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POVERTY ROSE BUT INCOME INEQUALITY FELL

Relevant for: Indian Economy | Topic: Issues Related to Poverty, Inclusion, Employment & Sustainable Development

COVID-19 has upended Indian society. Over two-thirds of the country has been infected by COVID-19 and perhaps five million or so people have died, directly or indirectly, from the pandemic. The economy too has taken a beating. Even though there has been a V-shaped recovery, output remains about 10% lower than 2019.

In macroeconomic crises, including the oil shock of 1990-91 or the global liquidity crisis of 2007-08, many expect the poor to bear the brunt of the pain. They are the most vulnerable, without contractual protections and adequate safety nets. But there are signs that this pandemic has not followed that script.

Poverty certainly rose during the COVID-19 pandemic. We examined monthly data from nearly 2,00,000 households with a total of one million members from the Consumer Pyramids Household Survey through 2021.

We found that extreme poverty, defined by the World Bank as the percentage of the population with an income below $1.90, rose from 7.6% in November 2019 to 11.7% in July 2021.

However, income inequality actually fell. In 2019, the average monthly income of households in the top 25% and bottom 25% of the income distribution was approximately 45,000 and 8,000, respectively, in urban areas, and 22,500 and 7,500, respectively, in rural areas. While the average monthly income of the top quartile in urban areas fell almost 30%, to 32,500 by July 2021, the monthly income of the bottom quartile in July 2021 remained at pre-pandemic levels. In rural areas, the top quartile income fell by perhaps 20%, while the bottom quartile income grew slightly during the same period. The result is that inequality, measured as the percentage change in the income of the top quartile minus the income in the bottom quartile, fell by 15-20 percentage points. This is a robust finding: richer households saw larger drops in income all along the income scale, in rural and urban areas, within each State, and even within caste groups.

This remarkable finding is not unprecedented. Historians observed the same dynamic during the plague in 14th century Europe. Given how much the world economy has changed since then, however, the explanations for India’s experience will differ.

To learn why inequality fell during the pandemic, we examined three sources of household income: government transfers, business profits, and labour income. Government transfers are cash or in-kind payments. Profits may be from any business, be it a food cart, a farm, or a manufacturing plant. Labour income is wages earned from hourly work or employment contracts.

Government payments to the poor cannot explain the decline in inequality. To be sure, income support was not insubstantial. Households received roughly 400 per month in urban areas and nearly 500 per month in rural areas during the lockdown and the Delta wave. They received roughly half that much during the rest of the pandemic. However, even when government transfers were netted out from income, income inequality fell by over 20% points by July 2021.

Business profits play a bigger role than transfers. The rich saw a larger decline in business income and depended more on that income than the poor. While just 7% of a bottom quartile household’s income is from a business, nearly 15% of a top quartile’s household’s income is from a business. Unlike labour income, business income is volatile because it is susceptible to changes in demand, and thus to aggregate income. We find that business income of the top quartile is four times more sensitive to the aggregate performance of the economy than the business income of the bottom quartile. Given the large negative effect of COVID-19 on the economy, this suggests that some of the disproportionate losses of the rich operate through business income.

Labour income, however, plays a critical role (Table). Labour income is just over 65% and 80% of the income of the top 25% and bottom 25% of households. These are larger shares than those of government transfers or business profits. To explain the decline in labour income, we looked at supply-side and then demand-side explanations.

Looking at supply, one might suspect the rich chose to work less than the poor, perhaps out of fear of contracting COVID-19. That was also our conjecture, but it proved wrong. When the economy contracted, people lost jobs and income. They tried to compensate by finding alternate work, sometimes even in other occupations. While this seems a natural response for the bottom 25%, it was even more true for the top 25%. While the minimum amount that the poor were willing to accept to take a job fell roughly 40%, the minimum amount fell more than 45% for the rich.

The better explanation for the disproportionate loss of labour income among the top quartile households is that demand for their labour fell more. The rich tend to work in the service sector, and demand for services fell more than demand for other sectors. While 30% of workers in bottom quartile households work in the service sector, 45% of workers from the top quartile households do. During the pandemic, consumer spending on services fell by 30%-40%, far more than the decline in spending on manufacturing or agriculture.

The situation was reversed in manufacturing. That sector employs a larger share of bottom quartile workers than top quartile ones: 35% versus 15%. But manufacturing declined less than 20% during the pandemic. The progressive contraction of demand for services swamped the regressive contraction of demand for manufacturing.

To be clear, our analysis does not suggest that the pandemic was good for the Indian economy. The loss of life and rise in poverty make it one of the larger disasters the country has borne. The reduction in inequality would be a silver lining if it were accomplished by lowering poverty rather than reducing the income of the rich.

Nevertheless, by understanding the decline in inequality during the pandemic we can assess prospects for inequality after it ends. Once demand for services rises, along with aggregate income, both demand for the labour of the rich and the business income of that group will likely return. There is a risk that inequality will return to pre-pandemic levels.

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