

India's Missing Middle: A big question?

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Today, India's growth and prosperity depend mainly on its ability to populate its missing middle—the medium-sized producers and the middle class of consumers. 'Can India Grow?'- A study by Carnegie provides empirical evidence over how the Indian economy lacks the middle in manufacturing and farm production and in consumption and market fragmentation. The greatest number of Indian businesses is in the form of small or micro enterprises many of which are in the informal sector and do not contribute to the tax base. Even agriculture in India is marked by tiny and decreasing farm sizes. The causes of these missing mid-sized industries can be government policies like the regulatory environment which hampers growth, India's large and poor population and poor HDI performance.

A mismatch between demand and supply for labour

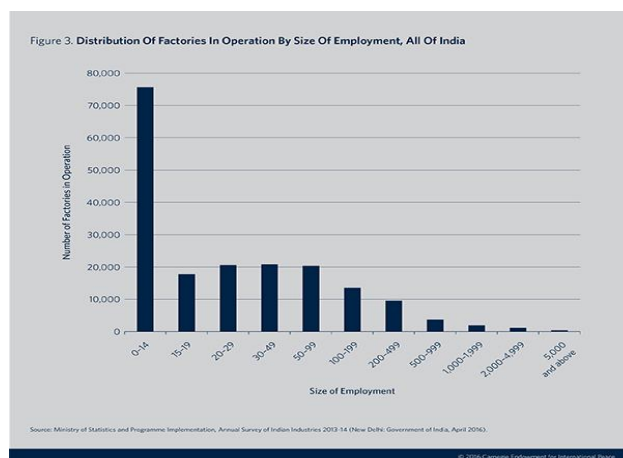
Lack of education, proper health care and low women participation in the workforce are three important factors which have led to a mismatch between demand for and supply of labour. The poor state of India's primary education system has been captured in several learning outcomes assessments including ASER Report. If this problem of a poor education system is not tackled soon, India's much-vaunted demographic dividend—an increase in economic productivity resulting from a shift in the population structure to more working-age adults with fewer dependents—could turn into a demographic disaster. Another important dimension of human resource development is affordable preventive and primary care.

Unfortunately, India's existing is characterized by dysfunctional primary care, deficient secondary care, overburdened tertiary care, a corrupt medical education system, and a largely unregulated private system.

India has a shockingly low female workforce participation rate. It was 24 percent in 2014 which is comparable to levels in the Middle East and North Africa, and just half that in Indonesia. A 2015 report from the McKinsey Global Institute showed that the female contribution to India's GDP, at 17 percent, is the lowest in the world.

Mid-sized manufacturing- alarming revelations

Historically, the mid-sized manufacturing units played a key role in the capitalist transformation and rapid expansion of economies like the US or Asian economies such as Japan, South Korea and Taiwan. They drive productivity growth through innovation and efficient resource allocation. They also create new jobs and sustain a strong pool of middle-class consumers. In contrast, India's manufacturing is marked by a limited number of large-sized firms and a multitude of small, household enterprises, with a gaping hole in the middle. According to the National Sample Surveys, about 50% of manufacturing jobs are in firms that employ less than 50 employees and a quarter is in firms with 500 or more workers. These small firms represent low-productivity, low-skilled manufacturing, which constrains the economy from growing faster, while the extremely large ones tend to lean on capital-intensive techniques and create fewer jobs.



The picture revealed by these figures is alarming. The number and proportion of small and micro-enterprises are staggeringly high whereas their contribution to output and employment is infinitely small. The capital and labour locked up in these unproductive enterprises represent lost economic opportunities.

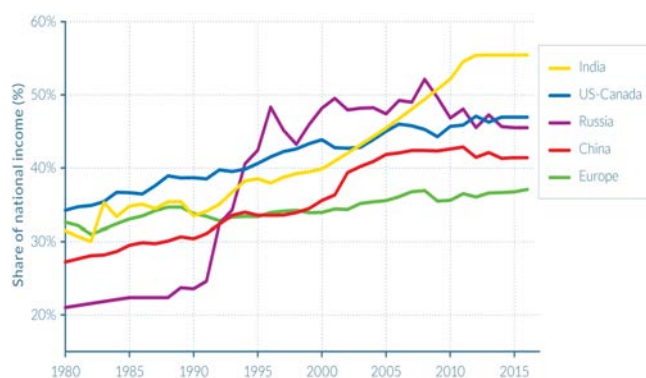
Thus, it is very important for India to address its missing agricultural and industrial middle if it is to avoid sudden stops and economic crises and to make headway in manufacturing and farming. Without these sectors, there will be lack of jobs. Millions of young people seeking entry into the workplace each year will remain unemployed. If the demographic bulge becomes a bulge of the underemployed and unemployed, it will have drastic implications for social stability and national security. Even the liberalization of the labour laws is only a partial answer to this problem and more aggressive solutions are needed.

A lacking middle class of consumers

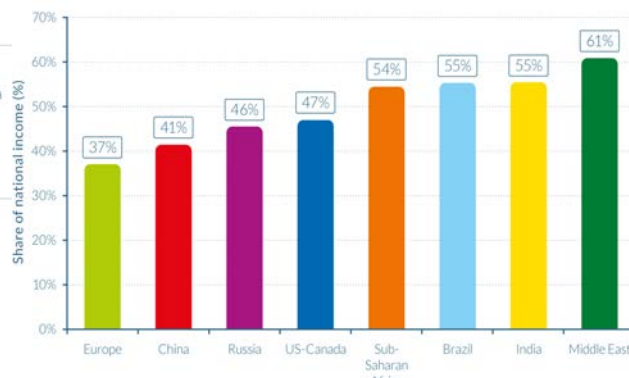
Without a middle class of producers, there cannot be a middle class of consumers. India's population show a great deal of variation with the top 1% of Indians making at least \$20,000 a year, which

equates to roughly Hong Kong in terms of population and average income. The next 9% is akin to central Europe, in the middle of the global wealth pack. The next 40% of India's population mirrors its South Asian poor neighbours, Bangladesh and Pakistan. The remaining half-billion is on a par with the poorest nations of Africa.

A recent study by Thomas Piketty has shown that the well-off in India are ten times richer now than in 1980 and those at the median have not even doubled their income. India has done a good job in getting those earning below \$2 to earn \$3 but it has not been able to help those earning \$3 to earn \$5 and \$10 and so on. According to the World Inequality Report 2018, Income inequality in India has reached historically high levels with the share of national income accruing to India's top 1 percent earners touching 22 percent in 2014 and the share of the top 10 percent around 56 percent. Inequality in India has risen substantially from the 1980s onwards, following profound changes in the economy due to the implementation of deregulation, liberalisation and opening-up reforms. The first graph below depicts top 10% income shares across the world from 1980 to 2016 and the second one depicts the same in 2016. They show rising inequalities everywhere but at different speeds.



Source: WID.world (2017). See wii2018.wid.world/methodology.html for data series and notes.
In 2016, 47% of national income was received by the top 10% in US-Canada, compared to 34% in 1980.



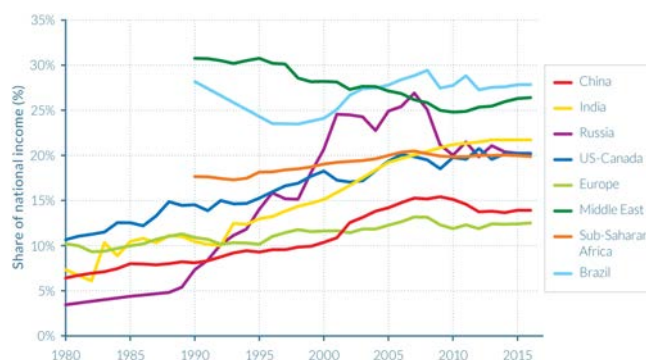
Source: WID.world (2017). See wii2018.wid.world/methodology.html for data series and notes.
In 2016, 37% of national income was received by the top 10% in Europe against 61% in the Middle-East.

“Since the beginning of deregulation policies in the 1980s, the top 0.1 percent earners have captured more growth than all of those in the bottom 50 percent combined, while the middle 40 percent have seen relatively little growth in their incomes. This rising inequality trend is in contrast to the 30 years that followed the country’s

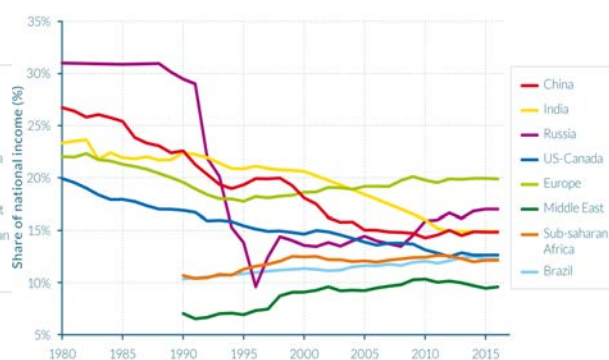
independence in 1947, when income inequality was widely reduced and the incomes of the bottom 50 percent grew at a faster rate than the national average”, said Lucas Chancel, Co-Director of the World Inequality Lab at the Paris School of Economics.

The graphs below show the top 1% and 50% income shares across the world from 1980 to 2016. India’s yellow line can be seen standing on

the graph with the share of top 1 percent continuously rising and that of the bottom 50 percent continuously falling.



Source: WID.world (2017). See wii2018.wid.world/methodology.html for data series and notes.
In 2016, 14% of national income was received by the Top 1% in China.



Source: WID.world (2017). See wii2018.wid.world/methodology.html for data series and notes.
In 2016, 12% of national income was received by the Bottom 50% in Sub-Saharan Africa.

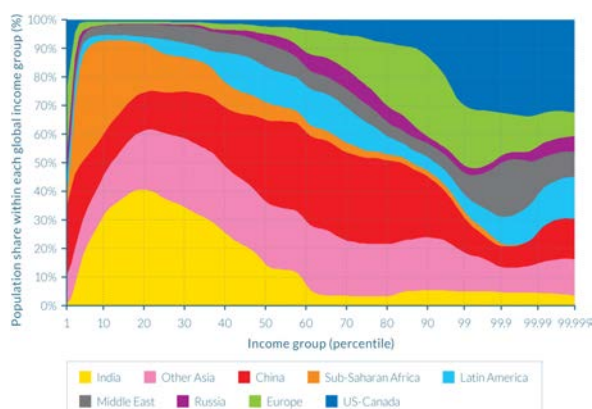
Top 1% income shares across the world

Bottom 50% income shares across the world

Comparing India with China

When we compare China and India, we observe that one of the major reasons as to why inequalities rose at a moderate level in China and extreme level in India is China’s investment in health, education, infrastructure for its bottom 50% population. In India, the structural changes to the economy along with changes in tax regulation appear to have had a significant impact on income inequality since the 1980s. In 1983, the share of national income accruing to top earners was the lowest. The top 1 percent captured approximately 6 percent of national income, the top 10 percent earned 30 percent of national income, and the

bottom 50 percent earned approximately 24 percent of national income and the middle 40 percent just over 46 percent. But by 1990, these shares had changed notably with the share of the top 10 percent growing approximately 4 percentage points to 34 percent from 1983, while the shares of the middle 40 percent and bottom 50 percent both fell by 2 percentage points to around 44 percent and 22 percent, respectively. The graph below shows the geographic breakdown of global income groups in 2016. As we look at the yellow and red portion depicting India and China, we can easily analyse the difference between two nations and a large data from various sources is available to support what we see here.



Even before the World Inequality Report, there have been various studies showing the lacking middle in India's consumer class. A 2014 report by *Mckinsey Global Institute* defined an empowerment line as the per capita minimum basic needs for a decent standard of living and showed that 56% of Indian population lacked the means to meet their basic needs and 90% could afford a per capita monthly consumption expenditure of INR 2800 per month. A *Pew Research Center* income survey found that in 2011, less than 3 percent of the total population, or 37 million people, had incomes above \$10 per day, or enough to be classified as middle class.

Comparing India and China, Data from *BMI Research* show that in 2014, per capita spending by those in the middle 60 percent of the income distribution in China was 5.5 times to that of India. In 2012 an estimated 192 million Chinese households had an annual income above \$10,000, a rough measure of the middle-class threshold, compared to just 24.5 million Indian households, and again, China had reached that figure well

before the turn of the millennium. *Credit Suisse's Global Wealth Databook* for 2015 found similar patterns. It found that India's middle class numbered just 24 million households which is less than one-fourth of China's 109 million. In addition, it found that 95.4 percent of Indians had wealth below \$10,000. The share of the population with higher incomes was essentially negligible.

The Wall Street Journal reports that the leading global food chains have started exiting Indian markets due to declining sales growth. Their entry was based on their expectations of India's decade-long high growth rates which in turn were based on a Chinese type massive middle-class model, which India could not provide them with. All these studies and cases hereby convey that it is high time that India focuses on its missing middle if it has to experience a booming economy and attract greater foreign investment in its country.

Sources

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