Rising tides of Consumption : India's Labor Revolutions in the Spotlight

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Vinod wakes up with the first rays of light, ready to tackle another day. As he steps out of his modest abode, he joins the steady stream of workers making their way to the nearby construction site. Vinod is a familiar face in this labor-intensive sector, where his skills and strength are put to the test each day.

Meanwhile, in another corner of the city, we find Aashna preparing for her day ahead. She greets the morning with determination and purpose. However, instead of heading to a construction site, Aashna walks confidently towards a manufacturing facility. As she enters the gates, she becomes part of a well-organized workforce engaged in the production of goods that shape the world around us.

Vinod and Aashna symbolize two distinct worlds within the workforce. Vinod, the construction worker, toils under the scorching sun, relying on his physical strength and manual labor to earn a living. His work is transient, with projects coming and going, leaving him in search of the next opportunity.

In contrast, Aashna finds herself in a different realm of employment. Her role in the manufacturing industry offers her a structured routine, consistent income, and access to various benefits. She is part of a well-oiled machine, working alongside skilled professionals and contributing to the production of goods that reach far beyond the city limits.

In a world grappling with the challenges of an aging and declining population, India's remarkably young and large population presents a myriad of opportunities waiting to be embraced. To better understand India's prospects, let's draw a comparison with Indonesia, a country sharing similar demographic characteristics[1].

Indonesia's GDP per capita, PPP (current international $) of USD 13,027, surpasses India's $7,242[2]. This gap is also reflected in the differences in per capita consumption between the two countries. For instance, India has relatively low household ownership of assets compared to Indonesia. Only 50% of Indian households own a two-wheeler, while in Indonesia, that figure is 80%. Similarly, the percentage of Indian households with cars and computers is lower, at just 7.5% and 9% respectively, compared to 13% and 22% of households in Indonesia[3].

So why is this promising? The answer is scale! With a population of 1.4 billion, India's total private consumption amounts to USD 2.2 trillion, far exceeding Indonesia's USD 0.7 trillion[4]. Even a small change in per capita consumption, when combined with a large population base, has the potential to exert a remarkable influence on economic growth. However, for this to happen, India's workforce must undergo critical transitions.

This is where we revisit Vinod. India's low per capita consumption and income can be attributed to the fact that the workforce is primarily engaged in informal, low-productivity sectors without contracts or social benefits. The value added is highly skewed, with only a small proportion of the workforce contributing to a significant share of GDP. For instance, despite services being a labor-intensive sector, only 30% of the workforce in the services sector contributes to 54% of gross value added.

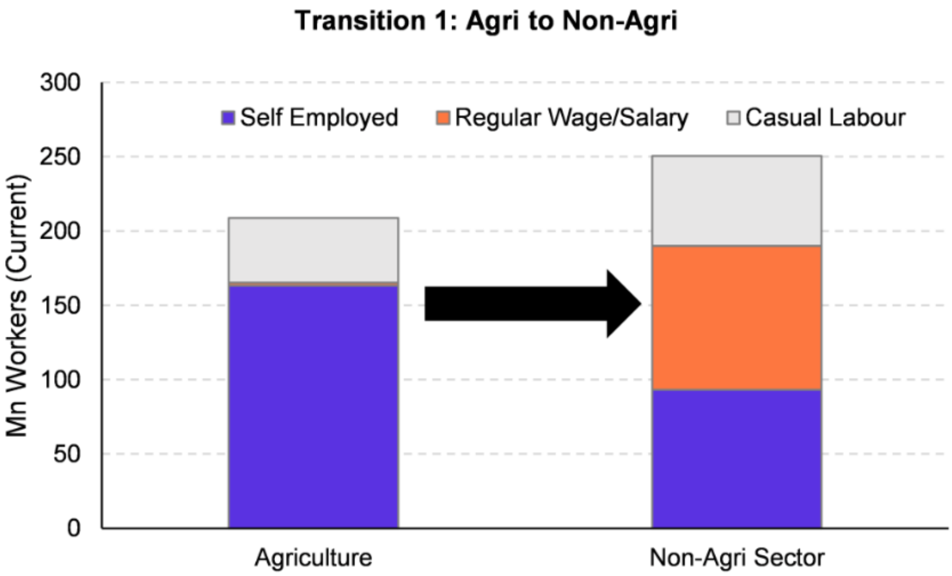
To unlock economic value, it is essential to break this status quo and facilitate the transition of the workforce from low-wage, low-productivity sectors to higher-wage, higher-productivity sectors, where Aashna operates. Over the next decade, India is expected to undergo three defining workforce transitions.

1. Agriculture Sector to Non-Agriculture Sector

The first transition involves shifting labor from the agriculture sector to the non-agriculture sector. Currently, 45% of the Indian workforce is employed in agriculture, yet it only contributes to 15% of GDP.

Moreover, the agriculture sector is plagued by underemployment, with multiple family members often working on a single small-scale farm. In response, more farmers are diversifying into allied activities such as animal husbandry, forestry, and fishing. This has resulted in a decline in the crop sector's share of agricultural gross value added from 65% in 2011 to 54% in 2022. However, there is a need for further labor mobility to reduce over-employment in crop farming.

The agriculture sector has the lowest labor productivity[5] (value added per person employed at constant 2011-12 prices) at Rs 89,000, 65% lower than the average productivity of the overall economy. The transfer of labor to the manufacturing sector, which has a labor productivity of Rs 4,12,000, will increase value-added at the margin by over four times.

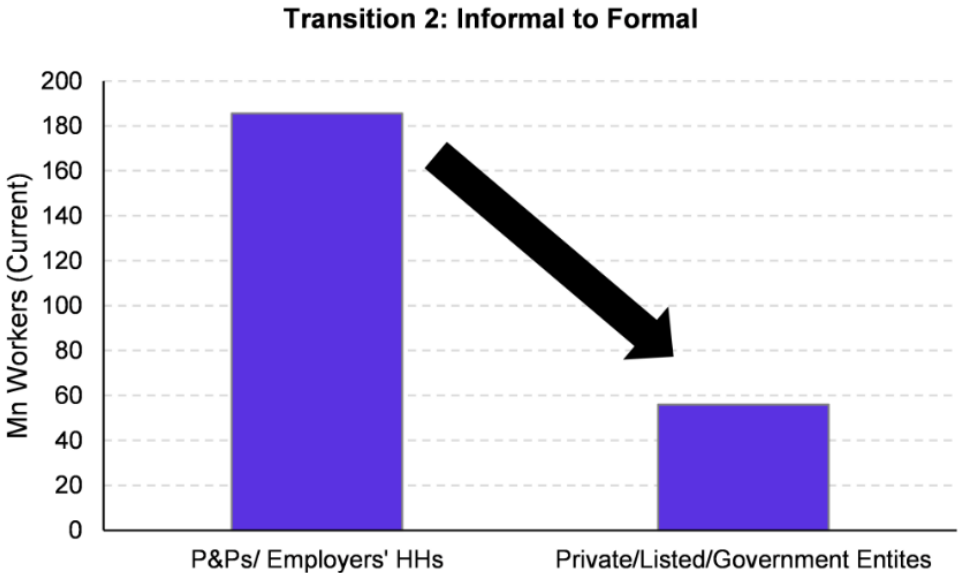


Source: PLFS Jul'21-Jun'22

2. Informal Sector to Formal Sector

The second transition involves shifting from small-scale, mostly informal 'Proprietary and Partnership' businesses to formal listed or private sector companies. Currently, these small-scale units employ nearly 72% of the non-agricultural workforce in India but lack economies of scale. Many of these firms, known as 'dwarf' firms[6], have less than 100 worker's despite being more than ten years old. Due to low productivity, their contribution to value-add remains low. By transitioning to larger enterprises, productivity and wages can increase, enabling greater spending on consumer discretionary goods.

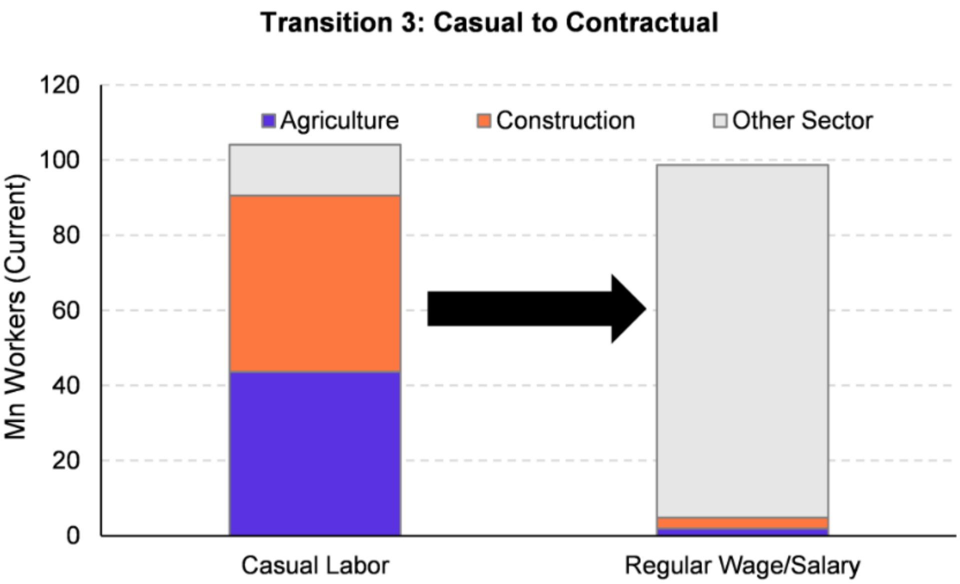
Although quantifying productivity in the informal sector is challenging, we can use low-skill, labor-intensive sectors like Textile and Footwear as a benchmark. Shifting labor from these sectors to more organized sectors like financial services would result in a value-added increase of over five times. Similarly, transitioning to the manufacturing of rubber and plastic products, for example, would result in a threefold increase in value-added.



Source: PLFS Jul'21-Jun'22

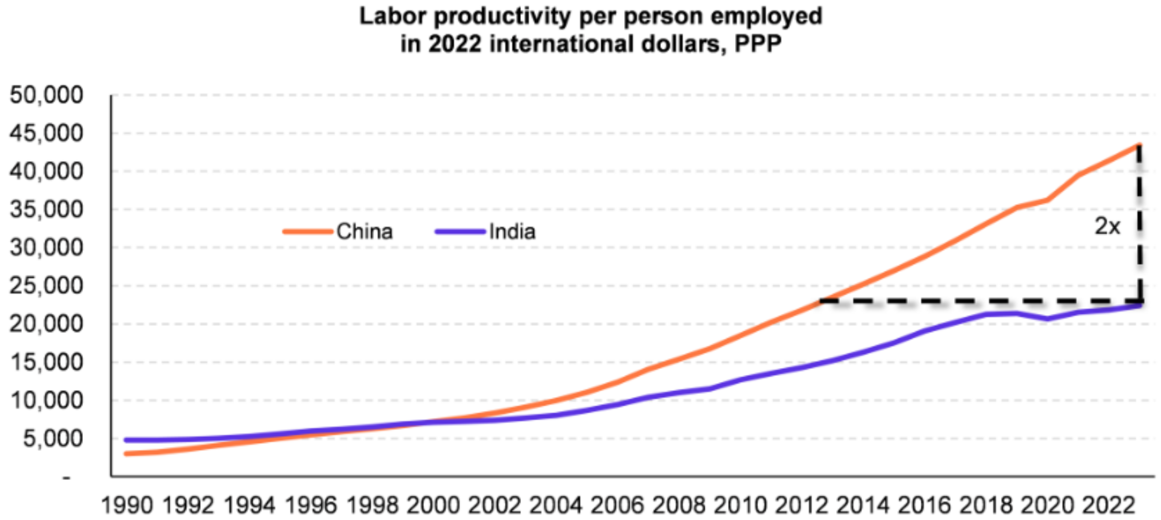
3. Casual Labour to Contractual Employment

A third shift will involve workers transitioning from sectors such as construction, which predominantly employs casual labour and daily wage workers, to sectors with stable jobs. Construction employs 12% of the workforce but contributes only 8% of GDP and demonstrates a labour productivity of only Rs 172,000 (33% lower than the national average). However, by transferring labour from the construction sector to manufacturing, productivity would increase by two and a half times. Sectors that rely on cheap casual labour will be disrupted as labour gets absorbed into sectors that provide more stable contracts.



Source: PLFS Jul'21-Jun'22

It is challenging to determine the exact magnitude of India's future increase in labour productivity. However, drawing a comparison with China can provide a valuable reference. Presently, India's labour productivity stands at a level comparable to China's in 2012. Since then, China has witnessed a doubling in productivity. If India were to follow a similar trajectory, there is potential for its labour productivity to double within the next decade.



Source: The Conference Board

In the realm of economics, Nobel Prize laureate Milton Friedman crafted a theory called the Permanent Income Hypothesis. It's quite simple: people spend money based on what they expect to earn in the long run.

Now, let's tie it all together. The transitions we've explored – shifting labor from farms to other sectors, moving from informal to formal jobs, and embracing contractual work – will boost future income prospects. This, in turn, will instill confidence and stability, paving the way for greater discretionary spending.

These transitions aren't separate chapters but interconnected threads that weave a brighter future for workers. As they climb the value ladder, their consumption will soar, fueling a harmonious symphony of progress and advancement. This surge in consumption will, in turn, act as a catalyst for higher economic growth

(Note: Vinod and Aashna are fictional characters used for illustrative purposes)

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References

1.Median Age 2023 – India: 28.2 yrs., Indonesia: 29.9 yrs.
Share of Population ages 15-64 – India 68%, Indonesia 68%.

2.Source: World Bank. Comparison year: 2021

3.Source: India 2019-21 DHS, Indonesia 2017 DHS

4.Source: World Bank. Comparison year: 2021a

5.India KLEMS database 2021

6.Economic Survey 2018-19: Nourishing Dwarfs to Become Giants: Reorienting Policies for MSME Growth

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