

# Making out a case for propping up the middle class

Leaving out a shrinking middle class in policy to handle the deep economic impact of COVID-19 will hamper recovery



FURQAN QAMAR &  
TAUFEEQUE AHMAD SIDDIQUI

Nobel laureate (2017) Richard H. Thaler segregates the population into “Econs” and “Humans”. Short for ‘Homo Economicus’, ‘Econs’ seldom defy economic assumptions of rationality and are flawless decision makers – akin to a preprogrammed machine. But they exist in economic literature only figuratively and are conspicuous by their absence in real life. In contrast, a vast majority of people fall under the category of ‘Humans’. They rarely behave rationally and are, thus, credulously susceptible to a wide variety of behavioural biases in their decisions.

## Planners and issues

What is true for the vast populace is equally applicable to policy planners. Their education, professional training, varied experiences and grass-roots connect notwithstanding, they remain ‘Humans’ than ‘Econs’. Even when their decisions have far-reaching consequences, they are scarcely immune to the ‘present bias’ and entrust greater weight to the payoffs that are closer to the present time, thus favouring ‘instant ambitions’ over ‘enduring economic gains’. Similarly, they could be amenable to ‘overconfidence’, ‘optimism’ and ‘framing effects’ and get swayed by the way information is presented to them.

Their thought processes may al-

so be hinged on the ‘confirmation bias’ tempting them to search, interpret, and recall information which support or validate their predisposition. Even as they mean no malice, they might be manoeuvred by ‘group reinforcement’ and ‘inter-group opposition’.

Cognitive distortion such as ‘availability heuristic’ may, concurrently impel them to believe that what comes to mind more easily is likely to be a far more accurate reflection of reality. What gives them further confidence is the ‘illusion of control’ leading to overestimating their ability to control events or to take mid-course correction if the designed policy fails to deliver the desired result.

## The ‘present bias’

Let us examine these phenomena in the context of handling the economic impact of COVID-19 and policies to revive the economy. The stimulus packages announced so far to mitigate the impact of the novel coronavirus and to revive the economy have included the poorest sections of the society, and the major thrust has been on the supply side. This reflects the penchant for procrastinating the immediate cost activities and pre-properating the immediate reward activities. In the process, the middle class has simply been left to fend for itself.

This is juxtaposed with the obvious policy option of directing attention to long-lasting benefits focusing on the larger picture rather than being reactive to instantaneous ambitions. This simply vindicates Richard Thaler’s view that ‘humans’ tend to be myopic and Ted O’Donoghue and Matthew Rabin’s proposition that decisions in-



GETTY IMAGES/ISTOCKPHOTO

variably suffer from the ‘present bias’.

## A segment with influence

Many studies, notably, a decade-old Asian Development Bank study covering 72 countries on ‘The Role of the Middle-Class in Economic Development: What Do Cross-Country Data Show?’ (ADB Economics Working Paper Series No. 245, January 2011; <https://bit.ly/3t59Eom>) established that the middle class fosters innovation. Their “values also encourage the accumulation of human capital (via education) and savings (that can then be used for productive investment in the economy)”. Ubiquitously, “policies that factor in the welfare of the middle-class and nurture their growth may be more effective in [the] long-term”. These findings confirm what Nobel Prize winners (2019) Abhijit Banerjee and Esther Duflo have been arguing: that the middle class has a constructive influence on the economy and society.

Closer home, it may be recalled that a 20-time increase in the middle class during the post-reform period had laid a strong foundation for high economic growth. Even as of now, the middle class constitutes close to a fourth of the

population but accounts for a four-fifths of the taxpayers’ base. Censoriously, it accounts for three-fourths of the total consumer spending leading to the demand for consumer durables.

## The pandemic’s impact

Going by a Pew Research Center report, that the middle class in the country shrunk by a third or over 32 million following the first wave of the novel coronavirus pandemic, their numbers may have further withered subsequent to the second wave, which was all the more devastating. During the past year or so, rural as well as urban unemployment rates have been high. At 8.13% on August 30, 2021, it is still quite high to impact the middle class adversely. Further, out of the total non-farm jobs losses since January 2021, the middle class comprising salaried employees and entrepreneurs has been as high as 13.7 million. Only in July, 3.2 million salaried people lost their jobs.

Rising petrol and diesel prices, and edible oil and retail inflation hovering at 32.5% and 5.6%, respectively, have been further eroding their disposable income. Explicitly, a hike in food prices reduces consumers’ income which could have been spent elsewhere to generate demand and thus boost the economy. The plight of the middle class can be understood by the fact that they are selling their family silver and gold jewellery to pay hospital bills, school fees and shop rent, particularly during the last four months, which may lead to further suppression of demand.

In Thaler’s taxonomy, ‘Econs’ are only imaginary; the populace as a whole, irrespective of their position in the society, are only

‘humans’. So are the middle class. Herbert A Simon, yet another Nobel laureate (1978), in his theory of ‘bounded rationality’, argues that individuals with their limited attention span do not follow complete rationality. The temperament of their brain limits their ability to recognise pertinent stimuli and get vacillated by the excessive information presented by the media, publicity, or propaganda.

Despite their deteriorating condition, the middle class have neither been reactive nor have found a collective voice. Concurrently, they have become quite risk averse, which is evident from the fact that bank deposits have increased by 11.4% in 2020-21, even though interest rates have declined as their inclination to spend has subsided. This further leads to a fall in the demand. The verity is also substantiated by Reserve Bank of India’s consumer confidence index. For July 2021, the index stood at 48.6 points which is just about record low.

A shrinking middle class never augurs well for the economy anywhere in the world. They need to be propped up to bring dynamism in the economy, and thus rapidly revive growth by enthusing, among other things, consumer confidence and positive sentiments.

*Furqan Qamar, a Professor in finance at Jamia Millia Islamia, is a former Secretary General of the Association of Indian Universities (AIU) and also a former Vice-Chancellor of the Central University of Himachal Pradesh and the University of Rajasthan. Taufeeque Ahmad Siddiqui is an Assistant Professor in finance at Jamia Millia Islamia. The views expressed are personal*