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The Indian Economy is Doing Well, But Not Many Indians Are

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The economy is growing rapidly and many economic indicators are flashing green. But the path that India has chosen, of promoting national business champions, has its limits. Economic distress is widespread, which cannot be handled forever with welfare handouts or religion as an opiate.

There has been no shortage of sceptics who question India's economic performance and the Narendra Modi government's track record this past decade, what with the quixotic demonetisation of 2016, the chaotic introduction of the Goods and Services Tax in 2017 (some 500 subsequent rate adjustments, and counting, according to one tally) and the tragic handling of Covid-19 in both 2020 and 2021 – first the overnight lockdown that saw millions of migrants trudging or cycling back to their homes hundreds of kilometres away, then the shortage of both oxygen and hospital beds after the government had prematurely declared victory over the pandemic. Independent assessments of the death toll are many times the government's estimate.

These episodes and associated controversies are now part of a fading memory, even for those who suffered. In their place, there is now the story of an economy handled well during Covid-19 and its aftermath, and the success in quickly developing and rolling out vaccines. Indeed, the 'twin deficits' of bad loans on banks' books and heavy debt on companies' books, which the government inherited, have given way to a bunch of positive economic indicators. Consequently, it has become increasingly hard to hear voices questioning India's macro-economic performance and its trajectory. As Goldsmith wrote, those who came to scoff remained to pray. That includes foreign observers – investment banks, multilateral institutions, and economic commentators in general.

Economic indicators flashing green

The sceptics have been in retreat as each quarter's GDP numbers have been trotted out, since none of them had predicted 7.6% GDP growth that the government expects for the financial year gone by. Half-way into 2023–24, the International Monetary Fund (IMF) was still talking of 6.3% growth. Now, as forecasts for the new financial year trend upwards again, with predictions of 7% growth (Reserve Bank of India, Asian Development Bank) for a fourth year running, the IMF is once again forced to raise its growth forecast for 2024–25 to 6.8%, after an earlier revision to 6.5% from 6.3%. The World Bank still sticks to 6.5%. But the ayes have it by a clear voice vote. Not only is India doing well by its own measure, it is also doing well in a world that has seen a slowing of economic momentum.

It is not just growth. Other macro-economic indicators too are flashing green. Inflation is trending down, so is the fiscal deficit (though the general government deficit of the union and states combined is still very high at over 8%). Tax revenues are buoyant, possibly at a peak as a share of GDP, and the external current account (trade and invisibles) has an easily managed deficit because it is more than made up by net capital inflows. The RBI's foreign exchange reserves have reached record levels, and the rupee has been holding steady against the US dollar. These numbers tell us that we have achieved that elusive goal, growth with stability.

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This has been complemented by the physical attributes of growth. The government has been in the middle of an unprecedented investment drive to build out the country's transport infrastructure – modernising the railways, building not just new highways but also new 8-lane-expressways, doubling the number of airports, substantially increasing sea-port capacity – and also to increase operational efficiencies by getting the private sector to move into these areas. To this one should add the spread of the digital infrastructure (a 100-fold expansion in optical fibre laid), the advent of low-cost digital payment and other systems, the spread of banking along with the rise to prominence of new fintech companies, and with all of these the birth of entire new businesses. It is reasonable to expect that the sum total effect will show up in improved productivity.

The figures put out by the government in a White Paper in February list a number of other achievements over the past decade. The economy has improved its scores on the logistics performance index (compiled by the World Bank), the complexity index of the economy, indicating greater sophistication (Harvard), and the innovation index (World Intellectual Property Organization). It has doubled the number of places in medical colleges, and multiplied six-fold the number of toilets. Also presented are impressive numbers on rural households electrified, quadrupling in four years the number of rural tap water connections, upping to more than 20 from 12 the average number of hours of power supply in rural areas, etc. Lee Kuan Yew was once dismissive when he said, “China does, India talks.” Well, India too is doing now (it is talking a lot too!)

Heft to the Indian economy

Sustained growth has given the economy a heft that it did not have before. The IMF’s numbers for 2024 put India’s GDP at $3.94 trillion (in nominal dollars), only fractionally smaller than Japan’s at $4.11 trillion. Germany is bigger at over $4.59 trillion. Given faster growth, it is reasonable to expect that India’s GDP will be bigger than that of both those countries in the next few years, emerging as the world’s third largest, though many leagues behind the first two (US and China).

More importantly, though, per capita income (measured using purchasing power parity, since it is a better comparator for standard of living), at $10,123, is only 43% of the world average of $23,444 (China’s is over $25,000). India’s rank here is an unflattering 125th. In nominal dollars, India’s per capita income is lower than that of all but one (Bangladesh) of the 50 largest economies, and slightly ahead of Cambodia, which is not flattering company. So there is a long road ahead.

Still, optimism abounds. Corporate profits, in relation to GDP, are at close to an all-time high, company debt levels are low, and bank balance sheets healthier than they have been in decades. The stock market reflects the buoyancy, with the main market indices climbing handsomely in 2023. There has been a surge in the numbers of demat accounts with the two depositories of company shares, and of mutual fund folios. Demat accounts now number 151 million, while mutual fund folios are even more numerous at 178 million. The number of unique investors would be much smaller because of multiple accounts and folios per investor, but asset managers talk of the stock market culture spreading beyond the top 30 towns and cities to the next 30 towns.

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Mutual funds now manage Rs 55 trillion in assets (up from Rs 10 trillion in 2014), having doubled in relation to bank deposits over the decade, to one-fourth from one-eighth. Ranked by the combined value of all listed companies, India’s stock market has become the world’s fourth largest.

The other side

As always in India, you can look at an alternative set of facts, or view the same facts through a different prism, and create a different narrative that is less flattering. Rapid growth over the past three years can (indeed should) be viewed in the perspective of what went before: a shrinkage of GDP by 5.8% in the Covid-19 year, 2020-21, and barely 4% growth in the year before that.

Taking all five years together (2019 t0 2024, co-terminus with the Modi government’s second term), average annual growth has been only 4.5% . That is slower than in any previous quinquennium of the last three decades. Over the Modi decade (2014–24), growth has been slower than in the Manmohan Singh decade that went before, though such comparisons are somewhat unfair to Modi because of the severe impact of Covid-19, whereas Singh’s first term coincided with a period when the global economy was on steroids.

Even providing for such factors, there are plenty of worrying trends to consider. The economy has turned more inward-looking, judging by the sharp reduction in the ratio between external trade and GDP. The exports of goods and services, in relation to the size of the economy, have shrunk to about 21% from 30% . This is rarely a positive development – almost all rapidly-growing economies have been outward-looking.

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Next come investment trends. Despite all the capital expenditure by the central government (almost doubling it in relation to GDP), overall fixed capital formation has been below earlier levels, recovering only now to match the 31% figure of 2013–14 (which was a drop from the levels earlier in Manmohan Singh’s term). Foreign direct investment has shrunk quite sharply for two years in a row, despite headline-hitting greenfield project announcements. For all the incentives being provided to companies encouraging them to invest and produce under the productivity-linked incentive programme, the pay-outs under the programme are still modest, signalling a slow pick-up. The only substantial success so far is Apple's decision to move some of its production ecosystem to India, not just phone assembly but also the production of some components. But as a reality check, phone exports from India are less than a fifth of Vietnam's. Overall, private investment has been noticeably lagging.

On top of that, there is the consumption slowdown, for which there will be many explanations (on which, more later). One factor must be the pile-up of household debt, which has caused net household savings to drop sharply. Private banks and the new fintech companies have preferred lending to individuals rather than to corporate clients, many of which do not need loans anyway because they are sitting on cash and not investing. Growth in such debt soared from an annualised rate of 20% to 30% . And a good part of the new debt to individuals has been in the form of unsecured credit, given on the basis of individual cash flows rather than the security of assets. This reached a level to worry the RBI. The central bank has therefore applied a squeeze, understandable when household debt in relation to GDP had reached an all-time high.

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Public debt is high too, at 82% of GDP (compared with a desirable 60%, as recommended by a committee), and will of necessity constrain future government borrowing. The central government's fiscal deficit is well above what it was a decade back and is proposed to be cut back. Taken together, these imperatives will force future budgets to focus on consolidation, not expansion. So the capital expenditure on infrastructure that has enabled investment-led growth these past few years may not be sustainable. Development expenditure that is classified under the revenue account has already been under tight control, a fact well masked by the publicity given to the government's signature welfare programmes. If budgets are to be in consolidation mode, growth will be affected unless private investment takes up the slack.

A new growth trajectory

These constraints – a more inward-looking economy, and structural constraints on both private consumption as well as public spending – have not prevented optimists from expecting the economy to get onto a new growth trajectory, moving up to a long-term rate of 7% and more in the next quarter-century from the over 6% in the last third of a century.

To this writer, the odds on that still look quite long. We will know in a year or two if such a transition is indeed under way. But, importantly, one does not need further acceleration for an economy already approaching $4 trillion in size to become $8 trillion in 12 years or less. With population growth down to less than 1% and tapering off, per capita income should double in 15 years or less (three terms of the Lok Sabha). At $5,500 in today's dollars (compared with about $2,700 at present), India then would be comfortably in the upper-middle-income bracket. Beyond the debatable question of an acceleration of tempo, it is this prospect of a giant economy in the making that is fuelling the upbeat global narrative about India.

Such a scenario raises an obvious question. Can one really assume sustained rapid growth of the economy over such long periods, without hiccups or unforeseen constraints along the way? Many economies that were once growing rapidly have come up against roadblocks or been hit by crises, including two of the original BRICS economies, Russia, and Brazil, both of which have performed sub-optimally since the BRICS coinage more than two decades ago. Both had larger economies than India barely a decade ago. Now their combined GDP will be only 10% bigger than India's, though of course with much higher levels of per capita income.

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Their experience brings up the question of a middle-income trap, a coinage based primarily on the finding that, since World War II, only a handful of developing economies have progressed beyond middle-income status and made it to the World Bank's high-income grouping (per capita income of over $13,800, using nominal dollars). The primary exceptions are the 'Tigers' of East Asia, including South Korea and Taiwan, with China now on the threshold of making the transition. India is still only a lower-middle-income country, and it will take till 2030 at the earliest to make it to the higher-middle-income category, for which the lower bound is per capita income of about $4,300. From there to the levels where the middle-income trap has been said to kick in is to look even further into the future. So, in the ordinary course, India need not have to worry about such a barrier to further growth until more than a decade from now.

Obvious constraints

Yet, many constraints are already obvious: the poor educational attainments and health metrics of the bulk of the population, the failure at a national level to move surplus workers on farms to higher-productivity jobs in the manufacturing and service sectors, and the vulnerability that comes with extreme external dependence for energy. Key developmental and structural transitions are therefore yet to be achieved, precisely the kind of issues that can prevent transition to the next stage of development and progress further up the income ladder to high-income status.

There are also environmental constraints that will flow from the much bigger carbon footprint of a rapidly growing economy, reflecting not just in climate change and the costs of mitigation, but also in more localised damage to the environment, such as in the fragile Himalayas or Western Ghats, or in the forested parts of the country. There is already the pressing problem of a growing shortage of water for both farming and everyday use in cities. Cropping patterns that are wasteful in their use of water, will have to change. So will the choice of crops in many years. All of these require governments to respond; there is not enough action to suggest that they have come to grips with the challenges.

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When considering the likelihood of sustained rapid growth, a crucial wrong turn that India took was to steer away from the Regional Comprehensive Economic Partnership (RCEP), a flexible, 15-country trading bloc that includes all the important economies of East Asia (including China, Japan, South Korea) plus Australia and New Zealand. To stay outside this bloc is to risk being locked out of supply chains in the world's most dynamic region. Smaller neighbours like Bangladesh and Sri Lanka have understood this and sought RCEP membership, while India pursues an '*atmanirbhar*' self-reliance strategy that is aimed essentially at import substitution. No country in history has sustained rapid economic growth for any length of time without achieving rapid export growth as well. But over the past decade India's goods exports have grown slowly and fitfully, to $437 billion in 2023–24 from $313 billion in 2013–14, signifying average annual growth of just 3.5%.

While this has lagged behind broader economic growth, it points to the failure to promote the production and export of manufactured goods, and to raise the share of manufacturing in GDP, an objective first spelt out formally in 2012, with little to show so far.

Cold shower comparisons

For all the talk of Make in India, and India featuring in the China plus One" strategy of western companies as they seek to diversify supplies away from China, it is countries like Vietnam and Bangladesh that have scored greater successes. In Vietnam's case, it is partly because Chinese companies themselves have moved some of their production to the smaller neighbour while India has sought to keep out Chinese investment and products. Yet imports from China into India continue to grow, which is not surprising since China is dominant in such products as solar panels and batteries for electric vehicles. Vietnam's exports of electronic items like computers, mobile phones, apparel, and footwear (all supposedly focus areas for India) are now multiples of India's, and the country enjoys a trade surplus to boot. Though Vietnam's population is only 7% of India's, and its GDP 12% of India's, its goods exports have grown to equal India's non-oil goods exports! It is only to be expected that, from being level with India's, Vietnam's per capita income is now 50% greater.

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Such cold-shower comparisons are what India needs to douse the premature triumphalism to which Indians are all too prone. Nevertheless, it is hard to argue that in broad terms the economy has not been doing well. With growth at more than twice the global average, and with good stability indicators to boot, India has a very good story to tell about macro-economic performance. The problem seems to be that even if India is doing well, all too many Indians aren't. Such an assertion brings one into contentious territory, with sharply differing interpretations of the same data by those who either broadly support or are critical of the Modi government. Still, it would be fair to say that the results of periodic surveys of employment and household consumption and the tracking of wage levels show that life for many has not got better in recent years.

K-shaped growth

Employment trends, which on some counts had been showing improvement (for instance, more people being on regular salaries and working in the organised sector), have turned regressive after Covid-19 in that the net movement of people is back to farms, from the manufacturing and service sectors where they were employed earlier. Almost by definition, work on farms is less productive, and falling back on it suggests distress following the loss of livelihood options in sectors with greater earnings potential. Recent surveys have shown more women to be working, but only by counting women doing unpaid work as being employed. Educated unemployment is down, but still at extraordinarily high levels. Wage levels too have shown little or no improvement for many, except in southern, western, and north-western states where there is a shortage of labour and growing dependence on migrants from further east. In pre-election polling, the almost uniform finding is that employment is the biggest issue for voters. The second issue is inflation. This suggests widespread economic distress, or at the least frustrated hopes.

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Naturally, private consumption would suffer. A bellwether consumer products company like Hindustan Unilever which produces everyday goods has reported flat sales and a drop in profits. As already discussed, one reason for lagging consumption could be that people are more indebted now than at any previous time. Servicing individual debt (usually taken on board for acquiring real estate, vehicles, household appliances or for financing higher education, but increasingly in the form of unsecured debt which is usually on more onerous terms) seems to leave little room for upping discretionary spending.

Households also have to factor in the greater unpredictability of future income streams at a time when even the big tech services companies are laying off workers in their tens of thousands, and when many new jobs in even the organised sector are on contract, or for gig work. Indeed, government data show that the bulk of new jobs in the organised sector are now on contract. Add to such job market uncertainties the long-term impact on consumer behaviour of the experience of the Covid-19 disruption and before that of the demonetisation caper, and it is not surprising that people are not opening their wallets, even if they have money in them. The end result is slow growth in consumption, especially in the lower income reaches.

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Unlike in the past, therefore, the economy in recent years has been driven more by investment, and that too investment by the government. Capital spending out of the union budget has more than doubled in recent years, to more than 3% of GDP while over-all investment numbers stay below their past peak. The private corporate sector’s focus in the initial Modi years was on paying down accumulated debt, acquired for projects that often did not work out well. But though balance sheets have become stronger, companies have remained slow to invest in new capacity, either because consumption has grown slowly and there was surplus capacity, or because of other factors. The most recent quarters have finally seen the beginnings of an uptick in private corporate investment. It remains to be seen whether this is the start of a new trend.

The kink in the consumption data is that companies that focus on pushing out premium products have done better than those catering to lower segments of the market. For a while, car sales were more buoyant than sales of two-wheelers, though the latter’s numbers too have picked up in recent quarters. Nestle, serving primarily premium products, has fared better than Hindustan Unilever, which has a broader spread of brands. Within that spread, Unilever’s premium brands have been doing better, so those have become the company’s focus. While government spokesmen argue strongly against any such trend, it seems beyond question that the economic recovery after Covid-19 has become increasingly K-shaped. The better-off have recovered better from the pandemic than those lower down the income ladder.

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That brings up the subject of growing inequality, the debate on which acquired fresh fuel recently when the World Inequality Lab, associated with Thomas Piketty, asserted that inequality in India is now greater than during even colonial rule during the inter-war years of the last century. Indeed, the report (titled 'Billionaire Raj') said India is now more unequal than countries like Brazil and South Africa, which traditionally feature on lists of the most unequal countries in the world. The top 1% of income-earners in India are said to account for 22.6% of income. The top 1 per cent on the wealth parameter accounted in turn for 40.1% of wealth. Yet, the Lok Sabha election campaign has seen Modi launch a frontal attack on the very idea of taxing wealth or inheritance, while the Congress hastily asserts that that was never its intention. Billionaires needn't worry.

Poverty reduction

Those defending the government's record argue that poverty reduction is more important than addressing inequality, and that periods of rapid growth are often associated with increased inequality. The accompanying assertion is that poverty levels have been reduced dramatically, with more than 250 million being brought above the poverty line. That surely must count for something. And it is indeed true that government surveys indicate a substantial drop in poverty levels in just over a decade. Absolute poverty, going by what is known as the Tendulkar estimation, is said to be down to 3% (from 15% earlier). The Niti Aayog, on its part, has used a broader set of multi-dimensional poverty parameters (some of them survey-based, others being projections from earlier numbers) to assert that multi-dimensional poverty has come down to 11.3% from 29.2%.

Without going into the specific assertions and numbers, it is a perfectly plausible proposition that an economy which has grown at a sustained annual rate of 6% or more for about a decade (therefore almost doubling in size over that period), should be expected to see a reduction of absolute poverty, even if the benefits of growth have been spread very unequally. That is especially so when the government is giving out free foodgrain, (modest) cash pay-outs of various sorts and subsidies for everyday consumption items like cooking gas. However inadequately the rural employment guarantee programme has worked in practice, it does provide some kind of a safety net.

Equally though, it is high time the country – which long ago graduated out of the low-income classification and became a lower-middle-income entity – adopted a less parsimonious definition of the poverty line. India's official poverty line (just shy of Rs 1,286 in urban areas and Rs 1,059 in rural areas, according to the latest iteration) is said to be broadly consistent with the World Bank's definition of absolute poverty, at $2.15 per day (using purchasing power parity). In urban areas, that works out to about Rs 5,000 for a family of four. Getting 90% or more of the people over such an absurdly low poverty line is no real achievement for one of the largest and most dynamic economies in the world. This therefore is no yardstick to use in today's India.

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The World Bank's poverty yardstick for lower-middle-income countries is $3.65 per day, which would take a four-member urban family's poverty-level monthly income to about Rs 8,500. Even this is modest enough and would yield only a very bare-bones existence. Most states have a higher minimum wage stipulation, but surveys show that wages tend to be lower in actual practice. Some 40% of the people were therefore said to live on less than this in 2021, i.e., in the middle of the pandemic. The situation would have improved since, but it is hard to guess by how much. If the majority of families manage to stay above such a poverty line, it is probably because a good percentage of families have more than one earning member (since at least 25% of working-age women do paid work).

East Asian model?

What has been the government's approach to an economy experiencing these diverse trends? Perhaps it is best characterised as an East Asian model of business and industry, with an emphasis on creating national champions in the business world, combined inevitably with an East Asian model of strong-man government that in its benign form would be paternalistic in approach, and in less benign ways seek a docile workforce in order to facilitate the functioning of the national champions. And there are indeed some superficial similarities. India's corporate sector saw quite a bit of churn at the top in the decade of the 1990s. More recently, the top companies or groups seem to have entrenched themselves at the top, yielding less churn. This has melded smoothly into the Modi government's emphasis on building national champions amongst industrial enterprises. A strong government-industry nexus, aimed at building national capabilities (for strategic autonomy in high-tech and defence sectors), is manifested in the offer of large subsidies and the protection of tariff walls, combined with the selection of specific companies for important projects.

But there are important departures as well. The East Asian economic model had as its foundation the creation of a healthy, educated workforce capable of doing what national ambitions asked of it. India is yet to achieve this, perhaps it has not even been seriously attempted. Similarly, countries like South Korea and Taiwan, not to mention Japan earlier and China later, expected their national champions to be outward-looking, and therefore export champions as well. This too is not India's primary objective, though it is a subsidiary one. India's national champions, all of them large conglomerates with multiple businesses, are primarily focused on capturing the domestic market for themselves. The difference in the two approaches, when it comes to the government-industry interface, is that an outward-looking system has an automatic test of success in the global marketplace. Without that external audit, an inward-looking, domestically-focused system can easily lead to crony capitalism with negative manifestations in terms of state capture on the one hand and business alignment with the strong ruler on the other.

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While such a nexus would by definition benefit the big corporations, smaller ones may not do so well. Marcellus Investment Managers, a portfolio services company, reported a couple of years ago that the top 20 corporate profit-earners accounted for 70–80% of the total profits of the more than 5,000 companies listed on stock exchanges. The comparable figure for the top 20 in the US was 25%. Other numbers suggest that companies below the top deck of 10,000 did poorly till Covid-19 (i.e. the period of demonetization and GST introduction) but may have recovered subsequently.

International companies eyeing India have got the message. Quite a few have chosen to invest in partnership with the local champions rather than do it on their own. And the local champions have grown sometimes by gobbling up unwilling targets or muscling out other bidders in corporate auctions. Dominance manifests itself in different ways.

But India is not without dynamism. It has done well when it comes to start-up firms. And the creation of the digital services backbone, the democratisation of credit and the expansion and improvement of the highway network (faster truck movement extends the reach of same-day supply by small businesses) have all served to ease small business operations. Yet, many small businesses are said to have suffered on account of the sundry shocks of recent years, while the flow of economic news is replete with massive investment announcements by the biggest corporations in all the sunrise areas. In case such announcements lead to facile conclusions, do note that overall corporate investment is said to be lagging. One of the verities about India is that all the indicators rarely point in the same direction.

> The stress on building national capabilities in new areas requiring heavy investment and the deployment of advanced technologies, can lead in the context of limited resources to a misallocation of those resources.

It is worth noting that the East Asian economic model was introduced in societies that were run autocratically, and which then became progressively more democratic. India is starting at the opposite end, and becoming quasi-autocratic though still democratic in that elections are held on schedule, even if on a non-level playing field. While the reverse movement has political risks, there are economic risks as well. The stress on building national capabilities in new areas requiring heavy investment and the deployment of advanced technologies, can lead in the context of limited resources to a misallocation of those resources, like the 70% capital subsidy for companies willing to set up chip fabrication plants.

Besides, in some ways this is a repeat of Nehru's mistake of looking to build heavy industry while neglecting the light industry that would have provided more jobs by being less capital-intensive. The difference is that Nehru depended on the public sector, which did not deliver. Today's favoured private groups are likely to make a better job of it. But the neglect of the social infrastructure (health and education) and of the need to urgently create employment in large numbers would inhibit the growth of modern industry and act as a demand constraint because of a narrow consumption base in the population.

Time-limit for jugglers

The Indian variant of the 'national greatness with national champions' strategy therefore has limitations that East Asia did not have. Meanwhile, the political strategy to deal with the inevitable pressures from below (for want of jobs and livelihoods) is to create the rudiments of a welfare state, as is being done along with an image build-up of the leader as the benefactor. And, simultaneously, to play on identity politics, which too is being done. But government hand-outs are no substitute for jobs, and religion cannot for all time serve as a mass opiate. For the moment, Modi is almost universally expected to win the current Lok Sabha elections and get a third term in office. Which would be strong political validation of his strategy so far. Yet it is well understood that the countries which do well over a long period have strong institutional guardrails, whereas strong-man rule is usually associated with a weakening of autonomous institutions, though it is also true that Modi is building national competencies that can only be to the good. Perhaps the conclusion at this point should be that the strategy is too Modi-dependent. Even if he is able to keep all the political and economic balls in the air, there is usually a time limit for most jugglers.

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