

GROWING INDIAN MIDDLE CLASS AND THEIR CONSUMPTION PATTERN

Aswathy R

Assistant Professor, Department of Economics, Sree Narayana College for Women, Kerala.

Abstract

The rise of the middle class is one of the most important developments of the modern world. Over the last few decades, rapid growth in emerging market economies have enabled millions of people to rise above poverty and enter the new global middle class. Middle class growth has a significant impact on consumption. With higher incomes, a feeling of being upwardly mobile, easy credit access, and consumption of goods and services which they could not previously afford, the middle class consumers play a very important role in economic growth. The new middle class in Asia is expected to grow by more than one billion people in the next decade. This will cause a shift in the centre of world consumption from the West. The liberalization of the India economy in 1991 has led to rapid economic growth during the past few decades. This growth has not only reduced poverty but also witnessed the emergence of a class of population called the “new middle class.” A study by the McKinsey Global Institute shows that if India continues to grow at the current pace, average household incomes will triple over the next two decades and it will become the world’s fifth largest consumer economy by 2025. This paper gives an overview of the growing middle class by presenting its global scenario, its impact, Indian scenario, their consumption pattern and measures to sustain their growth.

Key Words: Middle Class, Consumption Pattern, Income.

Introduction

The world over the rate of absolute poverty is declining. This decline has created a class of people called the “new middle class” in the developing countries. Most of the developing countries already have a middle class. The difference with the “new middle class” lies in its size. The hundreds of millions of people in Asia, Latin America and Africa whose incomes have increased over the last decade or so are called the “new middle classes” of the developing world. In the near future this “new class” and their consumption pattern will play an important role in the domestic as well as world economy owing to its huge size.

Defining Middle Class

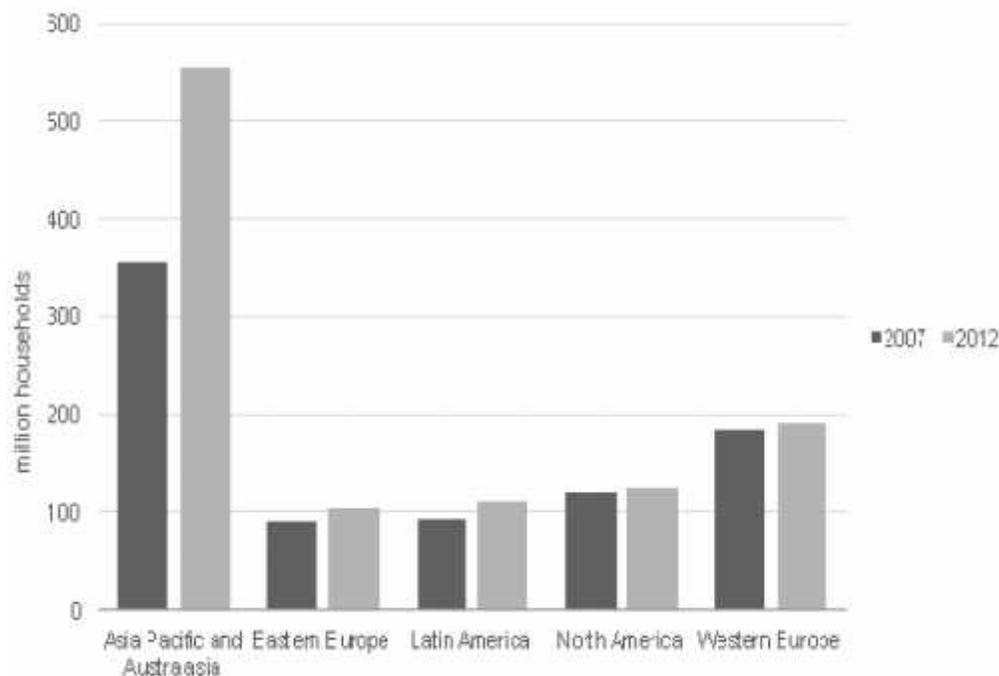
There is no clear definition of the middle class. Economists prefer to measure it in terms of income or consumption levels. The definition varies across the developed and developing countries. A few studies have tried to define the middle class. Birdsall et al., (2000) defined the middle class as those with incomes between 75 per cent and 125 per cent of the median in each country. Ravallion (2009) distinguished the “developing world’s middle class” from the “Western world middle class.” To define the former, he uses the median value of poverty lines for 70 national poverty lines as the lower bound (\$2 per person per day) and the US poverty line (\$13) as the upper bound. Bussolo, De Hoyos and Medvedev (2009) have defined the middle class as those with average daily incomes between the poverty lines of Brazil (\$10) and Italy (\$20). A \$ 10 per capita per day at (2005 PPP) minimum is suggested by Birdsall (2010) for being middle class in the present global economy. Taking an absolute approach Bhalla (2009) defines the middle class as those with annual incomes over \$3900 in purchasing power parity terms. According to Banerjee and Duflo (2008) the middle class in developing countries are those earning between \$2 and \$10 a day. Kharas (2010) and World Bank (2012) suggest \$10 per capita per day as minimum criteria for a person to be middle class. In India the NCAER defines the middle class as those whose annual household income lies in the income range of Rs 2,00,000 - Rs 10,00,000 (\$4000 - \$21,000). The majority of other studies such as the McKinsey and Company (2007) and Saxena (2010) have used the NCAER definition and data of the Indian middle class.

Growing Middle Class –Global Scenario

The world has witnessed the growth of the middle class since 1800. The growth of the middle class can be divided into three periods. First period is the 19th century which witnessed the Industrial Revolution. This led to the emergence of a huge middle class in Western Europe and the United States. The second period of the middle class growth took place after the Second World War. This growth again happened in Europe, North America and Japan. Third period of growth is the one which is taking place presently especially in the emerging markets particularly Asia.

The new middle class in Asia is expected to grow by more than one billion people in the next decade. This will cause a shift in the centre of world consumption from the West.. The global middle class is growing at a rapid pace due to rising disposable incomes in developing economies. By 2020, the global middle class is expected to rise to over 1.5 billion households having an annual disposable income over US\$10,000 in PPP terms up from 1.2 billion households in 2012. Between 2007 and 2012, the new middle class increased by 29.1% globally reaching 1.2 billion by the end of the period (Figure.1).

Figure 1: Households with Annual Disposable Income over US\$10,000 (PPP) in Selected Regions: 2007 and 2012



Source: Euromonitor International from National Statistics

Impact of Growing Middle Class

The rapidly growing new middle class will have profound impact on global food demand and security, affecting businesses, consumers and the global economy. These new consumers are also likely to bring about environmental problems owing to their size and changing consumption patterns. Most of the middle class in the West enjoy comfortable living standards, including decent jobs, health care and annual vacations. But this prosperity of the middle classes come at the cost of the environment due to increased consumption of natural resources and services. Changing consumption patterns of the new class of consumers will adversely affect the ecological sustainability owing to their huge size. Water scarcity can be a severe constraint to the expansion of food production in the coming years. According to the United Nations (UN), agriculture uses about 70.0% of all water withdrawals while industry and domestic activities take about 22.0% and 8.0% respectively. Reducing the environmental footprint of consumption must be a global concern. Improving the efficiency of agricultural production and providing incentives for encouraging “green” consumption is essential for effectively managing the growing consumer demand.

The rising purchasing power of the new middleclass is bringing about a shift in their food consumption patterns from basic staples to more varied food items. Consumer expenditure on food in developing economies rose by 4.6% annually in real terms over the 2007-2012, compared to the average global increase of 2.8% per year during the same period. In 2012, the global economy faced its second major food crisis. In the coming years as demand exceeds supply of food, the global economy will face the growing pressures of food security. Higher food prices due to food shortage will be one of the biggest challenges for most economies. The problem of food security will be further worsened by rapid urbanization and deforestation. In Asian economies, increasing urban populations will lead to pressure on governments to curb food price rises, thereby undermining incentives to increase food production.

Businesses, consumers and food importing economies are facing higher food prices resulting from shortage of food supplies. Many economies are implementing protective measures to ensure consistent domestic food supplies during weather related disasters and uncertainties in food stock. Food importers and exporters are also affected. Food importing economies of Africa and Asia witnessed major unrest after the global economic crisis of 2008-2009 due to rising food import bills which are ultimately borne by the consumers. On the export side, countries like USA, Brazil, Argentina and others are facing the problem of a trade-off between increasing cereal production and biofuel production. Poorer economies are most affected by the frequent rise in food prices as a huge proportion of their spending is on food.

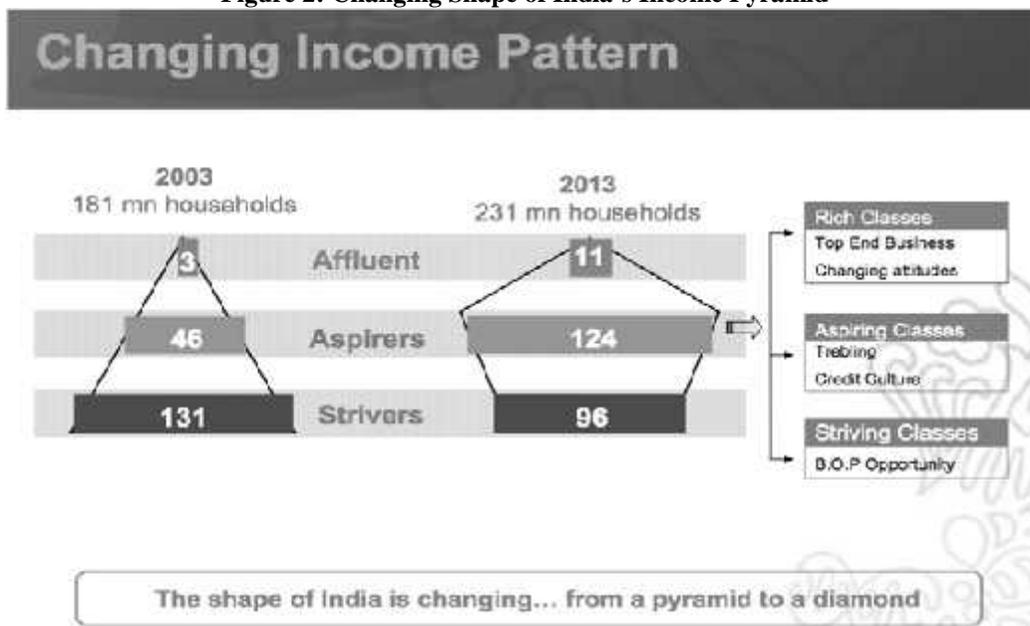
India’s Middle Class

The liberalization of the India economy in 1991 has led to rapid economic growth during the past few decades. This growth has not only reduced poverty but also witnessed the emergence of a class of population called the “new middle class.” The National Council for Applied Economic Research (NCAER) defines the middle class in terms of the “seekers” and “strivers”. “Seekers” are those with an annual household income between Rs2,00,000 and Rs5,00,000 while “strivers” are those whose annual household income is between Rs5,00,000 and Rs1 million at 2001/2002 prices. In 2015, the middle class is expected to represent 20% of the population holding 44% of the total income. The middle class population is predicted to reach 247 million by 2025. If we consider the standard international definitions of middle class, that is, consumption expenditure of more than \$10 per day, then India would have no middle class. The World Bank’s latest report on poverty in Latin American countries define the middle class in the \$10-\$50 range. By this definition India’s “middle class” would be in the top 10% of the country. Only a quarter of India’s 1.2 billion people are middle class according to the Asian Development Bank. India’s total household consumption is expected to multiply four times during the period between 2005 and 2025 according to McKinsey Global Institute. By its estimates India will be the world’s fifth largest consumer market consisting of a strong 583 million middle class by 2025. A typical Indian middle class household spends about 50% of the total income on daily expenses and saves the rest. India is perceived to be a consumer- driven economy and its growth trend is expected to continue for the next two decades providing ample opportunities for national and international companies to tap the demand generated by its growing middle class. Rising urbanization, a young population, higher incomes and the prospects for better lifestyles are some of the factors contributing to this growth process.

India’s gross domestic product (GDP) has grown at an average rate of 7.27 percent during the past decade (2000-2010) thus making it one of the fastest growing economies in the world. According to the Planning Commission estimates, the economy is projected to grow at the rate of 9-9.5 percent during the 12th Five Year Plan period (2012-2017). GDP growth has been accompanied by a rise in per capita income and the real household disposable income has more than doubled since 1985. Rising incomes have created a new middle class which is growing at an unprecedented rate with changing consumption patterns.

A study by the McKinsey Global Institute (2007)shows that if India continues to grow at the current pace, average household incomes will triple over the next two decades and it will become the world’s fifth largest consumer economy by 2025. India’s consumer market was broadly defined as a pyramid comprising of a very small affluent class at the top, a middle-class at the center and a huge economically disadvantaged class at the bottom. This pyramid structure of the Indian market is being replaced by a diamond consisting of a relatively large affluent class at the top, a huge middle class at the center and a small economically disadvantaged class at the lower end. The diamond structure shows the increasing volume and value across all classes of Indian consumer market (Figure.2).

Figure 2: Changing Shape of India’s Income Pyramid



Source: National Council of Agriculture and Economic Research

Middle Class and Changing Consumption Patterns

Growth of the middle class brings about a rise in purchasing power leading to change in consumption patterns. Studies show that as income increases, the amount of discretionary spending and variety of this discretionary spending increases. Studies also prove that as income increases, the proportion spent on necessities decreases. The amount of discretionary income (i.e. income available after taxes and essentials such as food and shelter are taken care of) for use at the disposal of the Indian middle class is very large and it will lead to more diversified consumption choices. This trend in consumption in India is evident in the national surveys conducted by NSSO which show that at the higher classes (12 is the highest class as categorised by mean per capita expenditures), the percentage of expenditure on food declines and the percentage of expenditure on non-food items increases. In India a large proportion of GDP is consumed. The share of consumption to total GDP is higher than that of investment. A study done by Mckinsey Global Institute predicts a change in consumption pattern in India by 2025 which will be dominated by the new middle class.

Table 1: Share of Average Household Consumption (% thousand, Indian Rupees, 2000)

Consumption	1995	2005E	2015F	2025F
Food, Beverages and Tobacco	56	42	34	25
Transportation	11	17	19	20
Housing and Utilities	14	12	12	10
Personal products and Services	4	8	9	11
Health care	4	7	9	13
Apparel	5	6	5	5
Education and Recreation	3	5	6	9
Household products	2	3	3	3
Communication	1	2	3	6

Source: "The 'Bird of Gold': The Rise of India's Consumer Market", McKinsey Global Institute, May 2007.

Note: Figures are rounded to the nearest integer and may not add up to 100 percent.

As Indian incomes rise, consumer spending patterns will also change significantly. A study undertaken by McKinsey Global Institute forecasts that Indian spending on discretionary items will grow dramatically, while spending on necessities will grow more slowly (Table.1). The largest categories of Indian spending today are food, beverages and tobacco followed by transportation and housing. By 2025 food and beverages will still be the biggest category, but its share will have declined from 34 per cent to 25 per cent. Second and third places will be taken up by transport and health respectively. Communications will emerge as one of the fastest expanding categories (Table 1).

Given the tremendous growth potential of the middle class population, an increasing number of products are being produced for this segment of the population. The growth of the middle class and economic growth of India are in a virtuous cycle. Rising incomes lead to more consumption, which in turn leads to higher economic growth leading to more employment opportunities and subsequently higher wages and the circle starts again. The middle class also demands better quality healthcare and education which will lead to more private expenditure on healthcare and education and thereby improvements in existing infrastructure. Their discretionary expenditure on recreation activities, leisure travel, and entertainment and luxury items will also increase. As income increases, the middle class will demand innovative and better quality products as they diversify their consumption of goods and services.

Ways to Sustain the Middle Class

In the future a substantial part of the Indian population will consists of the middle class and therefore they will play a major role in India's economic development. Therefore it is essential to sustain the growth of the middle class. The following measures are suggested by various studies.

- Control inflation particularly food inflation which affects the real disposable income adversely.
- Provide quality infrastructure and delivery services to satiate the changing tastes and preferences of the middle class.
- Getting rid of corruption and bribery through transparency and good governance.
- Promote research for understanding and analyzing their consumption pattern and thereby suggest suitable policy recommendations.

Conclusion

The growth of the middle class and their impact on consumption is indispensable for economic growth. The Indian middle class is growing at a fast pace bringing with it drastic changes in consumption pattern. Changing consumption pattern have

serious implications for economic growth. India was once considered as a country with a large number of poor people. But now it is recognized as one of the major sources of the growing middle class. The growth of the middle class over the next decades will bring about drastic changes in production as well as consumption patterns. Hence, suitable measures must be adopted to promote and sustain the growth of the middle class.

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