THE FINANCIAL EXPRESS

Impact of GDP growth on income inequality

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For every percentage point of GDP growth, there will be a spike in demand for consumer goods and services which, in turn, will boost investment, and the benefits of these will be felt across all sections of the income pyramid.

The continued slowdown in the Indian economy has caused much concern among a broad swathe of players, including economists, policy-makers, the corporate sector and consumers. This has led many to question if it is even possible to accomplish the 8% GDP growth that is widely quoted. While the government has indeed initiated reforms across multiple sectors and has aggressively increased public spending on infrastructure in order to kick-start the sluggish economy, the impact of these measures will be felt only in the long term. In the short term, however, they do signal the government's efforts to propel growth and create an enabling economic environment.

The expected growth rate of 7.4% in the current fiscal year (2015-16) and its rise to 8% growth scenario by 2020-21 needs to be examined in the broader context of its benefit not only on current household income and employment generation opportunities, but also to understand how it would impact us in the future if the growth trajectory is maintained. Intuitively speaking, higher growth benefits households across the income pyramid, but by different degrees. There has been criticism from many quarters that the high economic growth phase benefited only a select few. This argument, however, undermines the positive impact on the lives and incomes of the poor. Growth of the Indian economy has not only led to a rise in the incomes of the poorest households, but has also expanded the opportunities available to them, thus enabling millions to move up the income ladder.

The average Indian household income has grown from Rs 2,19,927 in 2004-05 to Rs 3,35,643 in 2013-14, at 2013-14 prices. This is further expected to rise to Rs 4,64,569 by 2020-21. The incomes of the bottom two income quintiles grew by more than 2.2 times over the past decade. In 2013-14, the bottom-most quintile (or the bottom 20%) households had a share of 6.63% of total household income compared to 46.11% of the top-most quintile (or the richest) households.

Significantly, for the first time—as per my knowledge—we have witnessed a decline in the share of the income of the top 20% households. The bottom 20% households have increased their share of income by 1.5% and the balance has been distributed among the middle 60%. The ratio of household income of the top 20% vis-a-vis the bottom 20% has declined from 8.09 in 2004-05 to about 4.89 in 2013-14, indicating that income inequality is on path of decline, which is good news for us towards noticing trickle-down effects.

According to ICE 360° projections, if GDP grows at the rate of 7.4% (recent revision by RBI) in 2015-16 and 8% in 2020-21, the bottom-most quintiles will see marginal increase in their share of total income to 6.87% in 2015-16 and 7.62% in 2020-21. In terms of average per capita income, that translates into Rs 23,776 in 2013-14, Rs 26,033 in 2015-16 and Rs 37,797 in 2020-21. Consequently, as the share of income of the poorest households increases, the distribution of the increased income for the richest households will marginally decline from 38.6% (2013-14) to 37.3% (2015-16) and 36.8% (2020-21).

These shifts have positive implications on several levels of household well-being, but at the same time these will pose many challenges too. The need to address some of these issues can be evidenced from the multiple schemes that have been initiated by the government. Take the example of the Jan-Dhan Yojana, which reportedly led to the opening of more than 140 million bank accounts for the unbanked masses and was packaged along with the RuPay card, an accident insurance cover and overdraft facility of Rs 5,000. Clearly, this is a step in the direction towards the larger objective of financial inclusion of the poorest of the poor, but the challenge lies in actually turning these new bank account holders into active banking consumers.

Many a times, a target-driven tactical campaign is needed to achieve certain outcomes, but in order to achieve sustainable and measurable results in the long term, there has to be a process in place. Gathering information, tracking progress and achieving key outcomes are all necessary steps in the creation of an enabling and effective ecosystem. The government's plan to link deliveries of subsidies with Aadhaar cards and banks is a step in the right direction and is bound to have several pay-offs—tagging bank accounts of those who are deserving of subsidies would protect against leakages and also introduce a whole new generation of bottom-of-the-pyramid consumers to banking services.

As income levels go up, there are also greater opportunities to be harnessed. Lack of affordable healthcare services for the bottom-of-the-pyramid groups is a case in point. Even though we have made great strides in the eradication of polio and small pox, we seem incapable of being able to provide our rural populations with universal healthcare. Or even ensure that the network of primary health centres and public hospitals are able to provide an acceptable quality of healthcare services that are within accessible reach to all rural Indians. It is indeed major concern that only 6% of the smallest villages in India have access to primary health centres as against 60% of the largest villages. Again, only 11% small villages have a pharmacy or a chemist shop.

The push towards entrepreneurship via the government's Start-up India programme has great potential, particularly in terms of harnessing the power of the youth. In the absence of employment opportunities—and the pressing need to create 10 million new jobs every year to absorb those who are being added to the workforce—the programme can be effectively used to build an army of young entrepreneurs who generate sustainable employment for themselves and others.

Media reports indicate that many such enterprises have already taken off in the areas of rural transport, agro-based industries, health services, etc. Young urban entrepreneurs are designing products and services to meet the needs of rural consumers. More importantly, the Start-up India programme offers a great opportunity to develop rural entrepreneurship and provide new avenues of meeting aspirations of the youth who live in far-flung villages. Establishing linkages between skill upgrade, mentorship, incubation and credit support would enhance economic development at the grassroots level. Setting up of small enterprises in agro-based industries would re-energise the agriculture sector and also promote innovation, value-addition and inculcate the spirit of entrepreneurship among those who are dependent on agriculture for their daily bread. At the same time, it would boost consumption—given that India is a predominantly consumption-driven economy to which the middle-of-the-income-pyramid group is a major contributor—leading to a spurt in overall economic growth. For every percentage point of GDP growth, there will be a spike in demand for consumer goods and services, which, in turn, will boost investment, and the benefits of these will be felt across all sections of the income pyramid.

At the policy-making level, the emphasis needs to be on developing a roadmap and taking steps to build a sustainable ecosystem, rather than adopt a campaign-mode, target-driven approach that is big on numbers but fizzles out after the campaign is over. With the right approach, Start-up India could give our growth story a whole new development spin.

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