

India's society is **young, growing, and urbanizing** – setting the demographic foundation for decades of turbo-charged economic development. The number of Indians aged 12 or younger exceeds the United States' *entire* population.¹ Over the next two decades, India is expected to add more people to its labor force *each week* than the U.S. adds in a *year*,² while its urban areas are forecast to gain a New York City's worth of new residents *every ten months*.³



*Mumbai schoolchildren.*⁴

Today, the average Indian is a 27-year-old villager eking out a modest living from agricultural-related rural labor.⁵ By 2050, the average Indian will be a 37-year-old city-dweller, with a manufacturing or services job generating over three times more economic output than farm work.⁶ The members of her generation will enter the prime of their working lives with relatively few dependents to support, allowing India to re-invest an increasing share of its income into infrastructure and education.

Expansion in the working-age share of a country's population (a phenomenon known as a "demographic dividend" – see *page 4*) and rapid urbanization (see *page 6*) are each historically-proven drivers of elevated growth in per capita GDP – even when occurring in isolation. Through our analysis of decades of demographic and economic data (see *page 11*), however, we demonstrate that countries experiencing a demographic dividend and rapid urbanization *simultaneously* grow per capita income at a rate *much* faster than economies benefiting from only one or the other.

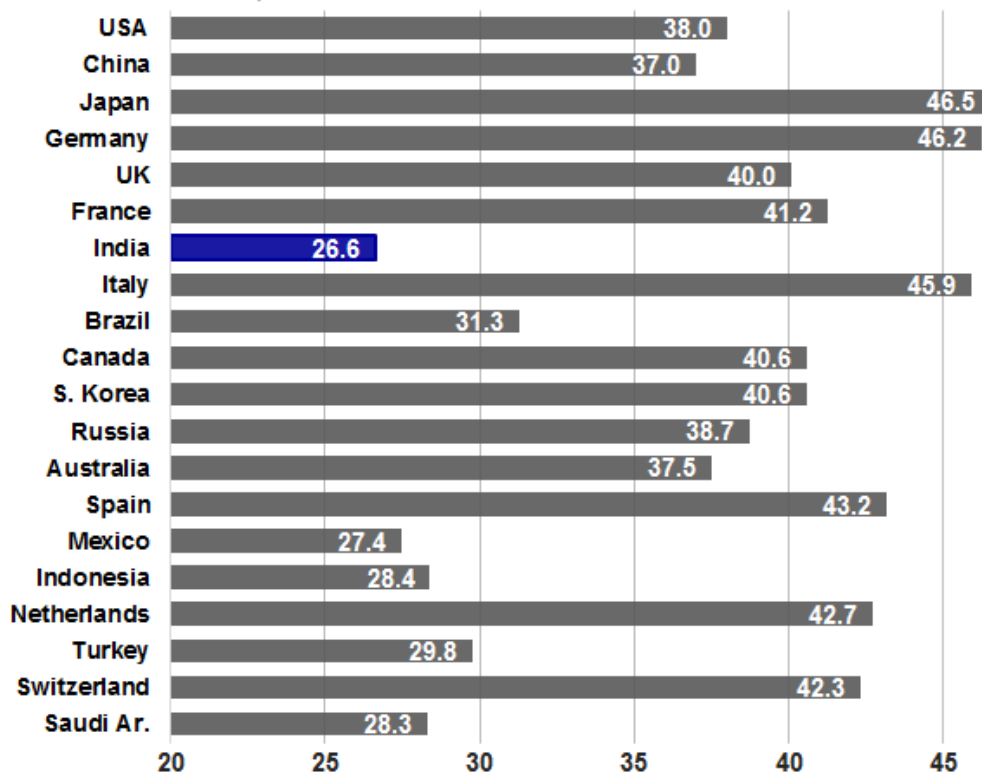
India – uniquely among the world's major economies – boasts the powerful combination of both phenomena, underpinning projections for a **sustained** period of **elevated per capita GDP growth**.

India: the world's youngest major economy

India has the youngest population among the world's twenty largest economies. Two-thirds of its 1.3 billion people are 35 or under; the roughly half a billion Indians who are under 20 years old account for one-fifth of the *entire world's* young people.⁷

Median age in the world's 20 largest economies

Sources: The World Bank, United Nations

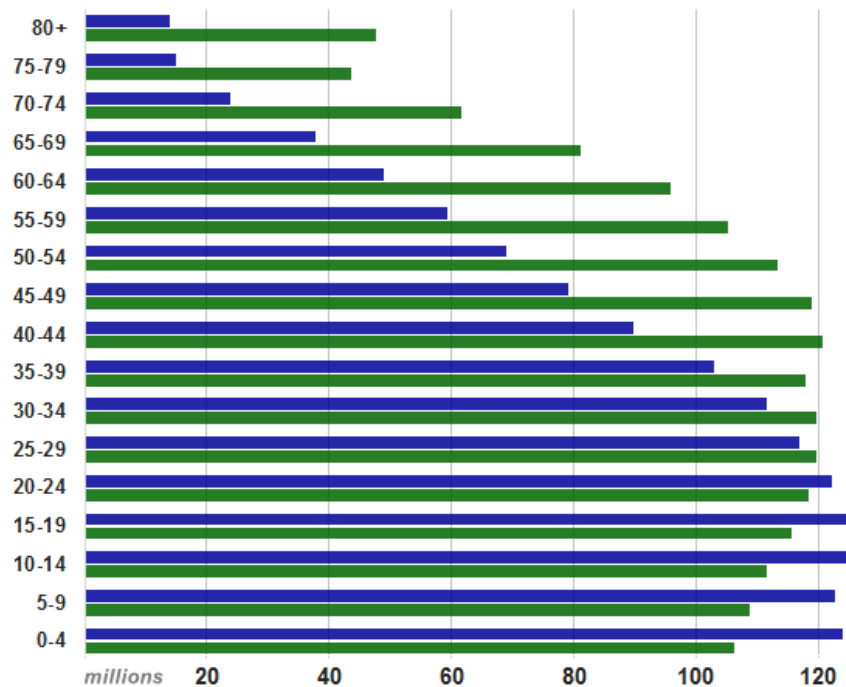


Since the birth of today's median-age (27-year-old) Indian, the country's birthrate⁸ has dropped by two-fifths.⁹ This has given rise to a "youth bulge" – a generation larger than those immediately before and after it – that is steadily working its way through the age structure.

As this "boom" generation gradually enters the labor force between 2015 and 2050, India's **working-age population** (defined as people aged 15 to 64) is projected to **expand by 33%** – in stark contrast to the grim demographic trends facing China and most of the world's developed economies, which will struggle to support ballooning numbers of senior citizen dependents even as their labor forces *shrink*.¹⁰

India population by age group: 2020 & 2050

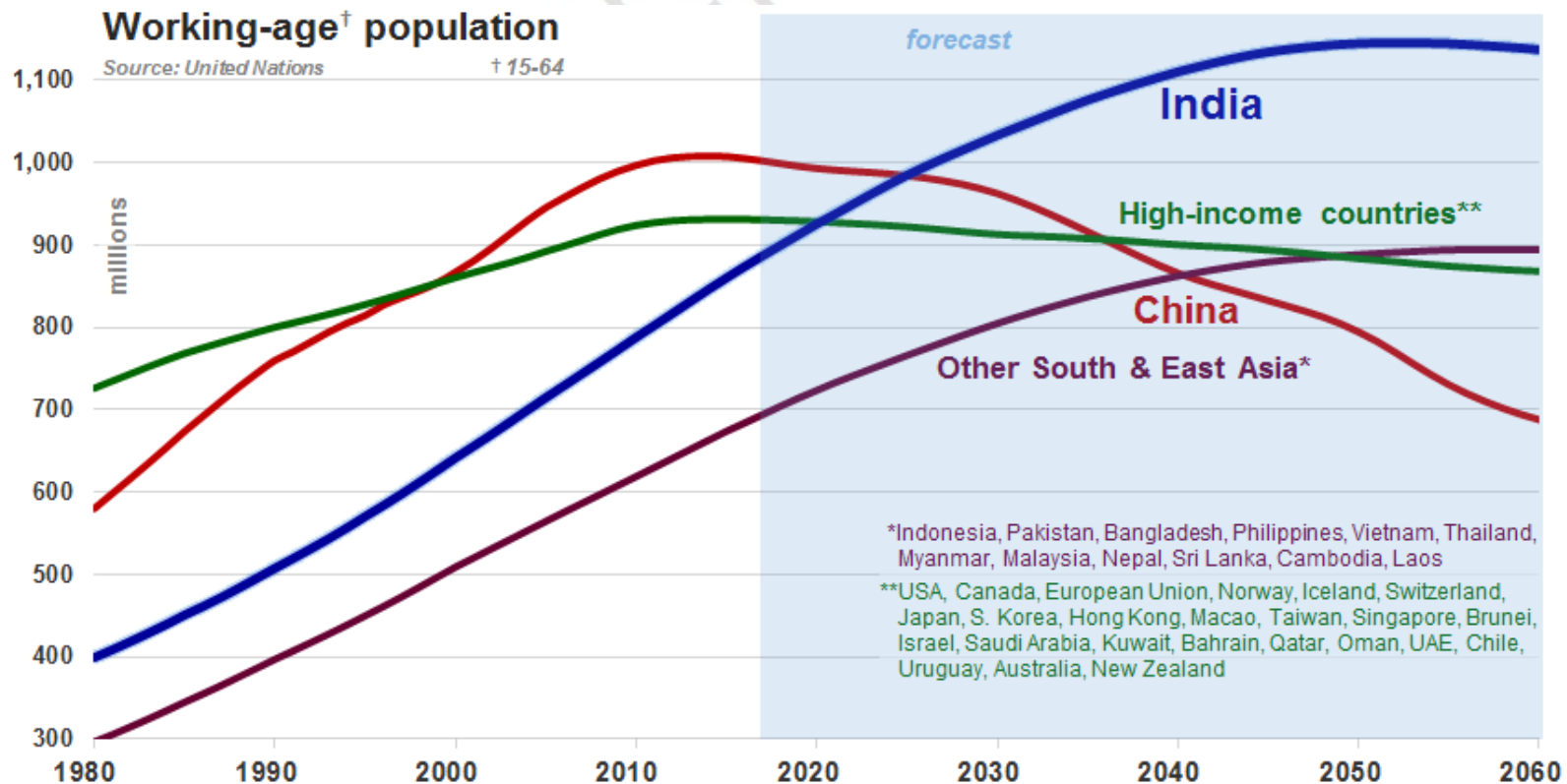
Source: United Nations



Working-age[†] population

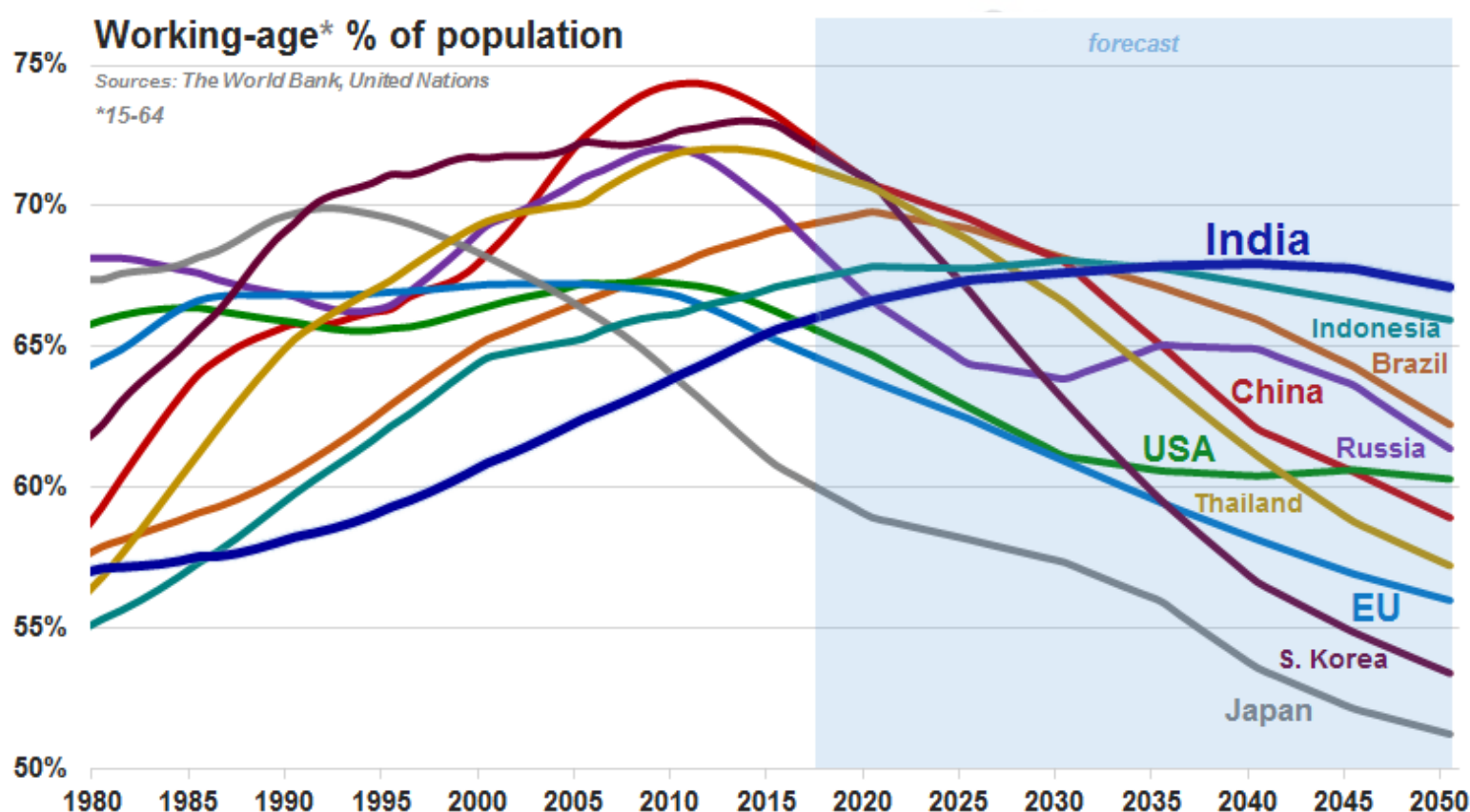
Source: United Nations

† 15-64



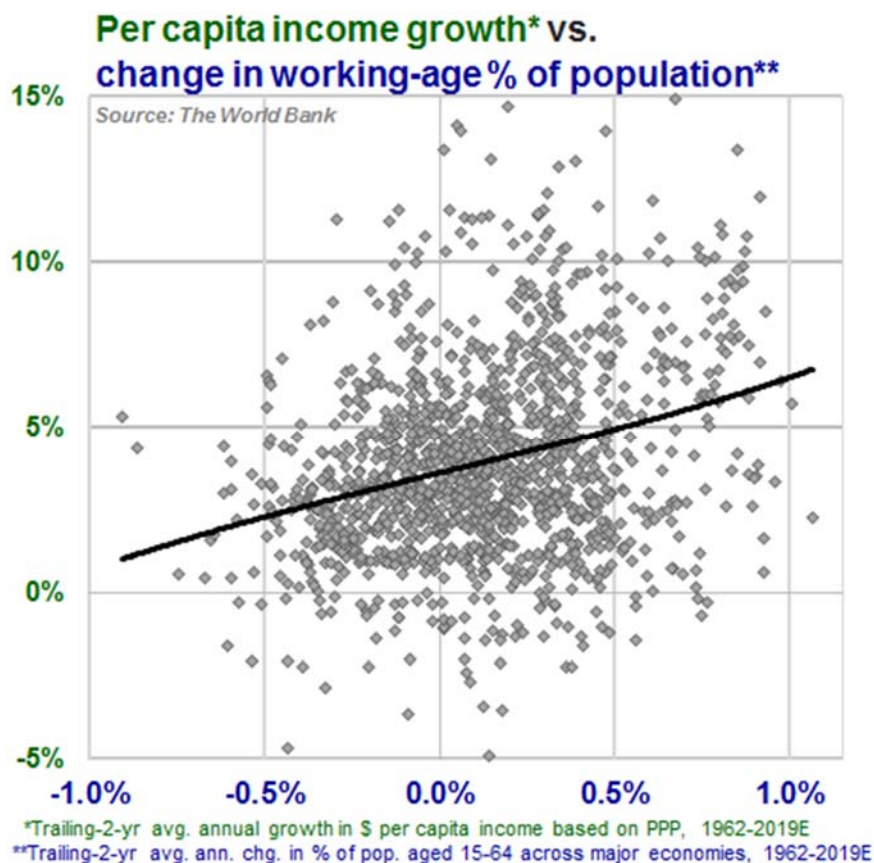
India's demographic dividend

Due to the combination of India's youth bulge, continued steady declines in the country's birthrate,¹¹ and the limited number of Indians approaching retirement, the expansion in India's workforce is set to outpace its *overall* population growth through the 2040s. Within the next two decades, India will have the highest ratio of working-age people to dependents among the world's twenty largest economies.¹²



The forecast steady **expansion in the working-age share of India's population** – a phenomenon known as a “**demographic dividend**” – can be expected to provide a **significant and sustained boost** to the country's **economic growth**. Across decades of economic history, there has been a strong positive correlation between increases in the working-age proportion of a population and faster economic development.¹³ Demographic dividends were key factors behind the exceptionally high growth rates achieved across Europe and much of East Asia in the decades following World War II, as baby boom generations entered those regions' labor markets.¹⁴

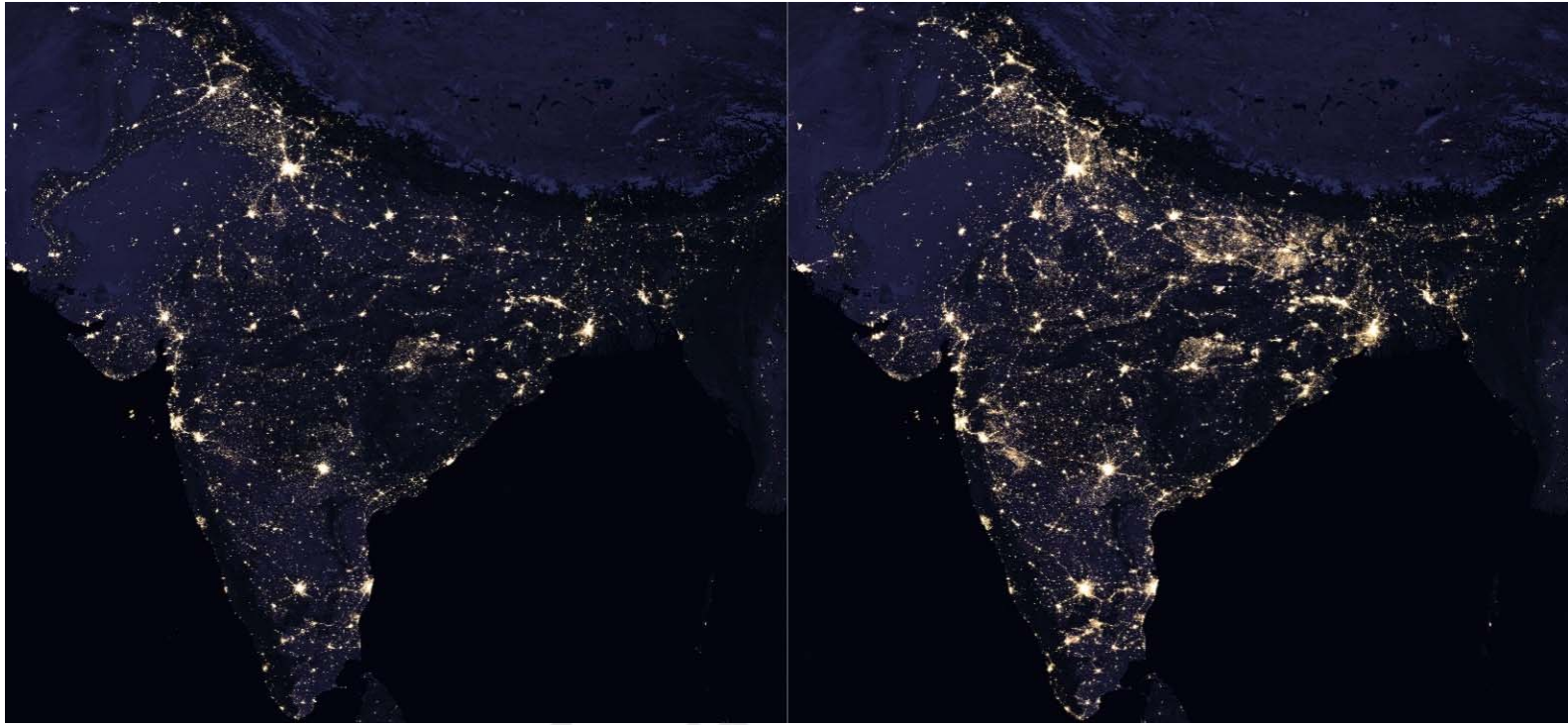
A demographic dividend lifts average incomes in two ways. As a growing share of the population begins contributing to GDP and the number of dependents per worker falls, GDP per head goes up. However, this first-order, “arithmetic” effect explains only approximately one-quarter of the overall uplift in per capita income growth achieved across historical examples of economies experiencing a demographic dividend.¹⁵



Most of the economic benefits of a demographic dividend arise from an assortment of second- and third-order “behavioral” effects. Because workers (unlike children and retirees) accumulate savings, an expanding ratio of working-age people is associated with a rising domestic **savings** rate – increasing the resources available for **investment** and allowing a country like India (which already invests in excess of its domestic savings) to fund that added investment **without relying on foreign capital**.¹⁶

With relatively fewer dependents to support, more capital can be directed toward productivity-enhancing investments (as opposed to, say, old-age pensions).¹⁷ As families become smaller, they are able to provide each of their offspring with higher-quality food, healthcare, and education. Falling infant mortality and better schooling (particularly for girls) improve children’s life prospects and reinforce the lower-birthrate trend at the root of the demographic dividend.

These demographic forces have already had a positive impact on India. Since the turn of the millennium, the year-over-year declines in India's infant mortality and birthrate have accelerated.¹⁸ Over the same period, the proportion of Indian high school-age children who are enrolled in school has doubled, to nearly two-thirds.¹⁹



India seen from space in 2012 (left) and 2016 (right).²⁰

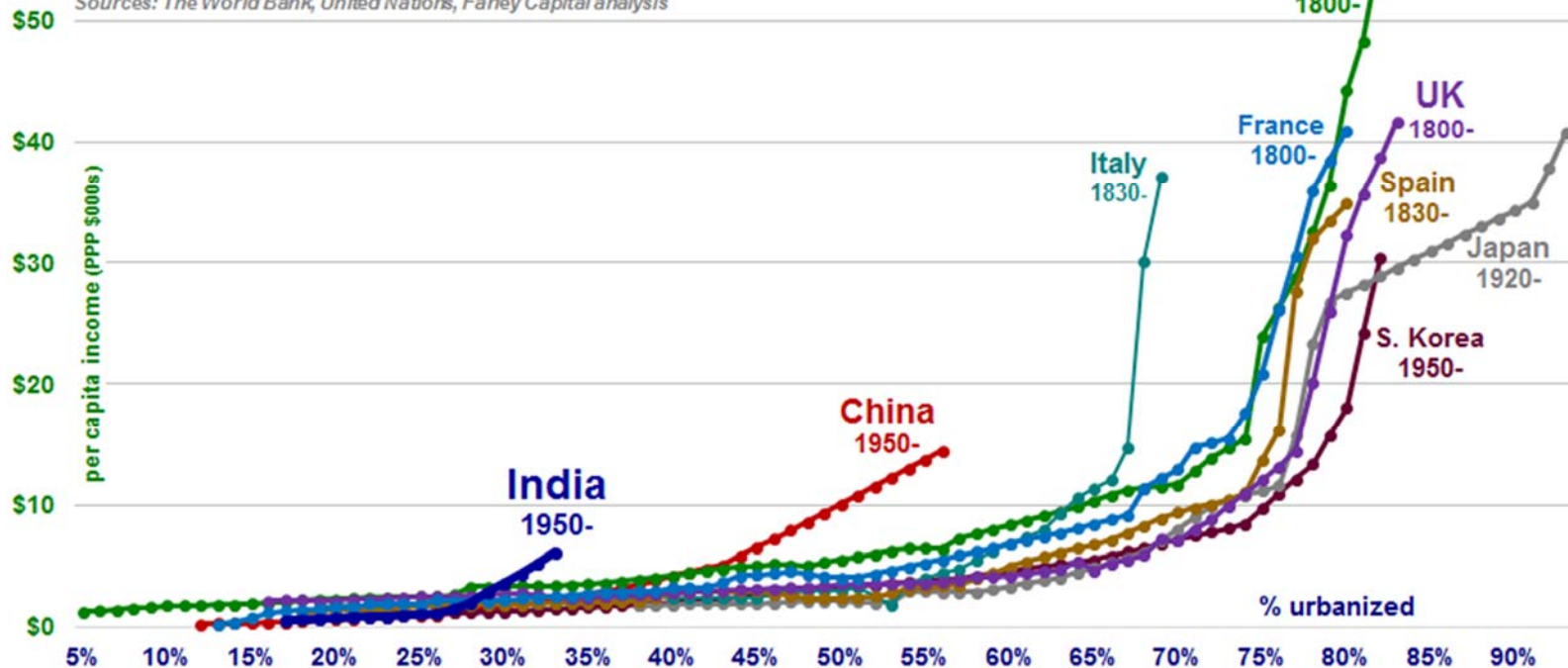
India's accelerating urbanization

Today, **two-thirds of Indians still live in rural areas** – making the country roughly as urbanized as China in 1995, South Korea in 1965, Japan in 1935,²¹ Europe in 1905,²² or America in 1885.²³

However, India's rural-to-urban migration is gathering pace, setting it on the rapid-urbanization trajectory followed by every country in history that has achieved an extended period of robust growth or reached "developed" (a.k.a. "industrialized") economy status. It took India nearly sixty years (between 1958 and 2015) to grow its urban population by 340 million (to a current total of approximately 420 million). It will add the next 340 million in half the time – laying the groundwork for decades of elevated economic growth.²⁴

Historical per capita income vs. urbanization

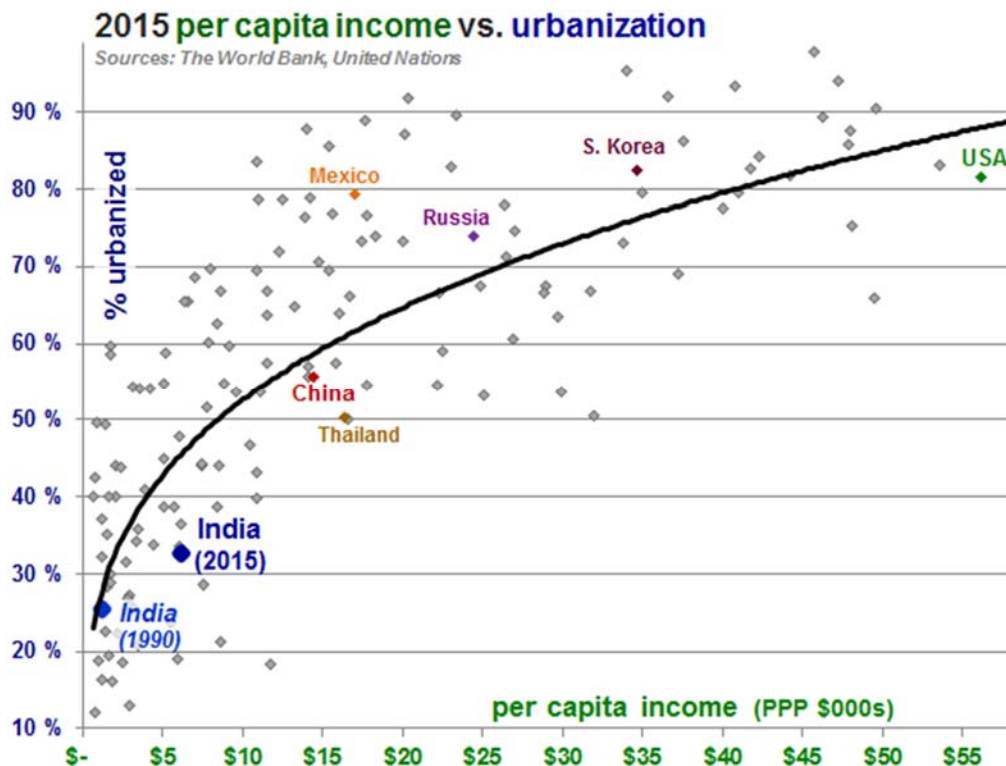
Sources: The World Bank, United Nations, Farley Capital analysis



Urbanization is typically the **biggest single factor** driving gains in a developing country's per capita income. The process by which urbanization accelerates income growth is well-understood. In every case to date – starting with Britain and the Netherlands in the 18th century – it has been led by a shift of agricultural laborers to urban jobs in manufacturing or services.²⁵ The average productivity of a worker in the latter two sectors is typically more than three times that of a farm laborer.

As cities grow larger and the urban share of a population increases, a second effect – faster growth in urban productivity – becomes increasingly potent.⁶ Productivity is higher in cities than in rural areas, and in bigger metropolises relative to smaller cities, due to “economies of agglomeration” that arise from clusters of increasingly specialized firms, suppliers, customers, and skilled employees.²⁶ Prominent Indian clusters include Chennai (automotive manufacturing), Vadodara (chemicals), and Bangalore (IT services).

India's urbanization yields second-order effects that further reinforce its economic benefits. Urbanization speeds the progression towards lower birthrates: Indian cities' fertility rate stands at approximately 1.8 – far below rural areas' 2.5 rate, and roughly in line with that of the developed world.²⁷ As new city-dwellers find employment, develop smaller families, and recognize the value of education in competitive urban job markets, they gain both the resources and the incentive to invest in additional schooling for their children.²⁸



Equipped with more advanced skills, subsequent generations gain access to even higher-productivity (and better-paying) opportunities – setting into motion a “virtuous cycle” of growing prosperity.²⁹ As cities expand and become more productive, they reinforce the economic incentives driving rural-to-urban migration.³⁰ Evidence for urbanization’s role as a catalyst for India’s economic advancement can already be seen in the disproportionate economic heft of the country’s existing urbanites: the **one-third** of India’s people who **already live in cities** contribute an estimated **two-thirds** of total **GDP**.³¹

India’s slums

The epic scale of India’s urbanization is not without its growing pains: most visibly, in the form of the country’s notorious **slums** – which accommodate millions of Indians, including over two-fifths of the total population in Mumbai and other large cities.³²

To a Western observer, slums may seem like places of static, squalid misery: crowded, dismal shantytowns without adequate sanitation, police protection, or other basic services essential for a dignified life. Yet given such conditions, why would millions of Indians leave villages for life in slums?



Dharavi, Mumbai: one of the world's largest slums.³³

Although not obvious to a Westerner, India's slums are largely the result of rational choices made by migrants in pursuit of higher-paying jobs and better opportunities. In China, authorities employ a system of internal passports to limit the flow of migrants into cities.³⁴ By contrast, India's democratic society affords its citizens free mobility, while also enabling interest groups to lobby for laws that impede the development of affordable housing. In Mumbai, a 1947 rent control act deters construction of rental apartments. As a consequence, slums – settlements built illegally on public land – represent the city's "only free market in rental housing".³⁵ Meanwhile, vested interests preserve prime tracts of real estate for sub-optimal use. India's Ministry of Defense, for example, operates 97 golf courses covering over 8,000 acres of mostly urban land.³⁶

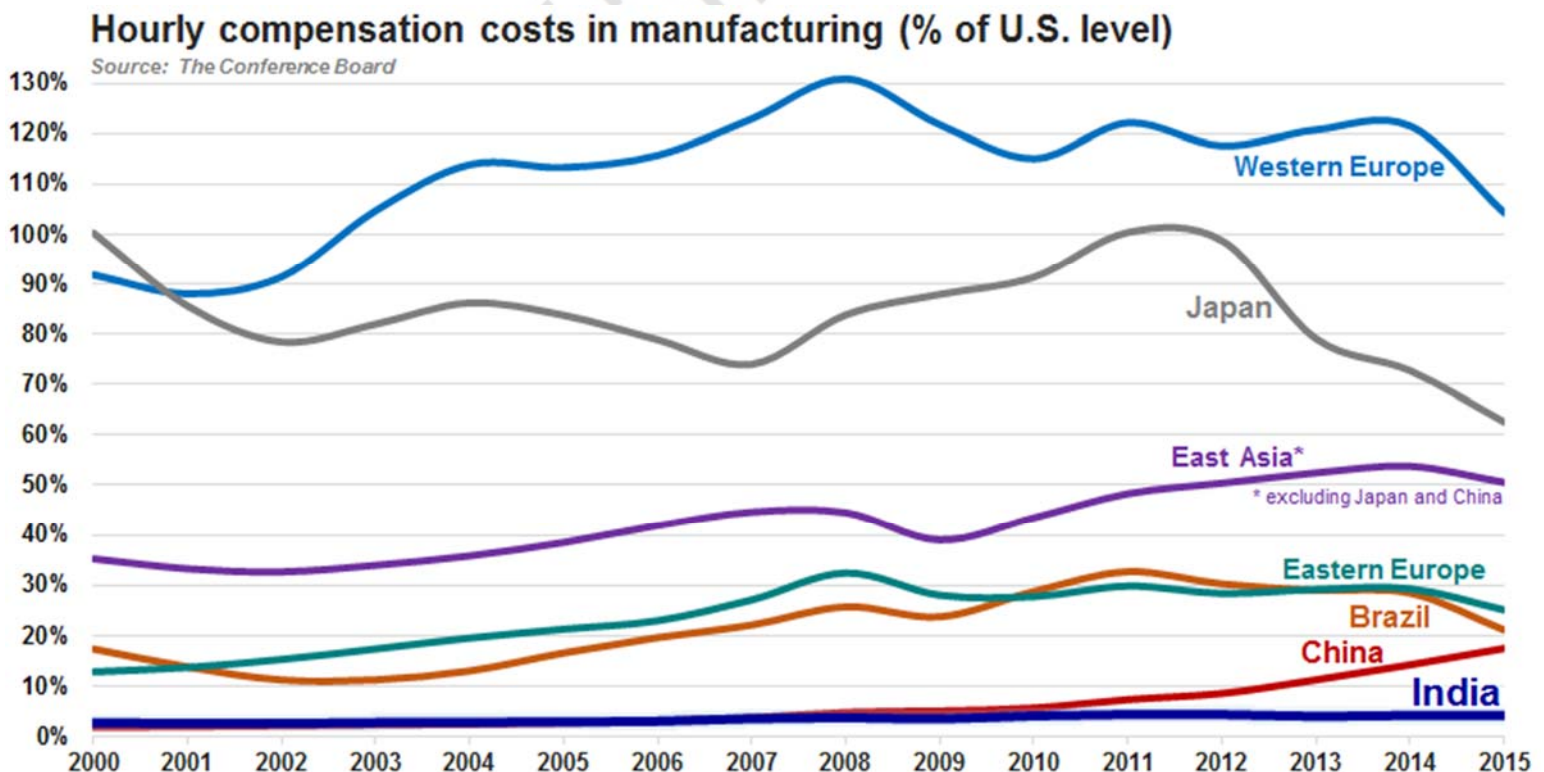
Slum-dwellers' alternative is not an idyllic pastoral life, but rather erratic agricultural work in an un-electrified village with little in the way of educational provision³⁷ but plenty of suffocating customs (e.g., co-habitation with one's in-laws, child marriage, and caste-based discrimination) that severely constrain autonomy³⁸ – especially that of young people.³⁹

Last year, I asked a young Mumbai resident, Aditya, why he had traveled hundreds of miles from his village in Rajasthan – leaving behind his wife and children – to work as a driver in the metropolis, where such work earns an average monthly salary of around ₹13,000 (\$200).⁴⁰ The answer was because for him, it was an upgrade. Even after paying his rent for a small shared room, Aditya netted enough money driving in Mumbai to support his family back in Rajasthan – and far more than what he could have made working back in the countryside.

Although a Westerner may find it difficult to see them as such, slums are steppingstones in the process of urbanization and economic development. Slums give migrants access to education for their children, allowing them to rise into the urban middle-class – making room for the next wave of arrivals.⁴¹ UN data show that over the past two decades, tens of millions more Indians have relocated *out* of urban slums⁴² than moved into them.⁴³

India's extraordinarily competitive labor costs

The average compensation of a single German factory employee (roughly \$46 per hour) is equivalent to the wages of approximately *thirty* Indian manufacturing workers.⁴⁴



Given the hundreds of millions of villagers yet to migrate into its urban workforce, India should be able to sustain this competitive advantage – a key feature of its increasing appeal for job-creating manufacturers – for decades.

In China, average manufacturing wages have risen by double-digits each year since 2010. Not coincidentally, that was also when the country's demographic dividend came to end, its demise hastened by China's decades-long "one child" policy.⁴⁵ By contrast, manufacturers can count on India's ongoing demographic dividend and rural-to-urban migration to ensure a ready supply of low-cost labor for the foreseeable future.⁴⁶ Alternatives such as Vietnam and Indonesia may also be attractive, but India is "the only country [with] the scale to take up where China is leaving off."⁴⁷

My visits to Indian companies usually involve interacting with an overstaffed security gate, a team of receptionists, an elevator operator, and multiple people offering tea and coffee. At hotel gyms, I've learned not to try to get a towel myself: there's an attendant whose job it is to hand it to you. On a 2014 visit to the campus of a Gujarat steel pipe manufacturer, I observed dozens of people tending to the landscaping and touching up the walls. The CEO explained paternalistically that India's "luxury" of "too much labor" allowed him to hire hundreds of "peons" – a word (often used in a derogatory way in the West) that I last came across in a book about medieval history.

India's complementary demographic advantages

Demographic dividends and rural-to-urban migrations are each historically-proven drivers of elevated growth in per capita income – even when occurring in isolation. **India – uniquely among the world's major economies – boasts the powerful combination of both phenomena.**

To quantify each phenomenon's economic impact, we conducted an analysis combining World Bank and United Nations data on twenty-five leading economies' working-age populations, urbanization rates, and real (inflation-adjusted) U.S. dollar per capita income growth over the 1950-2016 period.⁴⁸ For each of those 67 years, we assigned each country to one of four buckets:

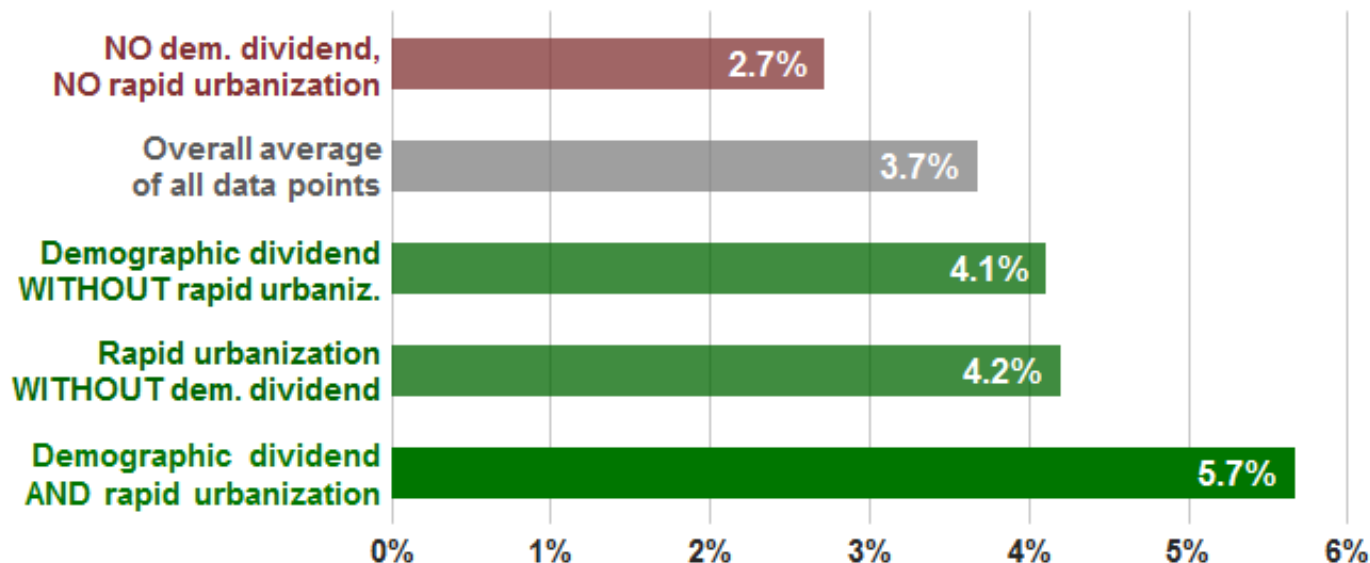
- (1) Economies that saw *neither* substantial growth in the working-age share of their population (i.e., a demographic dividend) *nor* a substantial increase in the share of their population living in urban areas (i.e., rapid urbanization);

- (2) Economies experiencing a demographic dividend, but *not* rapid urbanization;
- (3) Economies undergoing rapid urbanization, but *not* a demographic dividend; or
- (4) Economies experiencing both phenomena *simultaneously*.

We then averaged together the data points falling into each of the four categories, and compared the results to the overall average of all the data points in our 67-year, twenty-five-country sample. Major economies experiencing either a demographic dividend *or* rapid urbanization (but not both) had noticeably faster income growth, compared to the overall average. Per capita income in economies undergoing **both phenomena simultaneously**, however, grew ***much faster*** – at an annual rate two full percentage points above the overall average.⁴⁹

Per capita income growth in major economies, 1950-present*

Sources: The World Bank, United Nations, Farley Capital analysis



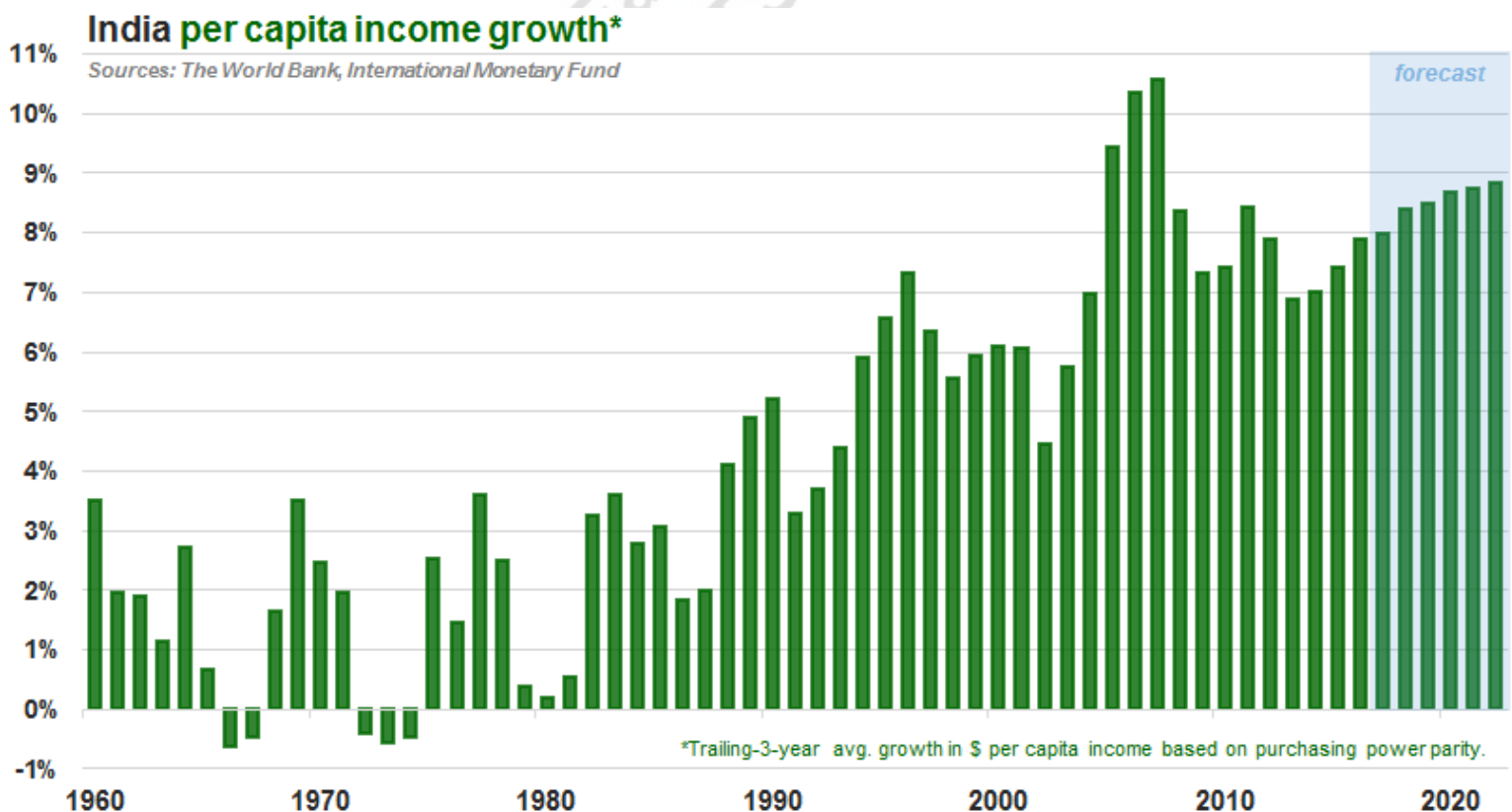
*Avg. annual growth in PPP \$ per capita income across the world's 25 largest economies, 1950-2016. Demographic dividend defined as >0.2% trailing-2-yr. avg. annual growth in working-age % of population. Rapid urbanization defined as >0.4% trailing-2-year avg. annual growth in urban % of population.

As recently as 2010, five countries met the criteria for inclusion in bucket (4): China, Thailand, Vietnam, Malaysia, and Turkey. Since then, all five have seen their demographic dividends taper off, relegating them to bucket (3). In 2010, India was still in bucket (2), with the pace of its urban-to-rural migration on the cusp of our threshold for “rapid” urbanization. Today, the **combination of a demographic dividend and rapid urbanization is present in only one major economy: India.**

Among economies with shrinking labor forces, those that are still experiencing rapid urbanization (such as China and Thailand) continue to boast relatively dynamic growth – despite the fact that such countries cannot count on the positive feedback loops between expanding working-age populations, rising savings, and the investment needed to create high-productivity urban jobs.⁵⁰ To a somewhat lesser extent, the same is true of economies that completed a rapid urbanization long before the peak of their demographic dividends (e.g., Mexico and Saudi Arabia).⁵¹

Unsurprisingly, bucket (1) showed the lowest average annual growth in per capita income: 2.7%, a full percentage point below the overall average. The economies falling into this category – as of 2016, every high-income country in our sample (including the U.S., Japan, and Germany), plus Brazil, Russia, and Argentina – can only continue to improve their standards of living by increasing the productivity of their already-urbanized, greying workforces.

Over the past 25 years (since 1992), India's per capita GDP has grown more than *three times faster* than it did in prior decades.⁵² Part of this improvement owes to the major economic reforms introduced following the country's 1991 crisis (a topic for a future post). However, India's demographic dividend and a significant acceleration in the pace of its urbanization deserve most of the credit.⁵³



With a labor force projected to grow through the 2050s, a steadily rising ratio of working-age people to dependents, two-thirds of its people yet to move into higher-productivity cities, and remarkably competitive labor costs, India boasts an exceptional combination of complementary demographic advantages. Their simultaneity – unique among the world's major economies – forms an extraordinary dynamic, one that will serve as a powerful tailwind to India's economic growth for decades to come.

* * *

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