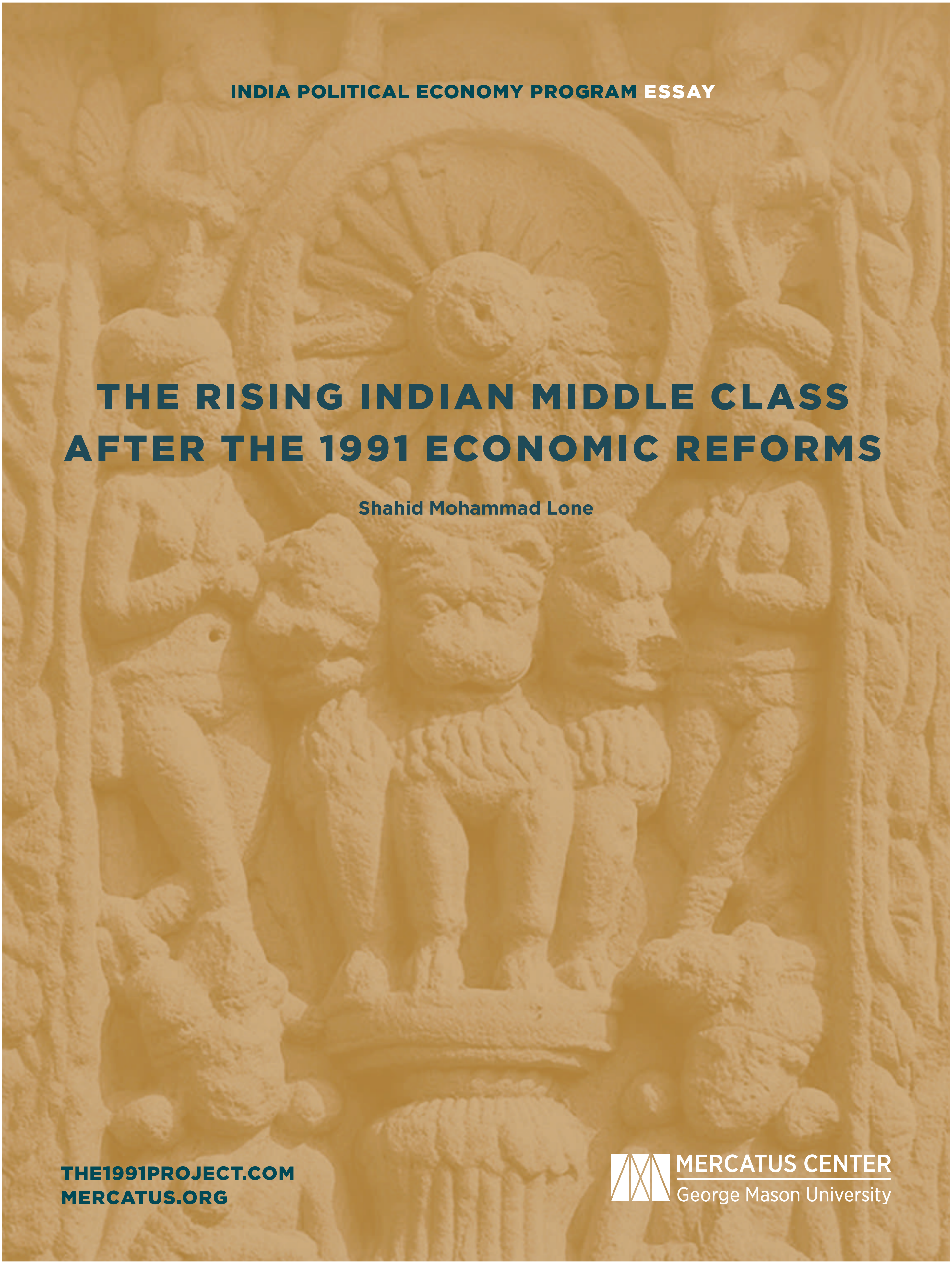

INDIA POLITICAL ECONOMY PROGRAM ESSAY

THE RISING INDIAN MIDDLE CLASS AFTER THE 1991 ECONOMIC REFORMS

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SUMMARY

This paper examines the evolution of the middle class in India, particularly focusing on the economic transformation resulting from the 1991 economic reforms. The 1991 reforms are credited with creating an ecosystem that fostered economic diversity and inclusion, laying the foundation for India's ongoing economic development and the expansion of its middle class. This essay utilizes an income-based classification to define the middle class. Analyzing national sample survey consumption rounds and World Bank indicators, the study traces the changes in income, expenditure, literacy, urbanization, migration, poverty, and unemployment among the Indian middle class from 1987 to 2012.

Keywords: India, political economy, economic reforms, middle class, human capital

JEL codes: B29; J11; O15; O53; P11

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On the cover: Pillar of Ashoka (detail) at Sanchi, Madhya Pradesh, India. The pillars of the emperor Ashoka the Great (268–232 B.C.), renowned for their polished sandstone and intricate carvings, were dispersed throughout the Indian subcontinent and carried imperial edicts promoting moral and ethical conduct. The Lion Capital of Ashoka, which tops the pillar at Sarnath, Uttar Pradesh, has been adopted as India's national emblem. Twenty of the pillars of Ashoka still survive.

The 1960s and 1970s were decades of middle-class booms in low-income developing countries (LIDC), particularly in Asia, both in terms of GDP and purchasing power parity.[1] But what specifically characterizes the middle class? In literature, the middle class has no distinct, universal definition. It is subjectively and narrowly defined by each scholar. From using median income to cultural affinities and education to consumption, scholars have defined and analyzed the middle class in myriad ways and yet have shied away from compartmentalizing it. In the absence of set parameters, economists Anthony Atkinson and Andrea Brandolini argue that though it might yield contradictory results, every framework holds true in its given setting.[2] In the same vein, this article makes use of income-based classification in the Indian context and determines the middle class according to the baseline set by the National Council of Applied Economic Research and People Research on India's Consumer Economy,[3] whose annual median income ranges between Rs 500,000 and Rs 3,000,000 (table 1). Once the median income target group has been determined, this article then uses national sample survey consumption rounds 43 (years 1987–88), 51 (1993–94), and 61 (2011–12) (consumer expenditure surveys that are conducted by the union, or central, government every five years to assess the state of household consumption spending patterns in the economy) and World Bank macro indicators to ascertain the comparable time-series trends in relation to various parameters such as per capita income and expenditure, literacy, urbanization, migration, poverty, and unemployment

1. Homi Kharas, "The Unprecedented Expansion of the Global Middle Class: An Update" (Global Economy and Development Working Paper 100, Brookings Institution, Washington, DC, 2017).
2. Anthony Atkinson and Andrea Brandolini, "On the Identification of the 'Middle Class'" (ECINEQ Working Paper 2011-27, Society for the Study of Income Equality, Rome, September 2011).
3. For detailed information and a disaggregated analysis on the Indian middle class, see National Council of Applied Economic Research and Business Standard, *The Great Indian Middle Class: Results from the NCAER Market Information Survey of Households* (New Delhi: National Council of Applied Economic Research, 2004).

within this middle class. At just under 50 million in 1990, India's middle class had not grown compared with its global counterparts in developing countries.[4] For a middle class to emerge and expand, there needs to be a marked improvement in primary barometers such as income, expenditures, education,[5] and employment. To explain the increase, this article traces the trajectory of change that occurred in these crucial areas by virtue of new economic reforms that opened new avenues of employment, access to credit, capital generation, and social mobility.[6]

After Prime Minister Indira Gandhi declared a state of emergency in 1975, the Indian economy was in crisis and in dire need of fiscal structural revamping. Manmohan Singh, who was India's foremost economist at the time and was serving in the Department of Economic Affairs, had floated the idea of privatizing the economy to then–Prime Minister Morarji Desai, but he was met with resistance from the ministry.[7] Push came to shove in 1991, when Singh himself was the finance minister and delivered the budget speech that set out the economic reforms that were to change Indian economic landscape drastically. The reforms ended license raj, a protectionist system under which licenses had to be obtained from the government to do business. License raj heavily affected Indian exports and imports from 1947 to1990. The reforms encouraged private enterprise in all areas and resulted in significant public-private partnership in India's growth and development. For the first time in public policy discourse in India, the public was situated at the center of policy making and became the actual beneficiaries of policy. Of course, this is not to say that the problems of bureaucratic red tape and corruption had been resolved.[8] Nonetheless, great strides were made toward building the middle class.

THE EXPLODING MIDDLE CLASS

India's new economic reforms, also referred as first-generation reforms, delivered significantly on two objectives, namely, reduction in poverty and sustain-

4. Rakesh Kochar, *A Global Middle Class Is More Promise Than Reality* (Washington, DC: Pew Research Center, 2015).
5. In the absence of data on education, I have used literacy as proxy for education, the shift for which is given in the figure 8.
6. Peter Stearns, *Consumerism in World History: The Global Transformation of Desire*, 2nd ed., (New York: Routledge, 2006).
7. A. K. Bhattacharya, *India's Finance Ministers: From Independence to Emergency (1947–1977)*, (New York: Penguin, 2023).
8. Dawid Danilo Bartelt and Axel Harneit-Sievers, *The New Middle Class in India and Brazil: Green Perspectives?* (New Delhi: Academic Foundation, 2017).

able economic growth. Millions were lifted out of poverty and moved up the income ladder, and two decades of phenomenal growth led to the emergence of the largest middle-class population in the world (figure 6). The Indian middle class, at present, is now estimated to comprise more than 300 million people, with some estimates even suggesting a figure of 500 million.[9] This growth is attributed to the structural economic reforms of 1991, also known as new economic policy, which liberalized and opened up the Indian economy, one that had previously been heavily regulated and protected under an apparent socialist economic regime.[10] Prior to the 1991 reforms, the middle class, consisting primarily of government employees, professionals, and businesspeople, was relatively small and concentrated in urban areas. India's small middle class was due to several factors, including lack of educational opportunities, limited access to credit, and the dominance of traditional social structures that limited social mobility.[11] The structural transformation of the economy allowed people to access opportunities in sectors such as education, healthcare, manufacturing, and services for upward mobility.[12] The increased per capita income and expenditure, the dramatically increased access to consumer goods, the growth and subsequent boom in the information technology sector, the increased access to credit, and the emergence of public-private partnerships led to a remarkably diverse Indian middle class, which continues to shape the country's economy and society.[13]

DISSECTING THE DATA

Monthly middle-class household expenditures increased from Rs 177.49 in 1987 to Rs 1599.03 in 2012 an almost 13-fold increase (figures 1 and 2). For the same period, average annual household savings as a share of income increased by at least 15 percentage points. This amount includes expenditure on all essential and

9. Data are for 2016 and from the National Council of Applied Economic Research, which has since its inception been conducting high-frequency research on the middle class in India. All of its in-depth reports are publicly available.
10. Shruti Rajagopalan, "The 1991 Reforms and the Quest for Economic Freedom in India," *Capitalism and Society* 15, no. 1 (2021): 1–26.
11. Ashok K. Lahiri, "The Middle Class and Economic Reforms," *Economic and Political Weekly* 49, no. 11 (2014): 37–44
12. Reshad N. Ahsan and Devashish Mitra, "Can the Whole Actually Be Greater Than the Sum of Its Parts? Lessons from India's Growing Economy and Its Evolving Structure," in *Structural Change, Fundamentals, and Growth: A Framework and Case Studies*, ed. Margaret McMillan, Dani Rodrik, and Claudia Sepulveda, 39–80 (Washington, DC: International Food Policy Research Institute, 2016).
13. Abhijit Roy, "Middle Class in India: From 1947 to the Present and Beyond," *Education about Asia* 23, no.1 (2018): 32–37.

fast-moving consumer goods, but the majority of spending was concentrated in food, education, and clothing, which is why we see a sharp uptick in real total per capita expenditure in both rural and urban India for the period under review (figure 5). Similarly, the income pyramid has also changed rapidly. The decade that followed reforms saw nearly a 20 percent decrease in the number of people in the aspirer's category, reflecting an increase in the aspirers' income profile and entry into the middle-class category. There has been a shift in the deprived category as well, with more than 39 percent moving into the aspirer's category. Within the middle class itself, the increase has also been exponential. There has been nearly a 300 percent increase in GDP per capita for the period under review (figure 3& 4), an indication that many people have moved above the poverty line. Those who moved to the rich category have also witnessed a substantial increase. Within the rural-urban divide, the overall impact is substantial. The aspirers, middle and rich class has annually grown by at least 8, 13 and 21 percent respectively (table 1). The percentage of deprived and aspirer households in rural India have witnessed a sharp increase explaining the rising inequality in rural India due to host of factors while urban India has seen a sharp decrease for the same categories (figure 9). The same economic class structures were absent from the postindependence economy. Only two classes existed: rich and poor. Before the reforms, the middle class was negligible if not nonexistent. Following the reforms, domestic savings went up to 29 percent of GDP, which enabled greater domestic investment, mainly as a result of fiscal consolidation around public sector savings.

The 1991 economic reforms resulted in the liberalization of trade barriers, incentives for private investment, and integration of the stock market with the global market.[14] A spectrum of choices and opportunities opened rapidly for a middle class that had been ignored in policy reforms and therefore lacked access to public goods. Structural transformation is deemed successful only if it can be sustained for a long period and ensures that people participate in economic activities via optimum utilization of resources. Embedded in this spectrum is the rise of the Indian middle class. Albeit understudied in mainstream literature, the license raj system is extremely important for a mixed economy such as India and helps us grasp the importance of the historical rise in India's GDP per capita, its consumption and employment diversification, and the significant increase in the country's literacy rate. For instance, the middle-class consumer car segment exponentially shot up by 300 percent—that is, from 3 models available in 1990 to

14. Rajagopalan, "The 1991 Reforms."

at least 30 models after three decades of reforms.[15] Second, employment in the information and telecommunication sector rose from a few thousand to more than 15 million for the year ending 2012. Those who moved up the ladder from aspirers to the middle class added to the total monthly per capita expenditure, as shown in figure 1. The average per capita household expenditure in 2010 constant prices when analyzed in conjunction with the GDP per capita shows a radical shift in both expenditure and income (figures 2 and 3). In addition, this led to an increase in children's education (figure 8), particularly female education. At the time of the reforms, it stood at a meager 39 percent, and for the year ending 2018, it reached more than 74 percent, and overall literacy increased from 13 to 26 percent from 1991 to 2016 (figure 8).

The information technology sector, which barely had any presence in the Indian economy, produced massive employment opportunities when a telecom policy was implemented in 1994. The policy introduced telecom tribunals and regulatory mechanisms, which played a crucial role in attracting foreign investment in value-added services and transforming the sector from a monopoly to one allowing open competition. For a regime-switching approach, one of the leading high-frequency indicators of economic relief is the employment opportunities created by the new regime's policies. A study by McKinsey & Company concluded that the sector contributed 1.2 percent to GDP.[16] Employment in information technology includes the employment generated in the public sector by virtue of using technology in all the sectors of any economy. The growth in the information technology sector is part of a trend of nonagricultural work replacing agricultural employment. In 1994, the labor force contained 381 million people, which rose by 104 million by the end of 2012, averaging a 5.5 million increase per year.[17] The national statistical survey data also show that employment elasticity of output (an economy's ability to generate employment opportunities for its population as a percentage of its growth) shot up from 0.27, 0.74, and 0.35, respectively, in 1994 in the manufacturing, nonmanufacturing, and service sectors to 1.35, 1.07, and 0.55, respectively, for the year ending 2012 (figure 7). The shift is attributed to the use of technology in agriculture and the increase in the literacy rate because of policies such as universal elementary education,

15. For a detailed discussion, see World Economic Forum, "Future of Consumption in Fast-Growth Consumer Markets: India" (Insight Report, World Economic Forum, Geneva, 2018).
16. Jonathan Woetzel, Anu Madgavkar, and Shishir Gupta, "A New Emphasis on Gainful Employment in India" (Discussion Paper, McKinsey & Company, June 2017).
17. Nomaan Majid, "Structural Change and Employment in India" (ILO Working Paper 1, International Labour Office, Geneva, 2019).

the right to education, and so on.[18] When Indian information technology started competing at global standards, it meant a healthy work-life balance and global pay scales as well, which played a significant role in cauterizing the brain drain and decreasing emigration (figure 10). In 1990, 0.86 percent of the population left India for employment opportunities outside the country; that number dropped sharply to 0.4 percent by the end of 2014.

The Reserve Bank of India's monetary policy played a crucial role in this shift, particularly with its approach to facilitating the credit base in the economy. In doing so, it allowed and ensured an ease of doing business for new companies that entered the market on the back of economic liberalization and restored consumer confidence in the market. Because of the constant shift occurring within economic classes owing to the population's higher income, the default risk decreased, and banks began lending to a large number of people whose access to credit markets was previously restricted. Indeed, few of the biggest incidents of stock market fraud that took place in the 20 years following the reforms could have occurred had the population's disposable income not improved so significantly, since it was that additional income that enabled people to invest in Ponzi schemes and chit funds. This period of financial integration of the capital market was carefully designed. Both from the regulatory perspective and the consumer participation perspective, it specifically allowed for the middle-class base to grow and to harness the benefits of competitive investing.[19] The effect of the reforms can particularly be seen for women. The national family health survey rounds observed that 78 percent of women have become part of the banking population, reaping benefits through various government programs. Women's participation in the labor force has played an essential role, with an almost 30 percent increase in the first two decades following the reforms. Increased labor force participation by women has led to a decrease in the total fertility rate, an economic indicator for measuring the standard of living and a proxy for economic mobility.[20] Women's employment rose by 14 million from 1990, mostly in rural India, for the period ending 2010.

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18. Santosh Mehrotra et al., "Explaining Employment Trends in the Indian Economy: 1993–94 to 2011–12, *Economic and Political Weekly* 49, no. 32 (2014): 49–57.
19. For a detailed discussion of how retail consumers benefited from financial integration of the capital market, particularly after the Basel Accords set up benchmarks, see, Janak Raj and Sarat Dhal, "Integration of India's Stock Market with Global and Major Regional Markets" (BIS Working Paper 42, Bank for International Settlements, Basel, Switzerland, 2007).
20. For a detailed sectoral and spatial employment diversity spread, see an in-depth analysis of National Sample Survey Office unit-level data in Mehrotra et al., "Explaining Employment Trends in the Indian Economy."

We can see with the benefit of hindsight that the historical trajectory of the rise in middle-class growth parameters has come to define India's consumption–production spectrum—that is, how much is invested back into the economy from domestic savings (often measured in relation to aggregate demand) and what and how much needs to be produced (often measured in relation to the factor market). After the reforms, when the private sector started to emerge in India, two immediate benefits arose for what would later be classified as middle class—namely, disposable income and upward mobility. Both are essential components that help determine overall GDP, but prior to the reforms, both were absent. With the benefit of hindsight, one can see that they were essential to India's attaining and sustaining 6 to 8 percent GDP growth until 2010.[21] In 1990, only 2.5 million people had an annual disposable income of $10,000 or more; by 2015, this number had sharply risen to 55 million people. This increase in disposable income led to three things: first, demand in the economy was created and sustained; second, middle-class consumption levels rose; and finally, the increase in per capita expenditure allowed the government to ensure stability in public goods, which is to say it gave government the much-needed green shoots to launch social welfare programs and increase public expenditure in healthcare, education, poverty reduction, financial inclusion, and infrastructure—areas that mattered for economic development and were alluded to in the budget speech Manmohan Singh gave in 1991.[22]

TAILPIECE

Income is not the only measure of economic well-being, as argued by Nobel laureates Amartya Sen and Angus Deaton.[23] But income remains an essential component in measuring how the middle class has progressed over time. Income, or consumption, also serves as a measure for reform outcomes. The increase in the middle class's disposable income resulting from the new economic reforms gave the Indian government enough space to cut public expenditure, to gradually initiate the process of eliminating subsidized public goods, and to focus instead

21. S. Chandrashekhar and Ajay Sharma, "On the Spatial Concentration of Employment in India," *Economic and Political Weekly* 49, no. 21 (2014): 16–18.
22. Prachi Srivastava, Claire Noronha, and Shailaja Fennell, "Private Sector Research Study: Sarva Shiksha Abhiyan." Report submitted to DFID India. DFID-UK Aid (2013).
23. See, for example, Angus Deaton, "Income, Health, and Well-Being around the World: Evidence from the Gallup World Poll," *Journal of Economic Perspectives* 22, no. 2 (2008): 53–72.

on economic activities. An environment more conducive to business was created through better policies, such as interest rate deregulation, tax reform, securities market development, and higher education reforms. The increased private investment stemming from the liberal market structure not only allowed India to thwart an impending balance of payment crisis but also vindicated the country's growth and development trajectory envisaged in the new economic reforms.

Over three decades, the sectoral (employment) gross value addition resulting from liberalizing the economy led to a staggering increase in the labor force participation rate, particularly labor performed by women. An economy that saw people primarily engaged in agriculture prior to the reforms has witnessed a drastic shift toward the services and manufacturing sectors in which most employment is now concentrated (figure 7).[24] That shift has generally been associated with a tremendous increase in education and literacy that arose via the 1991 reforms. The changing nature of the global economy, from agriculture to technology, had two distinguishing features: more people were eligible to join the workforce and the skill development of this workforce rose significantly. India had the advantage of its demographic dividend, but it was just waiting for the right set of policy tools to make the switch to the idea Singh's budget speech envisioned. An enormous shift after the reforms has occurred toward employment in industry, manufacturing, and services and away from employment in the agricultural sector. For instance, the massive infrastructure development, both public and private, that started after the reforms because of the liberal macroprudential regulations opened avenues of employment for both skilled and unskilled workers. Moreover, the labor-intensive service sector also experienced a boom, with fresh graduates from premier educational institutions setting up a new service sector that would come to employ a staggering number of people. Around the turn of the century, major multinational corporations took advantage of India's cheap labor and established business-process outsourcing in India, a trend that boomed for more than a decade. All this was possible because of the availability of employable people in search of diverse employment opportunities.

The reforms were fundamentally geared to meet two objectives: reduction in poverty and sustainable economic growth. Millions were lifted out of poverty and moved up the income ladder to form what is now the majority of

24. Jayan Jose Thomas, "The Demographic Challenge and Employment Growth in India," *Economic Political Weekly* 49, no. 6 (2014): 15–17.

the middle class. Of course, governments always operate within the scarcity of resources, which makes optimization of constraints fundamental to any economic policy. This optimization is always meant to meet twin objectives of controlling inflation and ensuring growth. Both have an immense effect on the decision-making of the middle class. After the economy was rapidly opened up to private investment, monetary policy got a handle on the repo rate—the interest rate at which the central bank lends money to financial institutions and commercial banks—to ensure unhindered credit facilities to the middle class. The middle class, in turn, developed an appetite for wealth generation and kept demand at par with the economy's output. The effect of such structural adjustments and the new outlook toward the economy was apparent in the increase in per capita GDP and per capita expenditure of the new middle class.[25] For any country to achieve economic growth, its policies must be reformed to adapt to the changing nature of the market—that is, its policies must allow the country to move from low-productive to high-productive sectors.[26] With the 1991 economic reforms, the Indian middle class emerged and has since been contributing to the growth of a more affluent and aspirational society. In fact, a report by Google and Bain & Company on the entrepreneurial ecosystem of India observes that women-led entrepreneurial ventures will create at least 200 million jobs by 2030.[27] It was the 1991 policy that led to the creation of an ecosystem that contained diversity, equity, and inclusion for the long-term development of India.[28] The reforms that enabled inclusive growth, supported by declining numbers of people living in absolute poverty; that reduced agricultural employment; and that increased real wages and fostered the subsequent rising standards of living across rural and urban India have all contributed to the ever-rising Indian middle class.

25. Xinshen Diao, Margaret McMillan, and Dani Rodrik, "The Recent Growth Boom in Developing Economies: A Structural Change Perspective" (NBER Working Paper 23132, National Bureau of Economic Research, Cambridge, MA, 2017).
26. Arvind Rajagopal, "The Emergency as Prehistory of the New Indian Middle Class," *Modern Asian Studies* 45, no. 5 (2011): 1003–49.
27. Megha Chawla, Sri Rajan, and Prapti Sahni, "Powering the Economy with Her: Women Entrepreneurship in India," Google and Bain & Company, February 18, 2020.
28. Ajay Mahal, Vivek Srivastava, and Deepak Sanan, "Decentralization and Public Sector Delivery of Health and Education Services: The Indian Experience," ZEF–Discussion Paper on Development Policy 20, Center for Development Research, University of Bonn, 2000).

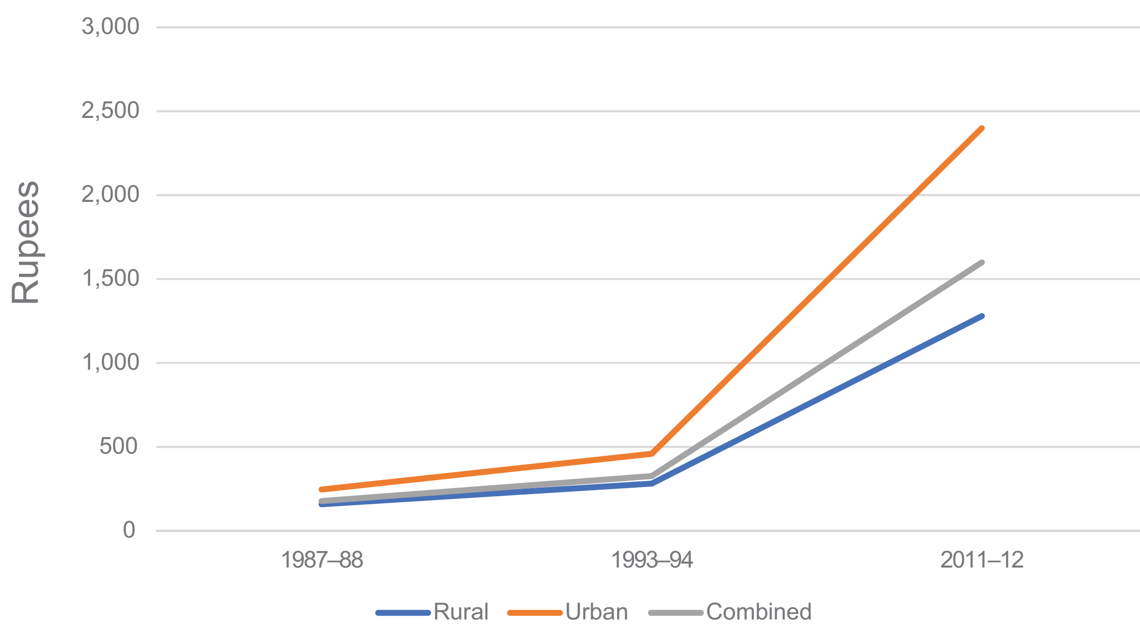
TABLE 1. HOUSEHOLD INCOME CLASSIFICATION

Consumer Class by Annual Household Income (Rps)	Number of Households (millions)		Share of Households (%)		Rural (%)		Annual Growth (%)
	2001–02	2009–10	2001–02	2009–10	2001–02	2009–10	
<90,000	135.4	114.4	71.9	51.5	81.8	84.2	−2.1
90,000–500,000	41.3	75.3	21.9	33.9	48.5	61.2	7.8
500,000–3,000,000	10.7	28.4	5.7	12.8	35.2	33.4	12.9
>3,000,000	0.8	3.8	0.4	1.7	22.9	22.2	21.4
Total	188.2	221.9	100.0	100.0	71.6	68.8	2.1

Source: Market Information Survey of Households, National Council for Applied Economics Research CAER, 2004.

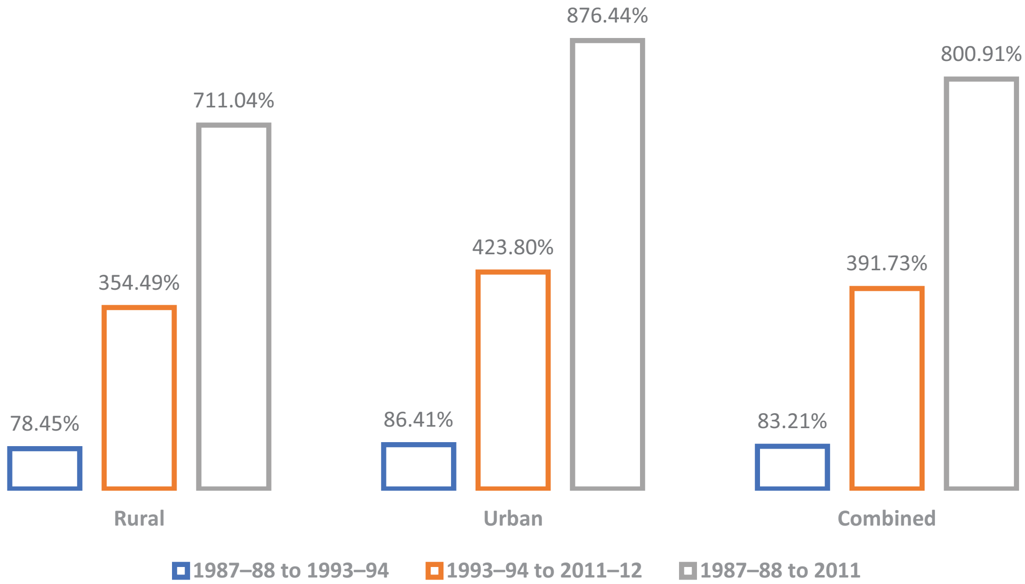
Note: Annual household income is divided into four groups. Those with less than Rps 90,000 are classified as *deprived*. Those with between Rps 90,000 and Rps 500,000 are classified *aspirers*. Those with between Rps 500,000 and Rps 3 million are classified as *middle class*. Those with more than Rps 3 million are classified as *rich*.

FIGURE 1. MONTHLY PER CAPITA EXPENDITURE TRENDS, 1987–88, 1993–94, AND 2011–12



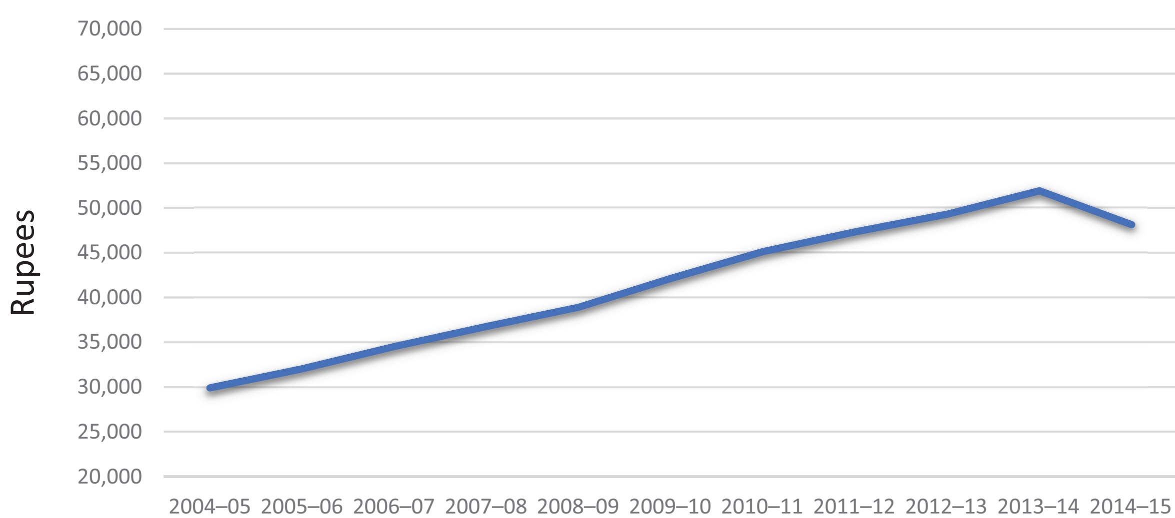
Source: Author's compilation from National Sample Survey Consumption rounds 43 (1987–88), 51 (1993–94), and 61 (2011–12).

FIGURE 2. PERCENTAGE OF CHANGE IN MONTHLY PER CAPITA EXPENDITURE OVER YEARS, 1987–88 TO 2011–12



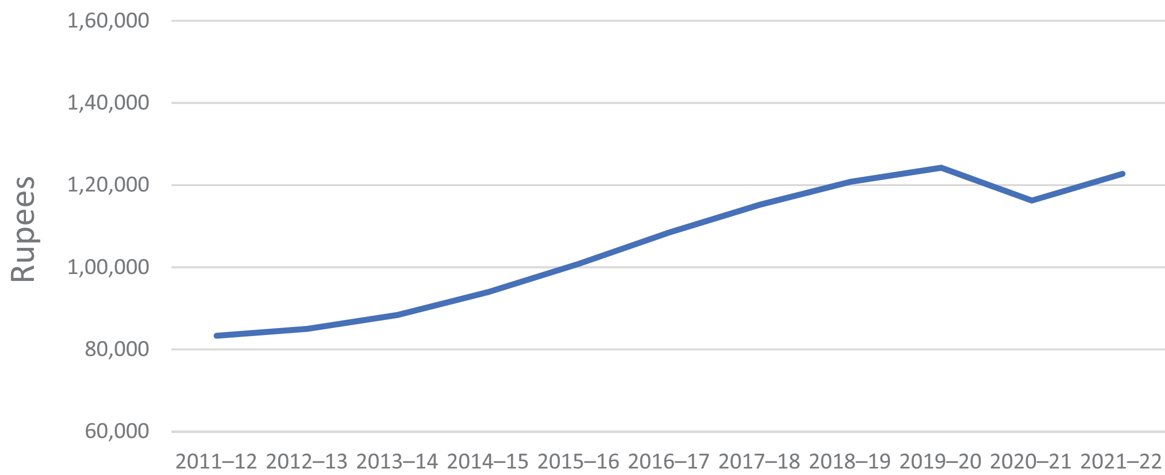
Source: Authors compilation from National Sample Survey Consumption rounds 43 (1987–88), 51 (1993–94), and 61 (2011–12).

FIGURE 3. REAL GDP PER CAPITA, BASE YEAR 2004–05



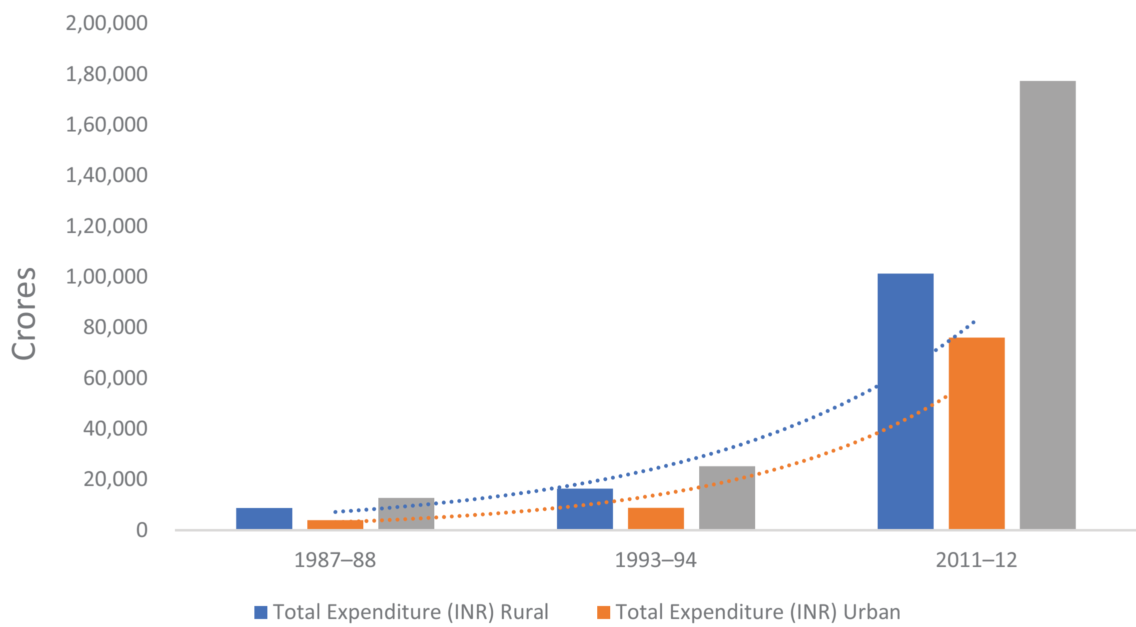
Source: Author's compilation from National Sample Survey Consumption round 51.

FIGURE 4. REAL GDP PER CAPITA, BASE YEAR 2011–12



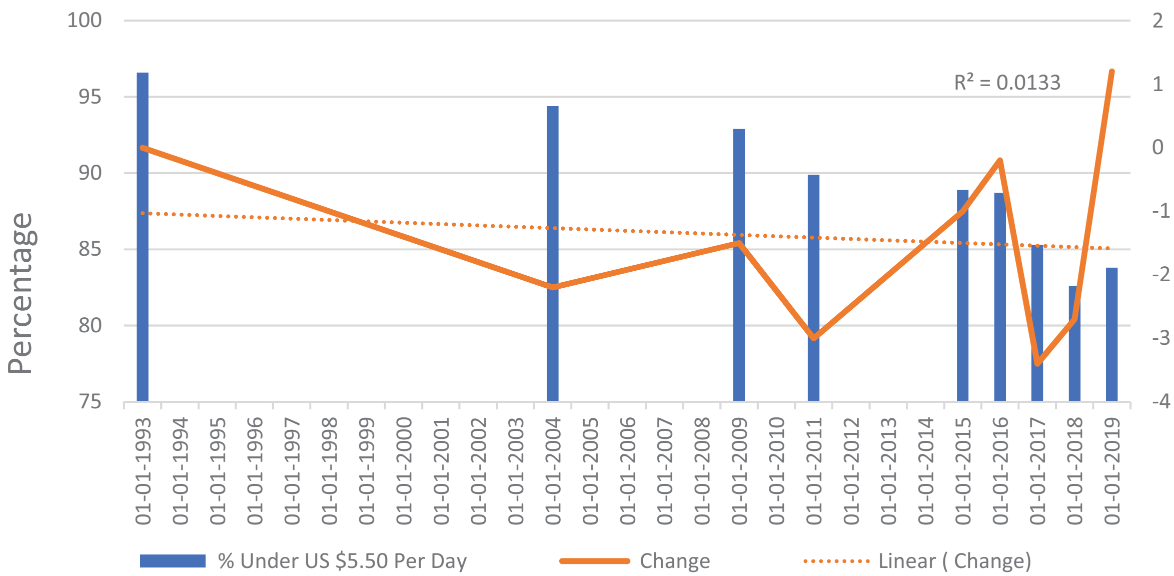
Source. Authors compilation from National Sample Survey Consumption round 61.

FIGURE 5. REAL TOTAL PER CAPITA EXPENDITURE, 1987–88 TO 2011–12



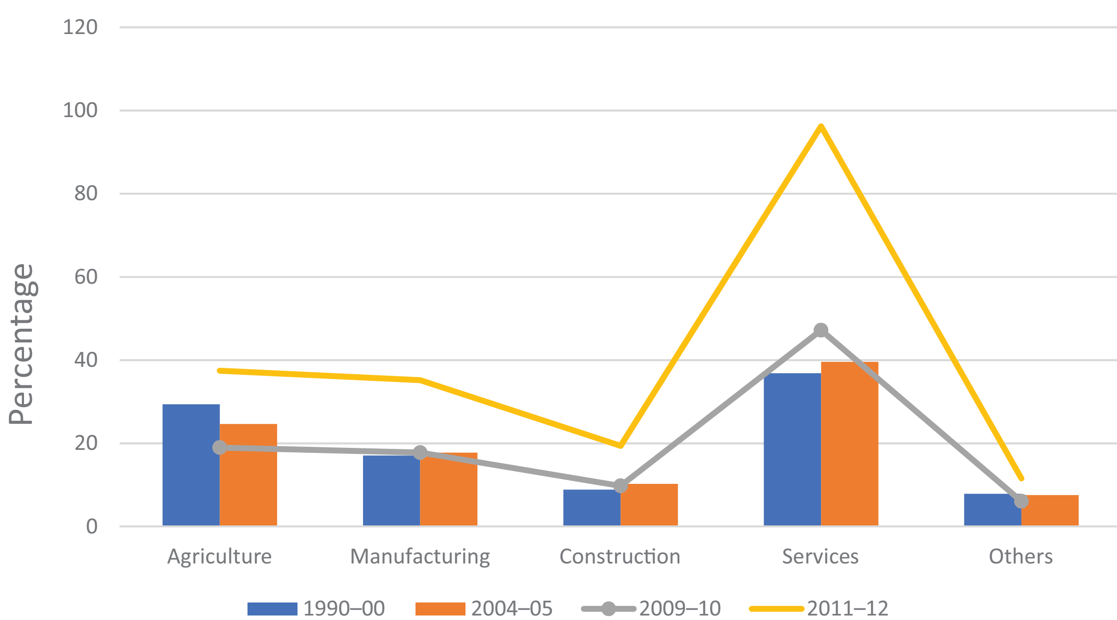
Source: Authors compilation from National Sample Survey Consumption rounds 43,51, and 61.
Note: 1 crore = 10 million rupees.

FIGURE 6. POVERTY TREND, 1993–2019



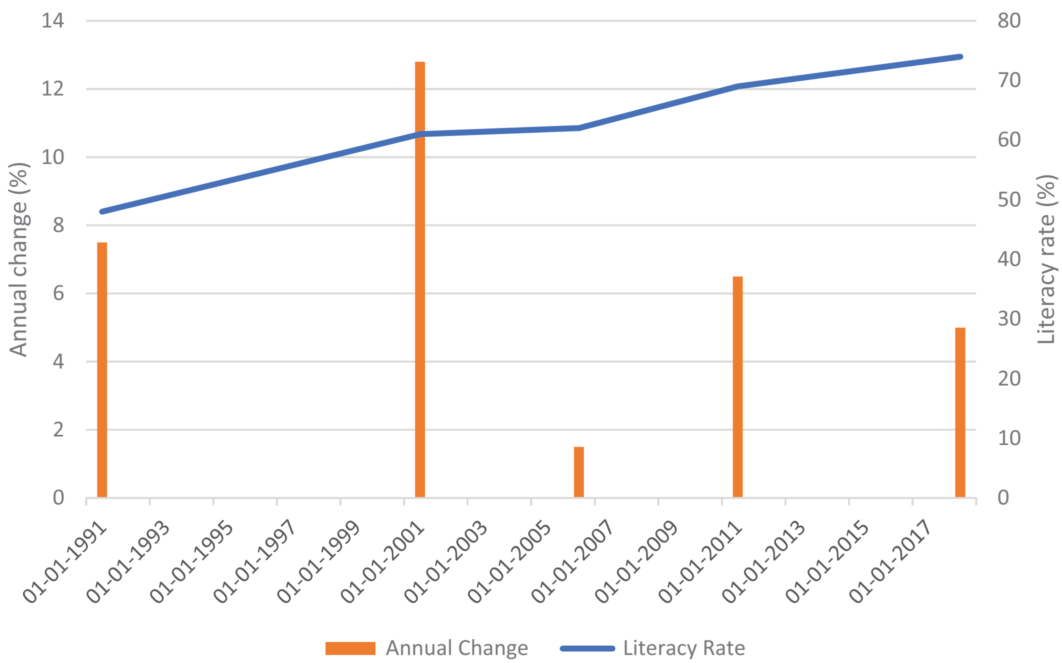
Source: Author's compilation from World Development Indicators (database), World Bank, Washington, DC, https://databank.worldbank.org/source/world-development-indicators.

FIGURE 7. SECTORAL EMPLOYMENT AS A PERCENTAGE OF GROSS VALUE ADDED, 1990–2000 TO 2011–12



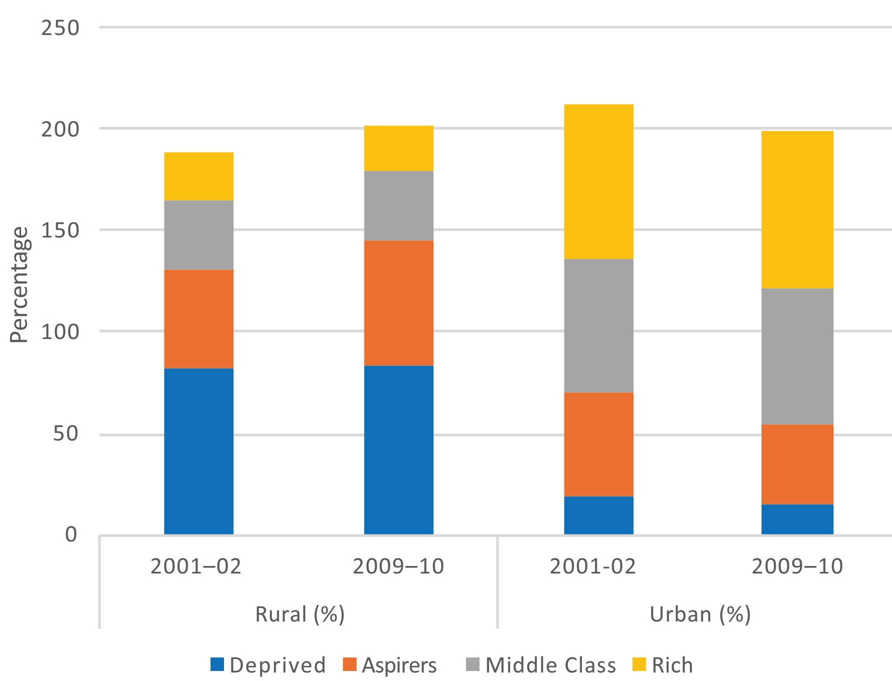
Source: Author's compilation from Nomaan Majid, "Structural Change and Employment in India" (ILO Working Paper 1, International Labour Office, Geneva, 2019).

FIGURE 8. SHIFT IN LITERACY



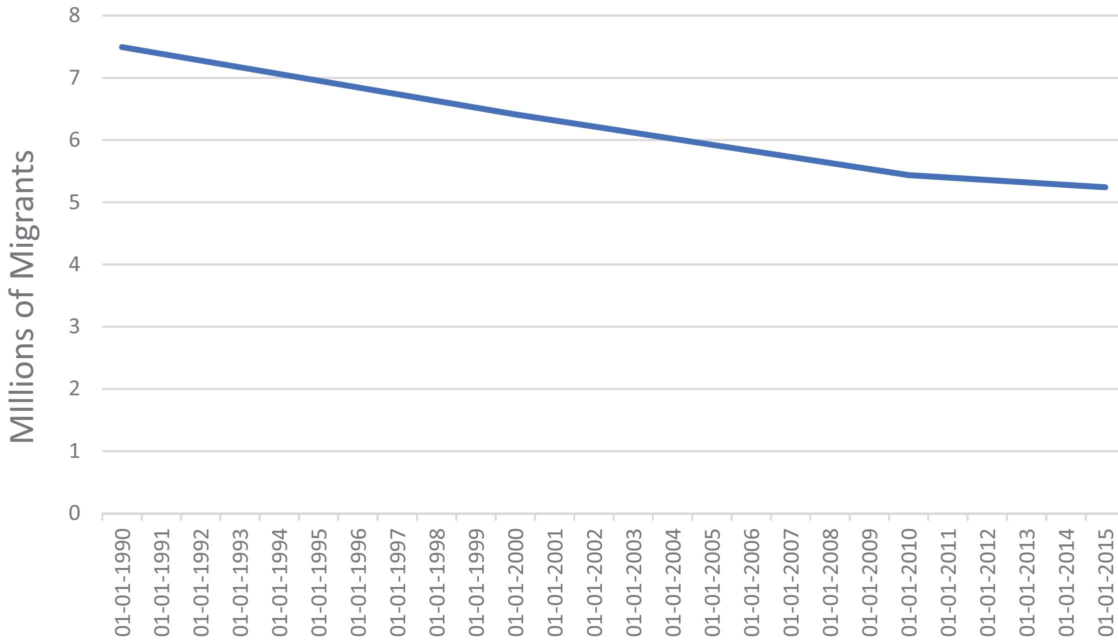
Source: Author's compilation from World Development Indicators (database), World Bank, Washington, DC, https://databank.worldbank.org/source/world-development-indicators.

FIGURE 9. RURAL–URBAN CHANGE IN CLASS COMPOSITION



Source: Author's compilation from National Sample Survey Consumption, rounds 55 (1999–2000), and 61 (2011–12).

FIGURE 10. OUT-OF-COUNTRY MIGRATION, YEAR OVER YEAR



Source: Author's compilation from World Development Indicators (database), World Bank, Washington, DC, https://databank.worldbank.org/source/world-development-indicators.

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