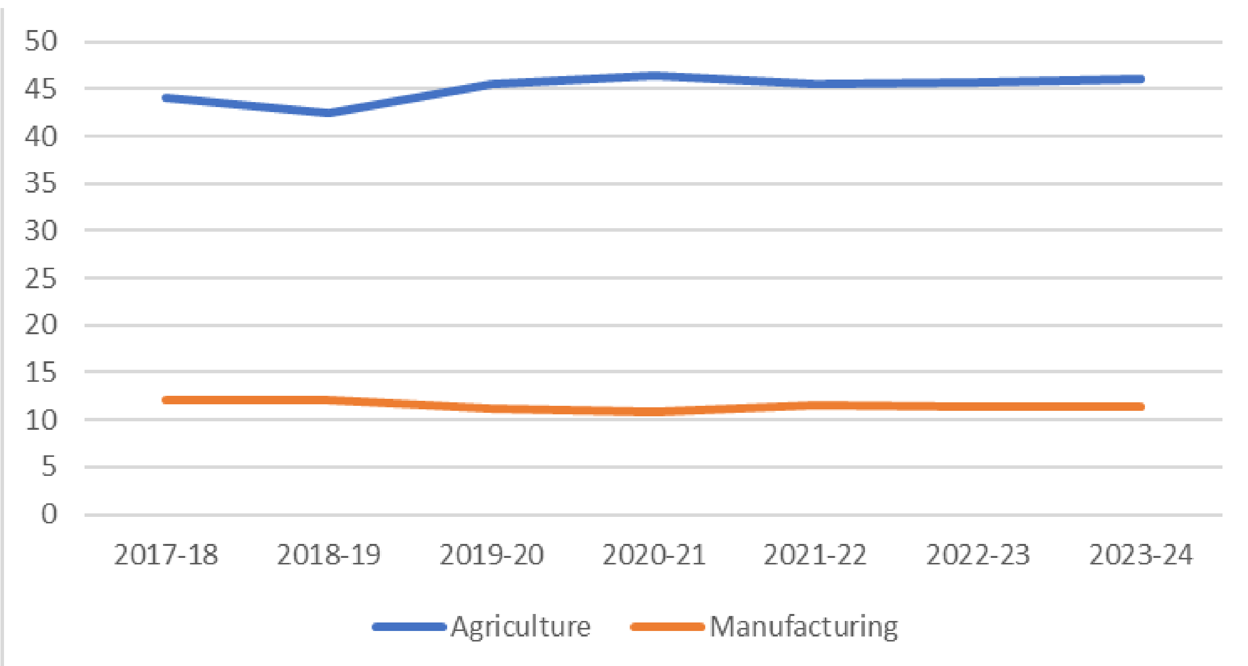
India's labour force participation rate trended down from 57% in 2000 and is low by global standards. Vietnam, Bangladesh, and China had higher rates of 73%, 59%, and 67%, respectively, in 2022.

Employment growth has stagnated at 2 percent for two decades - with the youth accounting for almost 83% of India's unemployed workforce, and the share of youngsters with secondary or higher education in the total unemployed youth almost doubling from 35.2% in 2000 to 65.7% in 2022, as per ILO and the Institute of Human Development (IHD)(1). Alarmingly, the unemployment rate among youth between 15-24 years of age stood at 45.4 percent in 2022-23(2).

As per the PLFS reports, the fall in the manufacturing sector's share in employment is being complemented by a corresponding rise in agriculture's share.

Fig 14. Percentage distribution of workers



Production has become more capital-intensive, which further rules out jobs for low-skilled workers.

While there has been some improvement in the efforts of the government to provide formal contracts and social security to workers in the unorganized sector, the share of unorganized sector employment has increased as compared to 2011-12.

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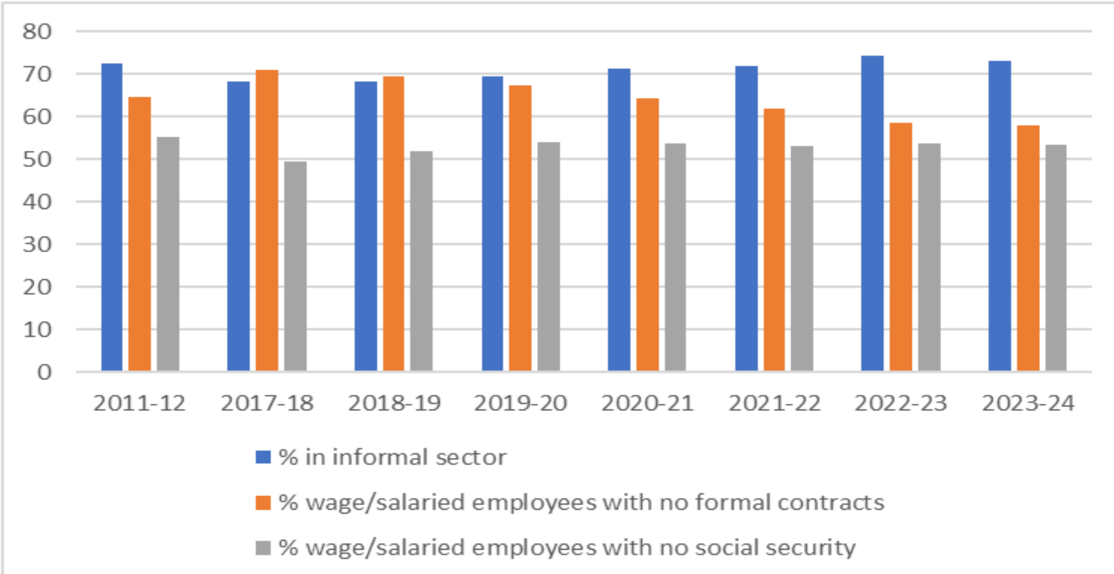
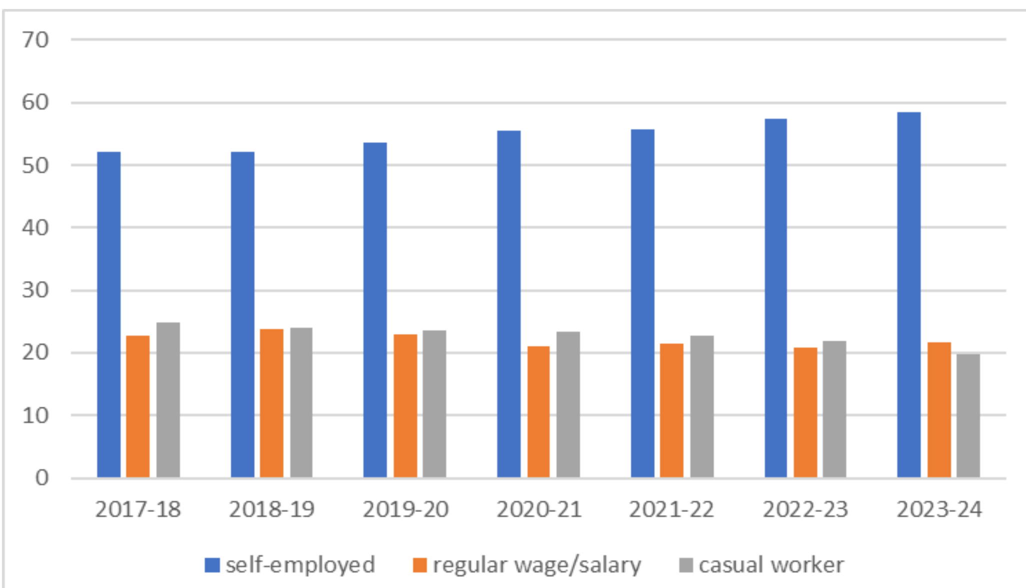
Fig 15. Formalization of Economy



Regular salaried employment only increased from 14% in 2000 to 21.5% in 2022-23. In contrast, 55 percent of self-employed, and 22.7 percent of casual labour are mostly in the informal sector.

Fig 16. Formalization of Employment



Workers moving to lower-productive informal sectors is a reversal of the structural transformation of labour. According to Simon Kuznets, structural transformation is the process

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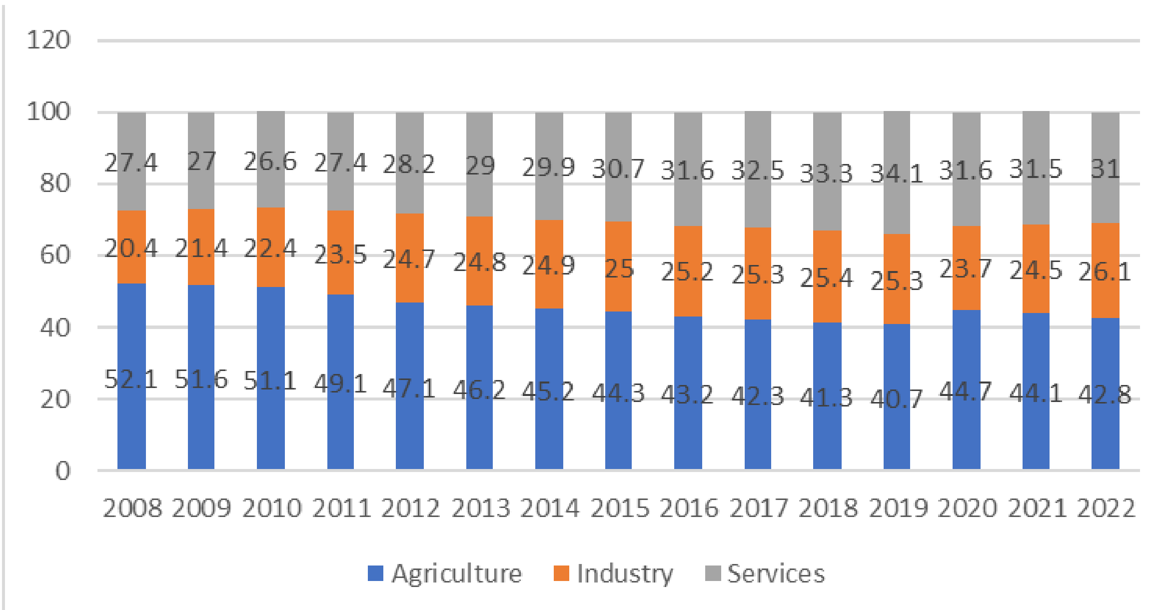
of workers moving from less productive sectors to more productive sectors and is a key feature of sustained economic growth.

45 percent of India's labour force in agriculture is producing just 16 percent of the total GDP.

Fig 17. Sector Employment (% of Total)



Agriculture comprises less than 10% of the GDP of China and Korea.

% of GDP	Agriculture		Industry		Manufacturing		Services	
Year	2015	2023	2015	2023	2015	2023	2015	2023
Korea, Rep.	2	1.6	34.1	31.6	26.6	24.3	55.6	58.4
China	8.4	7.1	40.8	38.3	29	26.2	50.8	54.6
India	16.2	16	27.3	25	15.6	12.8	47.8	49.8

With rapid industrialization, China and Korea have been able to pull its population out of agriculture.

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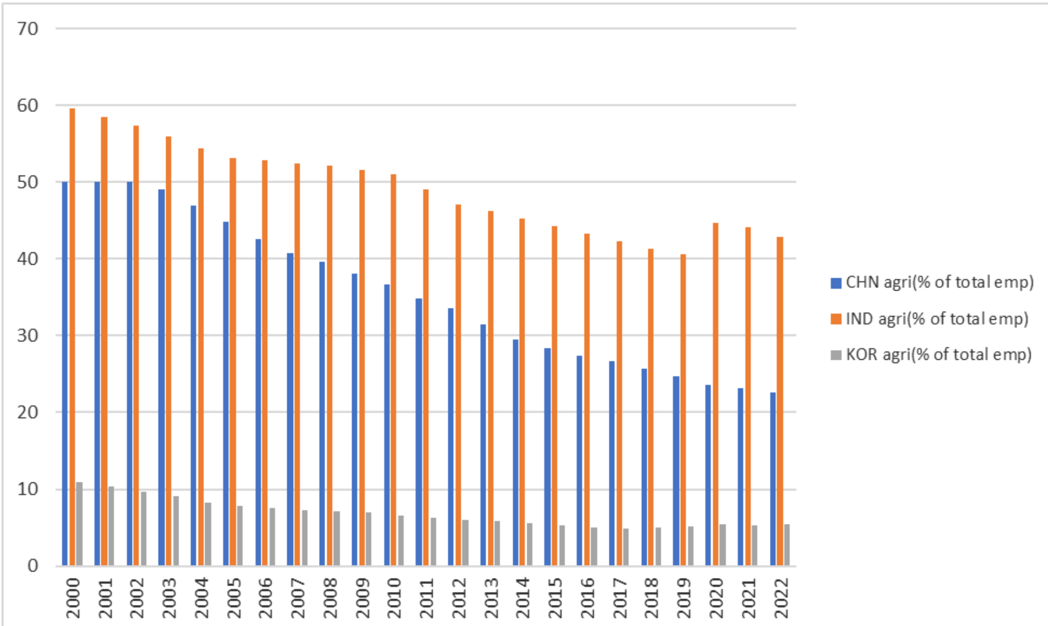
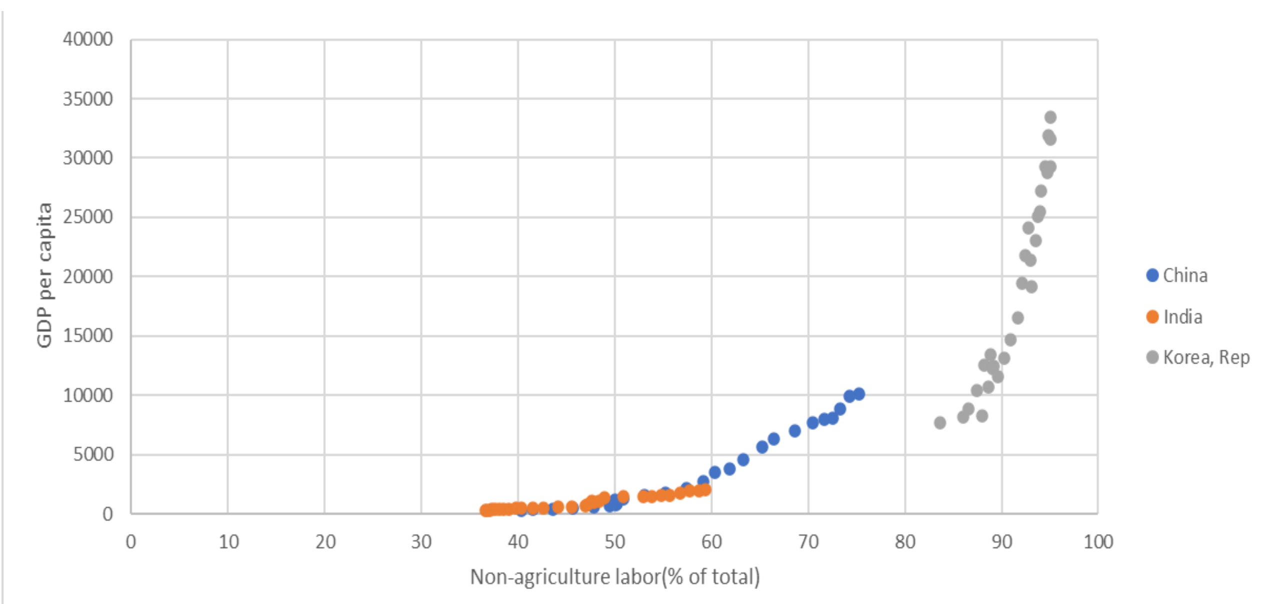
Fig 18. Population employed in Agriculture (% of total employment)



The structural transformation to higher productive sectors led to a higher per capita GDP in these countries.

Fig 19. Impact of Employment on GDP per capita



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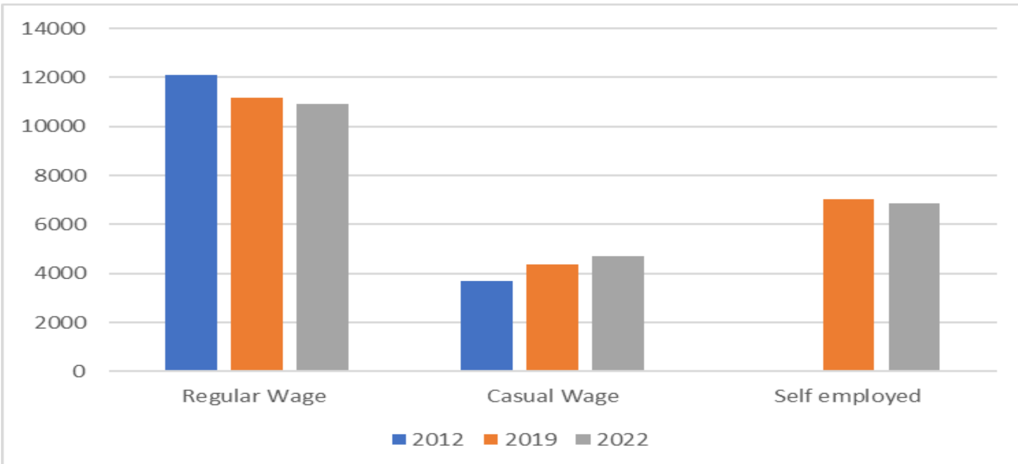
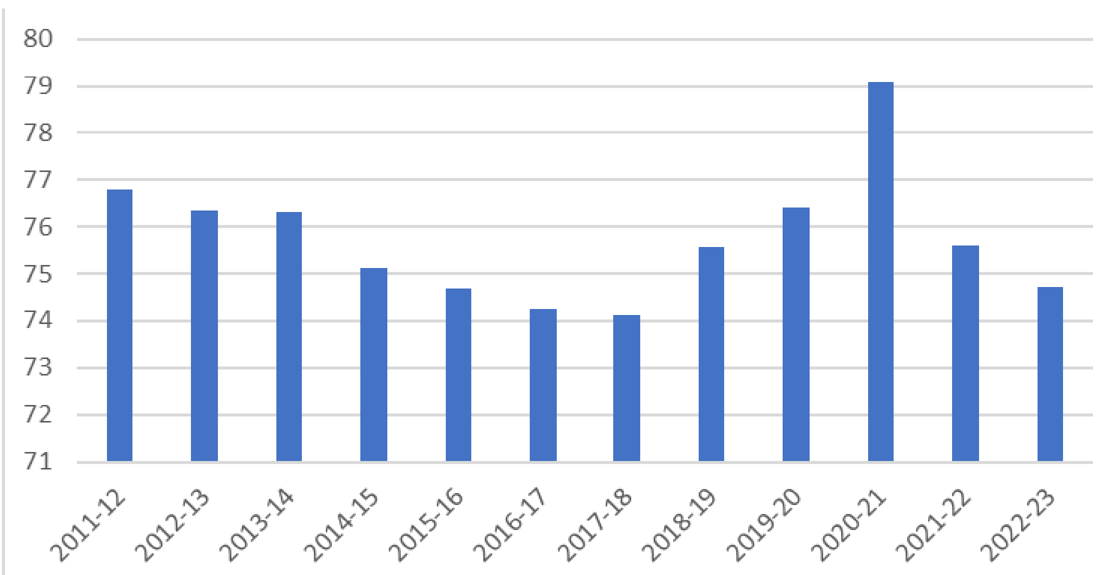
Over the decade until 2022, the average monthly real earnings of regular salaried, self-employed, and casual workers persons have displayed a decline or marginal shift (NSSO, 2023).

Fig 20. Average monthly real earnings of regular salaried, self-employed, and casual workers in 2012, 2019, and 2022.



The share of GDP that finally ends up in the hands of households is lower than a decade earlier.

Fig 21. Household disposable income (% of GDP)



Preliminary evidence from the Annual Survey of Industry (ASI) data also shows a consistent decline in the wage share in net value added, while the share of profits in net value increased.

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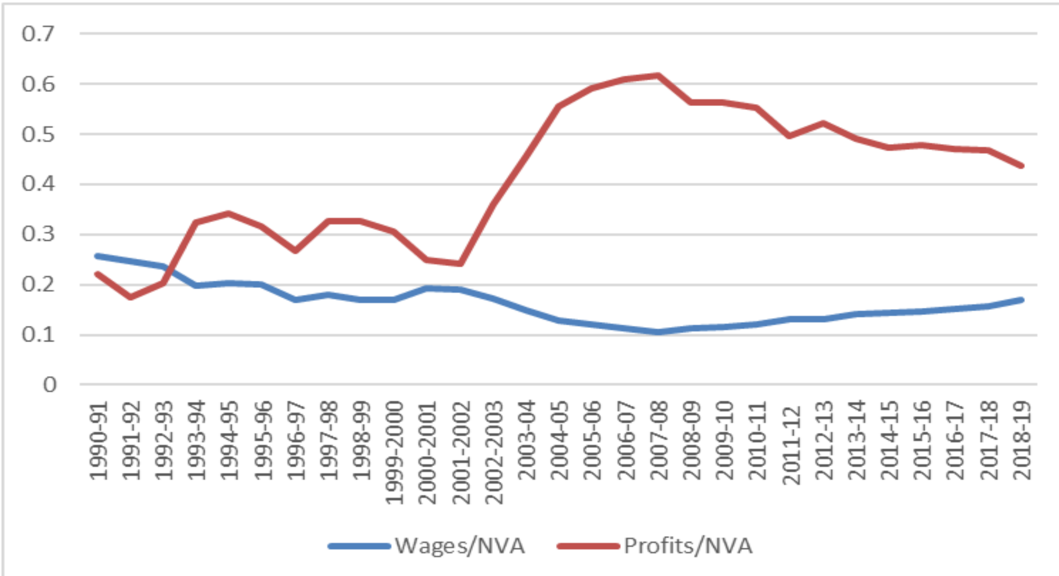
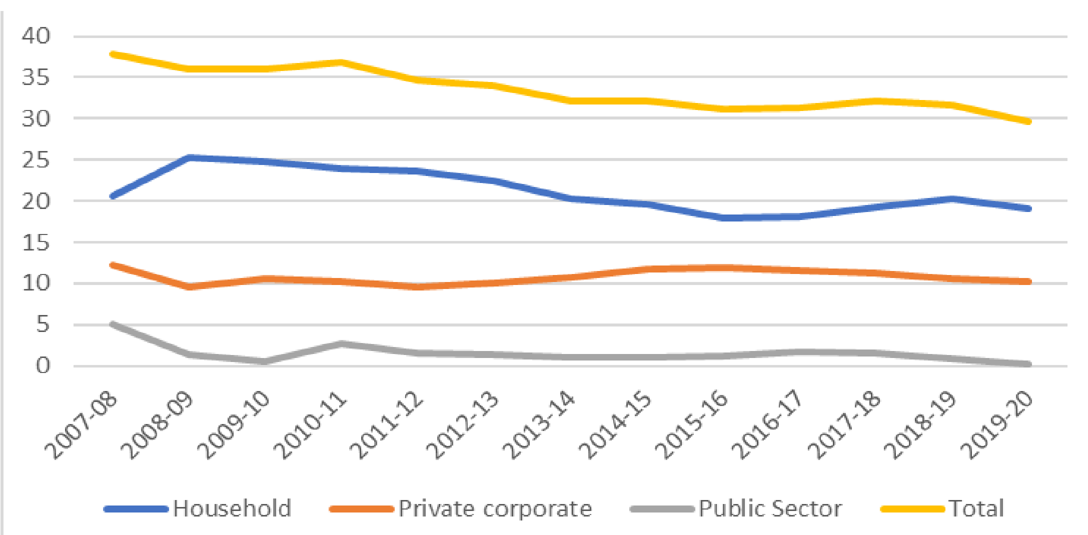
Fig 22. Wage share of profits



In effect, household incomes have grown at a slower pace than that of the economy. The national savings rate faltered between 2011-12 and 2022-23, driven mostly by the fall in the household savings rate.

Fig 23. Savings as a share of GDP (%)



Contrastingly, household debt as a share of personal disposable income has risen noticeably since 2017-18.

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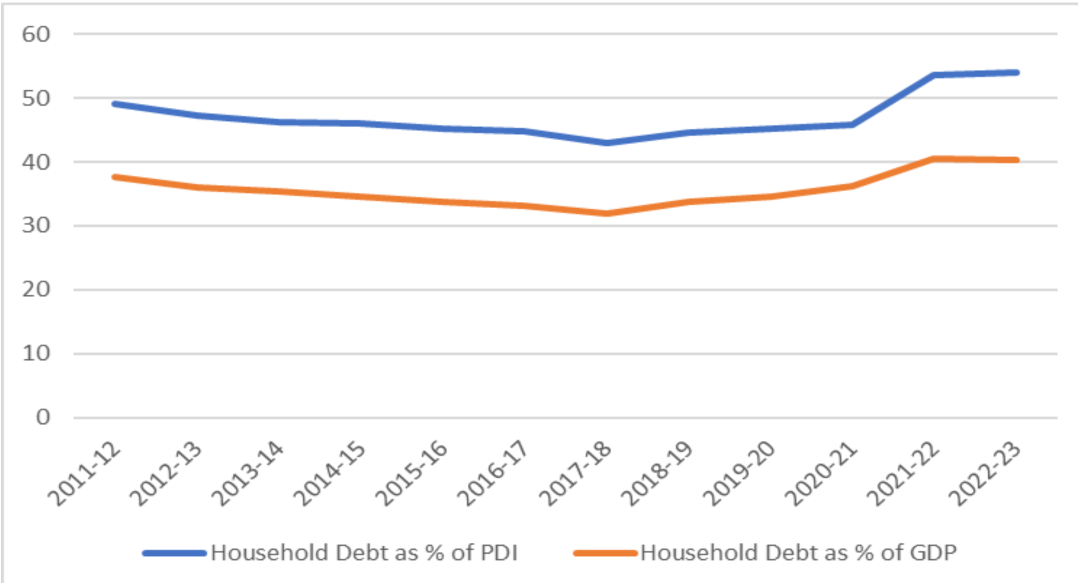
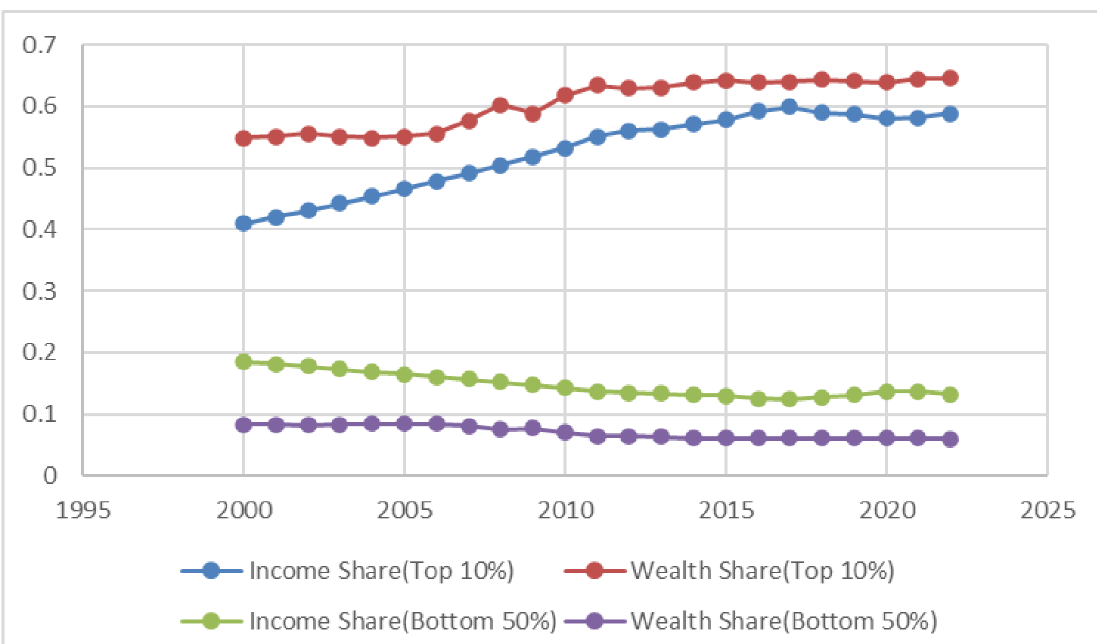
Fig 24. Household debt as % of PDI and GDP



Crony capitalism, wage inequality, pervasive indirect taxes, lack of safety net, and the inability of government to pull the population out of agriculture have inflicted a significant increase in wealth inequality in India since the 80s.

Fig 25. Income and wealth share among the population's top 10% and bottom 50%



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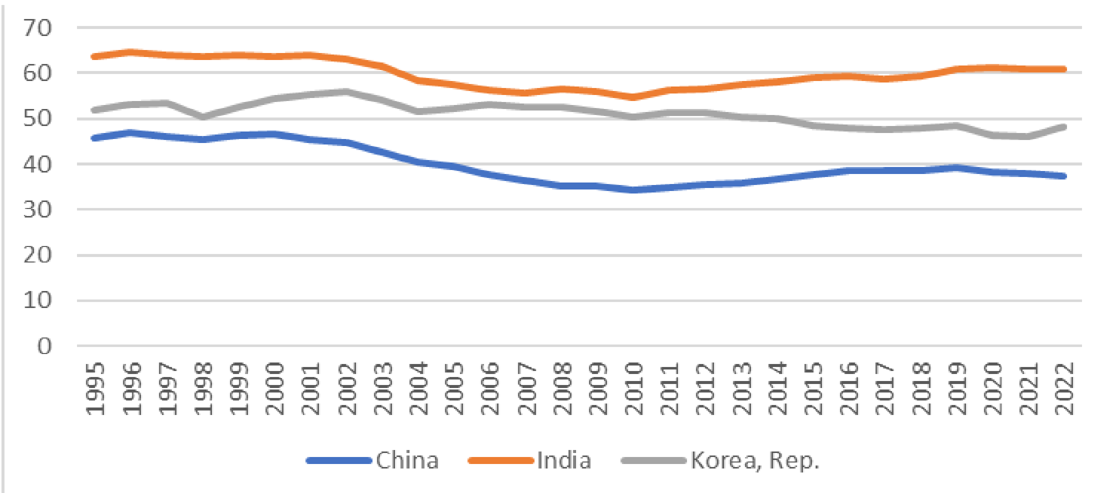
Furthermore, caste and gender discrimination inhibiting access to quality education, health, and opportunities for upward mobility have worsened the divide.

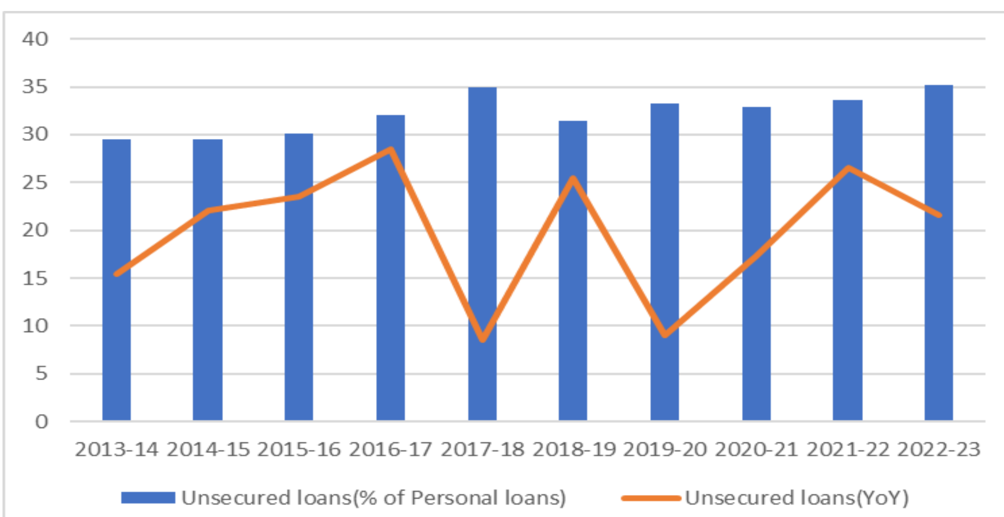
Interestingly, private (household and NPISH) final consumption expenditure (% of GDP) registered a continuous increase since 2010, facilitated significantly by the growth of retail credit, in lieu of depressed corporate investments.

Fig 25. Households NPISHs final consumption expenditure (% of GDP)



However, a dangerously growing share of retail credit is unsecured, and aggressively peddled to low creditworthy borrowers.

Fig 26. Unsecured loans



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Private non-financial sector (primarily households and NPISH) debt-to-income service ratio has spiked to one of the highest in the world, owing to high interest rates and predominantly short-term loans.

Fig 27. Private non-financial sector (primarily households and NPISH) debt-to-income service ratio

This is manifesting in a surge in retail loan defaults, forcing the central bank to step in to curb the "exuberance" in retail lending.

This has dampened the last standing engine of growth—consumption. Higher interest rates, muted wage growth, poor job prospects, and rising food inflation have deteriorated matters. Nomura India observes a sequential drop in growth momentum, encompassing consumption, investment, and external sector indicators.

Let us not forget that the demand for labour is closely tied with the demand of goods and services in general and India, due to its burgeoning inequality, has a very low formal domestic demand base.

CONCLUSION

Owing to a premature switch to services, India now needs to rapidly focus on more investment, infuse new technologies from around the world and grow innovation to propel industry, and pull people out of farms and into higher skill-level jobs. Not only did South Korea achieve this through an inspired industrial policy in the 1970s, the government also increased budgets and set targets for public universities to fill the skill gap.

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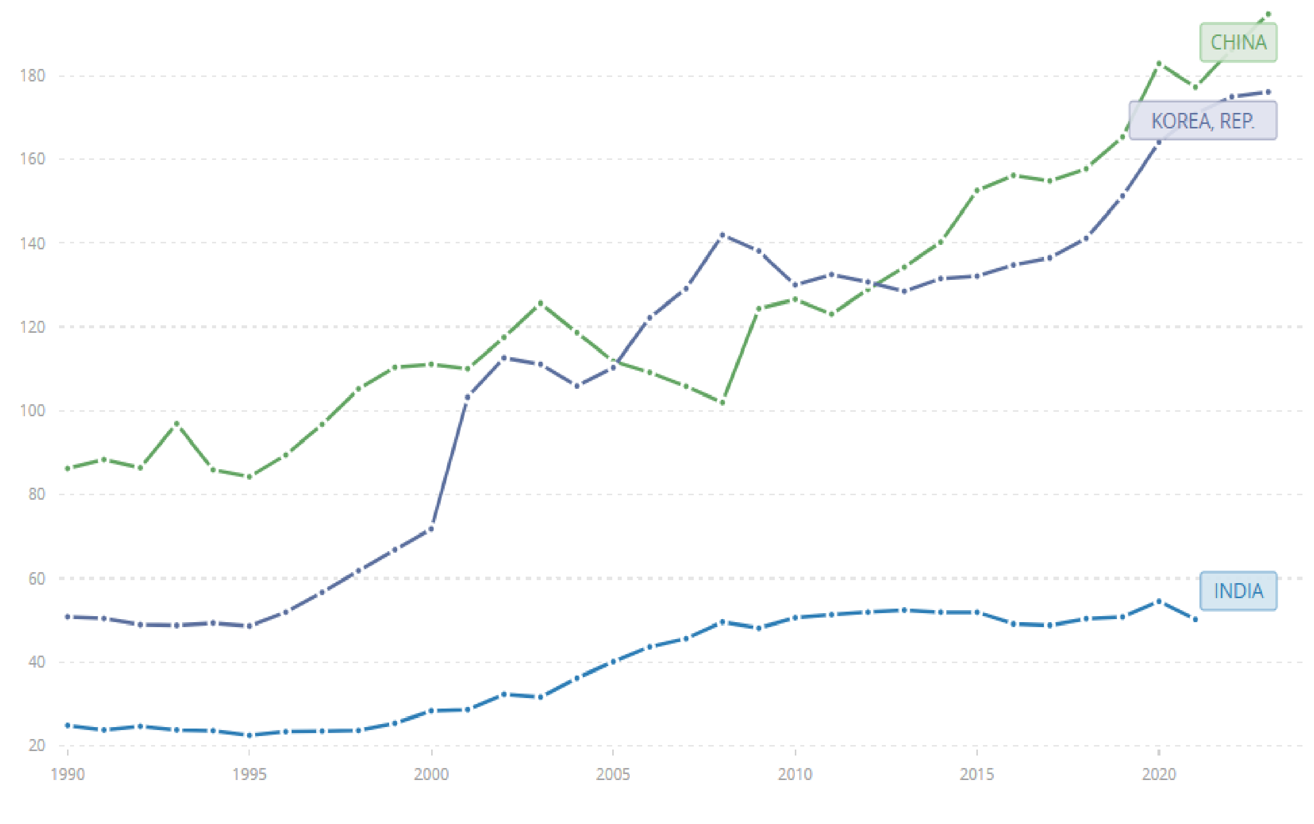
The government needs to step up industrial and infrastructure investment to create policy certainty for the private sector to invest. Rising public investment to improve education and health for the upliftment of skills and productivity is essential to raise the domestic savings rate and boost long-term financial institutions and credit.

India's domestic credit to the private sector at 55% of GDP in 2020 is remarkably below the world average (148%).

Fig 28. Domestic credit to private sector (% of GDP)



Apart from bank credit, the corporate bond market needs to be developed too. A robust corporate bond market is essential for the burgeoning gap in credit to MSME and the long-gestation infrastructure projects, as domestic financial institutions do not have sufficient capacity and appetite to fund such projects.

India's 'demographic dividend' - the rise in the share of the working-age population - is expected to peak around 2041. The window for India to raise its population from the lower middle-income trap is rapidly closing.

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