India's New Growth Recipe

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Presenters:
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RAKESH MOHAN, President & Distinguished Fellow, CSEPN & Member, EAC-PM
V. ANANTHA NAGESWARAN, Chief Economic Advisor, India
AJAY S. SHRIRAM, Chairman and Sr. Managing Director, DCM Shriram Ltd.
IREENA VITTA, Adviser - Sustainable Growth, Digital Transformation & Organisational Scale-up

Chair:

Discussants:
Motivation and objective

• There is near unanimity that India’s GDP growth had been slowing down, before the pandemic struck.

• As we come out of the two lost years due to COVID-19 accelerating economic growth assumes paramount importance, since it is critical for poverty alleviation, creating gainful employment, etc.

• There is a whole agenda of reforms that we need to undertake from improving education, skill building, prioritizing health, improving infrastructure and governance, etc, etc.

• The key question arises, these weaknesses were present even when we were growing much faster.

• What then is the key unlock for faster growth?
India’s GDP growth has gone through four distinct phases

Growth is driven by both structural and cyclical factors

Notes: The grey area depicts the period of analysis. GDP is at market prices, calculated at 2004-05 prices; the 2021-22 values are based on advanced estimates from the Government of India: Economic Survey (2022). Source: National Accounts Statistics, Census of India.
Investment and exports move with GDP growth

Note: Based on current prices. Source: National Accounts Statistics
Households provide savings; corporates drive investment

### Savings to GDP ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>Household sector</th>
<th>Private Corporate Sector</th>
<th>Public sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993-94</td>
<td>21%</td>
<td>3%</td>
<td>17%</td>
</tr>
<tr>
<td>2003-04</td>
<td>27%</td>
<td>4%</td>
<td>23%</td>
</tr>
<tr>
<td>2007-08</td>
<td>36%</td>
<td>9%</td>
<td>23%</td>
</tr>
<tr>
<td>2011-12</td>
<td>33%</td>
<td>8%</td>
<td>20%</td>
</tr>
<tr>
<td>2019-20</td>
<td>31%</td>
<td>10%</td>
<td></td>
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</tbody>
</table>

### GCF to GDP ratio

<table>
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<tr>
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</tr>
</tbody>
</table>

Note: Calculations are at current prices. The values in the boxes are aggregate ratios. A two year moving average (t-1, and t) is applied to smoothen out the series, for example, for 1993-94, average of FY1993 and FY1994 is considered.

Data on public sector is based on general government budget documents and the annual reports of public corporations. Estimates of private corporate savings are based on the annual accounts of sample companies adjusted for full coverage, on the basis of data on the paid-up capital of all companies. Private corporate capital formation estimates are based on the results of sample companies published by the RBI. For household savings, financial flow data is either a residual of the other two categories, and/or based on firm-level transactions with households. For the household sector GFCF, the sources of data are the AIDIS and enterprise surveys conducted from time to time. Source: RBI, National Account Statistics.
Fundamental drivers

A. Exports
- GDP

B. Corporate investment
- Corporate Sales
  - (Formalisation)
  - GDP
- Corporate Investment
  - (Business cycle)

C. Household savings
- GDP

World trade

Encouraging competition
Better macro-management

Growth outlook

Global economic environment

Reforms and Innovation

Demographic dividend
India’s exports growth mirror global trade; there is an exponential decline in global trade growth since 2008

Note: This correlation for non-fuel exports was 0.77 between 1980 and 2020 in current US$ (World Bank).
Calculated at current USD Source: World Bank

Correlation: 0.80
Our competitiveness has been largely static since 2004

*Export multiple is the ratio of India’s export growth to world export growth.*

Note: Calculated at current USD. Source: World Bank
Large firms account for 55%-60% of exports but exports account for only 10%-15% of their sales

- OECD average share of large firms in national exports is 51%.

Note: Corporates refer to large companies as mention in CMIE Prowess. The database is built from the audited Annual Reports of companies and information submitted to the Ministry of Company Affairs; and in the case of listed companies, the database also includes company filings with stock exchanges and prices of securities listed on the major stock exchanges. Incremental share of corporate exports in corporate sales is 16%. Source: National Accounts Statistics, CMIE Prowess

- In 2001, exports of firms with more than 500 employees in France accounted for 26% of their total sales (Berman et al, 2014).
- In 1993, in Korea, for firms with 200-299 employees, 29% of their sales were due to exports (Abe & Kawakami, 1997)
Trends of formalisation differ depending upon the definition used

<table>
<thead>
<tr>
<th>Definition of formalisation</th>
<th>Author</th>
<th>Year</th>
<th>Trend</th>
<th>Evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal share of employment</td>
<td>Soumya Kanti Ghosh</td>
<td>2021</td>
<td>Formalization of employment has increased between 2018 and 2021.</td>
<td>Between FY18 and July 2021, it is estimated that 36.6 lakh jobs have been formalized.</td>
</tr>
<tr>
<td>Number of informal enterprises</td>
<td>Pronab Sen</td>
<td>2022</td>
<td>Informal economy was hit by demonetisation and GST.</td>
<td>Number of MSMEs have fallen and small enterprises are worse hit.</td>
</tr>
<tr>
<td>Formal share of output</td>
<td>Nikhil Gupta</td>
<td>2023</td>
<td>Sales of listed companies declined between FY13-FY18 as a share of GDP.</td>
<td>Sales of listed companies fell from 30% of GDP to 18% of GDP between FY13 and FY18 before recovering to 22% in 1HFY23.</td>
</tr>
<tr>
<td></td>
<td>Nagaraj and Kapoor</td>
<td>2022</td>
<td>Formal sector share in GDP has been stagnant between 2012-19.</td>
<td>Formal sector share in GDP had been steadily increasing since 1980s from 30% of GDP to 55% of GDP. It has been stagnant between 2012-19.</td>
</tr>
<tr>
<td></td>
<td>McKinsey Global</td>
<td>2020</td>
<td>Decline in share of India's large firms to GDP post 2012.</td>
<td>Large firms, those with annual revenue of more than $500M, had a decline in contribution to GDP from 58% in FY12 to 48% in FY18.</td>
</tr>
</tbody>
</table>
Formalisation is predominantly driven by entry and exit of large firms.

Source: Formalisation is ratio of corporate sales from CMIE Prowess and ASI over National Output from National Accounts Statistics. NPA data is from RBI.
Formalisation drives growth, since formal firms are significantly more productive than the informal ones.

Note: Labour productivity numbers are weighted averages. They are calculated using the ratio of GVA or NVA to the total number of workers. Service employment numbers are based on residual after subtracting agriculture and industry employment from total. Source: RBI, NAS, IMF, ASI, ILO.
Corporate leadership in India is not contested as much as other faster growing economies.

**Average for the Outperformers is 45%.** Outperformers include China, Hong Kong, Indonesia, Malaysia, Singapore, South Korea, and Thailand.

Note: Percentage of firms which were in the top quintile for economic profit generation in 2001-05 and continue to maintain their position in 2011-15 as well. Source: McKinsey (2018)
Corporate investment is not low due to business cycle downturn

Source: CMIE Prowess
India’s GDP growth has been consistently overestimated for the last few years

*Since 2017, India’s growth projections have been higher than India’s actual GDP growth*

Note: The shaded grey area depicts the period where projections have been consistently higher than actual growth rates. Source: IMF World Economic Outlook reports
Household savings have been consistently rising till 2010, with a break post that

Note: Calculated at current prices. 1981-2013 it is based on 2004-05 prices. 2014 onwards it is based on 2011-12 prices. Source: National Account Statistics
There is no commonly accepted reason for this decline in household savings

<table>
<thead>
<tr>
<th>Themes</th>
<th>Author</th>
<th>Year</th>
<th>Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Explanations for decline in India's household savings rate post 2010</td>
<td>Jayshree Sengupta</td>
<td>2019</td>
<td>Household savings declined due to increase in unemployment and 'out of pocket' expenditure on necessary expenses</td>
</tr>
<tr>
<td></td>
<td>Ila Patnaik and Radhika Pandey</td>
<td>2019</td>
<td>Household savings, which include unregistered micro, small, and medium enterprises, declined due to implementation of demonetisation and GST</td>
</tr>
<tr>
<td></td>
<td>Nikhil Gupta</td>
<td>2017</td>
<td>Household savings rate has decreased because of increase in household debt. Household consumption has grown faster than household disposable income and hence consumption is financed by digging into their savings or taking on debt.</td>
</tr>
</tbody>
</table>
Declining share of young in the working age population could be a contributing factor

Share of young refers to share of 15-44 year old population over total working age population of 15-65 year old

- Share of working age in total population **increased by 8%** between 2001 and 2021
- Share of young in working age **decreased by 4%** between 2001 and 2021

Source: Census. UN population projection for 2021
There exists reasonable evidence to suggest household savings peak when they turn 45-50 years

Global
• In the US, savings as a % of income peak when the head of the household is between 40-45 years, (Laura Feiveson and John Sabelhaus, 2019)
• In Singapore, working adults in their 20s save 35% of their monthly income, in contrast to 29% saved by working adults in age group 55-65 years (OCBC Bank Financial wellness survey, 2022)

India
• Average age of marriage is 19-23 years (Census, 2011)
• In (rural) India, marriage cost can be six times a family income (Bloch et al, 2002)
• Prospect of paying higher dowry increases household savings, which are primarily financed through increased paternal labor supply (Anukriti, 2018)
Conclusion

• Three key drivers of India’s economic growth – global economic environment, demographics and economic reforms

• The outlook on the first two is not as positive as the historical trend

• Faster growth for the future rests largely on economic reforms

• Reforms accelerate growth by creating a competitive economy and macro stability

• Since large firms are 4-8 times more productive than smaller cohorts, they have pushed growth by formalising the domestic economy

• ‘India’s New Growth Recipe’ should now focus on improving the competitiveness of our large firms even more by making them global champions
Thank you