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Income inequality can spell trouble

Rajesh Shukla: 2010-12-31

ADAM Smith, the founder of modern economics, argued that the essential task of coordinating national economies fall to consumers in deciding how resources will be used, not kings, not politicians, not priests, not even chief executive officers (CEOs). Summarising his views in “The Wealth of Nations”, published in 1776 – ‘consumption is the sole end and purpose of all production and the interest of the producers ought to be attended to only so far as it may be necessary for promoting that of the consumer. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer’. Smith’s observations are more relevant to economies like India where household demand is one of the key pillars of national economy. The fast changing consumerism of the past two decades has made the Indian situation quite puzzling for marketers, analysts and policy makers.

Indian consumers are hydra-headed monster, and often beg the question: which India and whose India are we talking about? There is one India whose proud inhabitants enjoy higher per capita incomes than Brazil; a larger one that is slightly poorer than Indonesia and, a third India that is double in size to the sum of the first two, but almost as poor as Bangladesh. For instance, bottom 60% Indian households account for 30% of national income (NI) and about 40% of private final consumption expenditure (PFCE). The top 40% households in India have 72% of income and almost 90% of surplus income.

There is no way of knowing for sure. But there are two things about the future that we know with relative certainty; first, it will be different from today, and second, the future will be affected by what we do today. It cannot be denied that economic liberalisation and financial inclusion have benefited the masses.

The last decade was one of high economic growth and is expected to continue which will certainly bring further structural changes in the economy. Taking NNP growth at 8.75 % during 2010-15, the share of farm income, which made up 74% of rural incomes in the 1970s, is seen to have dropped to 32% in 2015-16. So the non-farm growth is substantial in rural India. Over 42% of rural households draw their income from non-farm sources, particularly traditional services (27%). The households engaged in modern services had the highest income increase (200%). The expected annual increase in average household income will be about Rs 11,000 between now and 2015, urbanites gain 3 times more than rural (Rs 3,600). Also, we see that the top 20%in both rural and urban India gaining Rs 24,000 and Rs 75,000 in their annual income. On the other hand, people at the bottom of the pyramid are seeing gaining only about Rs 2,100 irrespective of place of residence.

The top 20% households are seen gaining the most, from 37% share in total income in 1993-94 to 58% in 2014-15. However, the sharper decline is noted among middle than bottom, the share of bottom 20% is 7% in 1993-94 to 6% in 2014-15.

What could be the social repercussions of such a high increase in income inequality? For a populous country like India, the impact cannot be imagined. If the government doesn’t meet the economic and social needs of the majority of the people, then there could be widespread social unhappiness or even unrest as the disaffected masses begin to assert their right to equity. Of course, equity is different from equality. Their demand would not be for equality with the top of the pyramid but reduction of inequalities. The most disaffected section is the youth and so the government would have to contend with the sceptre of the usual disturbances. I think the government needs to take, to at least assure proper place for people to feel secure and happy. And at 20% we are talking about 220 million people of the country’s population that makes the bottom of the pyramid. I believe that it is the responsibility of the government, policy makers, corporations and rich people to make this 20% feel secure. Smith continued to advocate ‘consumer freedom and leadership’. He blasted away at what he called the ‘mercantile system’ with a tendency to favor the interests of merchants and manufacturers over the interests of consumers. But he harbored reservations. He wrote “temptation and manipulation could result in lousy decisions; unreliable information might cause resources to be pulled off course; and there were aggravated burglary, robbery, and scams galore – from which consumers might need protection.

—*(The author is director, NCAER Centre for Macro Consumer Research)*