7th Pay Commission report: Who will be the loser?

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7th Pay Commission: Urban households are likely to absorb 64% of the increased amount which will come from the Seventh Pay Commission award, while rural households will get only 36%.

The decision of the government to implement the recommendations of the Seventh Pay Commission and announce a hike of 23.5% in salaries and pensions of government employees has brought much cheer. The reactions have been swift, with the Sensex gaining 475 points and industry welcoming the move. It is expected to trigger a spurt in consumer demand, particularly in urban areas, and provide a fillip to sluggish economic recovery. Media reports confirm that the government will be spending an additional R1.02 lakh crore annually.

So, what could be the likely impact of this massive injection of cash on household income? Which segments of households are likely to benefit from this and who are going to lose out?

In order to analyse this, we, at the People Research on India's Consumer Economy (PRICE), decided to crunch some numbers and came up with some interesting insights.

Given that the target of the pay hike is salaried households, we decided to take a closer look at these. According to the PRICE 360 study (2014), there are 270 million households in India, with 90 million such units in urban India and twice that (180 million) in rural India. Nearly 61 million (23%) Indian households report salaries to be a source of income—it may or may not be the major source—and the rural-urban split is 27 million (15%) and 35 million (38%), respectively. Significantly, less than half of all salaried households (47%) across India have some form of employment contract which one can consider formal.

It will perhaps come as no surprise that a slightly higher percentage (50%) of all salaried income earners in urban India have job contracts, compared to those in rural India (44%). Similarly, the distribution of households by urban/rural clusters shows that metros have the highest share of salaried households (out of total 19.2 million households)—10.2 million, or 53% share. While underdeveloped rural areas have the lowest (out of total 97.4 million households)—10.1 million, or 10%—share. Developed rural's share of 29% salaried households is almost on par with that of other urban towns: 29% versus 32%, even though other urban towns have significantly larger number of households (46 million) compared to developed rural's 29.2 million. The other interesting aspect of developed rural salaried households is that nearly 56% of these households have employment contracts, which is on par with those in metros.

Again, in terms of salaried households, there are nearly 71% households in urban India for which salaries are the only source of income, compared to just 41% in rural India. There is a higher percentage of households in rural areas (31%) which depend on a combination of salaried and self-employed (agriculture) income. It also has 8% households which earn income from salaries as well as self-employed (non-agriculture) activities. The percentage of such households is 11%. The lower dependency on salaries in rural households suggests more stability of income, as the impact of a sudden job loss and the consequent drop in income from salaries can be cushioned by other sources of income.

Given these basics, how does the pay hike impact incomes of these households? Our calculations show that the average annual salaried household income in urban India—which is currently at R4,97,805—would go up by R1,16,984 (roughly a 27% increase) to R6,14,789.

In contrast, the average annual salaried household's income in rural India would increase by R84,503—from the current R3,59,586—to R4,44,089.

Therefore, in terms of distribution, urban households are likely to absorb 64% of the increased amount, compared to 36% for rural households. In other words, the net effect of the Pay Commission move is that it will further increase the rural-urban divide, particularly salaried segments. The biggest gainers will be salaried households in the metros, followed by boom towns (population between 2.5 million and 5 million) and niche cities (population between 1 million and 2.5 million), and other urban towns (clusters with population size of less than 1 million). The share of distribution for rural salaried households would be highest for developed rural households, followed by emerging rural, and the lowest for underdeveloped rural.

A pay hike for salaried households will definitely lead to a spurt in consumer spending in urban areas, as experts have suggested. However, a more equitable distribution of the government's largesse needs to be undertaken to ensure that the benefits are reaped by rural households where opportunities for salaried employment continue to lag behind. A more focused approach to increasing income on a sustainable basis is what would ultimately help the economy reach greater heights.

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