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INCOME-FINANCED VERSUS DEBT-FINANCED CONSUMPTION EXPENDITURE IN INDIA - A STUDY OF THE RECENT TRENDS

Sukanya N.*

ABSTRACT

Consumption expenditure forms the major share of aggregate demand in an economy the size of which determines the level of productive activity and employment in the economy. Though consumption expenditure of individuals is generally met by their current disposable income, the increasing practice of banks of lending for consumption activity in an economy provides the consumers with a supplementary source of meeting their current consumption expenditure. Consequently, two forms of consumption expenditure emerge in a modern economy; one, consumption expenditure financed by current income, and two, consumption expenditure met by borrowing or incurring debt, debt-financed consumption expenditure. This paper is an attempt at analysing, briefly, the recent trends in these two forms of meeting consumption expenditure in India in recent years and at discussing their implications. The paper is based on secondary data drawn from the publications of the Reserve Bank of India and the annual economic survey reports of the Government of India. The period of study relates to the period since 2000-01.

Keywords: *Aggregate demand; Consumption expenditure; Debt-financed consumption.*

INTRODUCTION

The ultimate aim of every economic activity is consumption or the satisfaction of human wants. Employment or work earns income which the individual uses to satisfy his wants. Since every individual has the tendency to save a part of the income for the future, only a portion of the income is spent for current consumption. Keynes (1936) terms the portion of current income spent for the satisfaction of current wants, the functional relationship between a given level of income and consumption expenditure out of that level of income, "the propensity to consume". While current consumption expenditure is generally met by current income, individuals often borrow to meet their current consumption expenditure, sometimes large in relation

* Lecturer in Economics, Sri Ramakrishna College, Mangaluru- 575 003, *E-mail: sukanya130176@gmail.com*

to income, necessitated by unexpected circumstances, with the intention of repaying the borrowed money from their future income. This gives rise to the phenomenon of debt-financed consumption expenditure. Two types of consumption expenditure, thus, emerge; one, income financed consumption expenditure, current consumption expenditure financed by current disposable income; and two, debt financed consumption expenditure, consumption expenditure financed by debt or borrowing.

The objective of this paper is to analyse, briefly, the recent trends in these two types of consumption expenditure in India in recent years, since 2000-01. The methodology adopted is macro in nature and it analyses and examines the changing trends in these two types of consumption expenditure at the level of the Indian economy as a whole. While income-financed consumption expenditure is taken as national income minus saving in the economy, which gives a measure of the consumption expenditure of the economy, debt-financed consumption expenditure is taken as the consumption expenditure financed by bank credit in the country. Though individuals borrow from different sources, banks, non-banks, business corporations and individuals, to meet current consumption expenditure that cannot be met fully by their current disposable income, the analysis in this paper is restricted to finance raised from commercial banks only while studying the extent of debt-financed consumption expenditure in the country.

THE PHENOMENON OF CONSUMPTION-LED GROWTH

The high rate of economic growth registered by the Indian economy in the recent years is basically consumption-led or market-led growth (Government of India, 2016). This is clear from the fact that private final consumption expenditure in the country formed 59.8 per cent of the Gross Domestic Product at constant market prices in 2015-16 as against 56.2 per cent in 2011-12 (Government of India, 2016a). Consumption expenditure forms the driving force of economic growth in the country at present. With its large and growing population, the country has enormous scope for the expansion of the domestic market as economic development proceeds, accelerating further economic growth in the country. Expanding domestic market and domestic demand is crucial for sustaining high rate of economic growth in the country for compensating the weak foreign demand for the country's exports, as stressed by the Union Finance Minister while presenting the annual budget for the year 2016-17 (The Economic Times, 2016).

INCOME AND CONSUMPTION EXPENDITURE

Since the basic objective of every economic activity of individuals is to satisfy their wants, individuals instinctively spend their income for consumption depending upon their propensities to consume. The surplus of income over expenditure on consumption is termed saving. According to Keynes (1936a) saving is the "excess of income over consumption".

Income thus gets divided into i) consumption, and ii) saving.

When this is stated symbolically, taking the economy as a whole, we get:

$$Y = C + S$$

Where: Y = Aggregate amount of income or disposable income of the economy during a period;

C = Aggregate consumption expenditure out of income during the period; and

S = Aggregate amount of saving during the period.

Using the above equation, consumption expenditure of the economy during a year/period can be estimated from the data for national income and saving of an economy during a year.

THE DATA

Using the relationship C=Y-S, the aggregate consumption expenditure in the Indian economy from 2000-01 to 2013-14 is estimated on the basis of the data for national income and saving as found in the annual economic survey reports of the Government of India, and these estimated data for consumption expenditure, national income and savings of the Indian economy are presented in Table I.

The data presented in Table I show the growth of National Income, Consumption Expenditure and Savings in the Indian economy over the period from 2000-01 to 2013-14. While National Income recorded a growth of 420.04 per cent from Rs. 2154680 crore in 2000-01 to Rs.11205169 crore in 2013-14, consumption expenditure recorded a growth of 371.54 per cent from Rs.1639135 crore in 2000-01 to Rs. 7729234 crore in 2013-14. Aggregate saving in the economy grew by 574.23 per cent during the period from Rs. 515545 crore in 2000-01 to Rs.3475935 crore in 2013-14.

The data, thus, show that while consumption expenditure increased as the national income of the country increased, the increase in consumption expenditure is less than proportionate to the growth in national income in conformity with Keynes' (1936) psychological law of consumption, that consumption expenditure increases less than proportionately with an increase in National Income, resulting in a positive marginal propensity to consume with a size of less than unity.

THE STATISTICAL RELATIONSHIP

The strength of the relationship between income and consumption expenditure out of that income is assessed by fitting a two variable linear

Table I
National Income, Saving and Consumption Expenditure in India during the period 2000-01 to 2013-14 at current prices (in Rs. Crore)

Year	*National Income in Rs. Crore*	*Consumption Expenditure in Rs. Crore*	*Savings in Rs. Crore*
2000-01	2154680	1639135	515545
2001-02	2335777	1750403	585374
2002-03	2519637	1863407	656230
2003-04	2820795	1997020	823775
2004-05	3219835	2169132	1050703
2005-06	3667253	2432102	1235151
2006-07	4261472	2775563	1485909
2007-08	4966578	3130246	1836332
2008-09	5597140	3794520	1802620
2009-10	6439827	4257489	2182338
2010-11	7702308	5080566	2621742
2011-12	8755188	5761262	2993926
2012-13	9871777	6690514	3181263
2013-14	11205169	7729234	3475935
Growth over2000-01	9050489	6090099	2960390
PercentageGrowth	420.04	371.54	574.23

Source: i) For National Income: Government of India- Economic Survey, 2014-15, Vol. II, Table-1.1 in P. A2.
ii) For Savings: Government of India – Economic Survey, 2014-15, Vol. II, Table 1.5 in PP. A12-13.
iii) Consumption Expenditure: Estimated using the relationship: C= Y-S.

relationship to the data in Table I, taking national income as the independent or explanatory variable and consumption expenditure as the dependent or explained variable. The relationship is assumed to be linear of the form

$$C = a + bY + u$$

Where: Y = National Income or disposable national income

C = Consumption expenditure

u = the random error term.

'a' and 'b' = The parameters of the consumption function, 'a' being autonomous consumption or the intercept of the function, and 'b' being the slope of the function representing marginal propensity to consume of the economy.

The value of 'b' is theoretically or a priori expected to be positive and less than unity, the corollary of Keynes' (1936b) psychological law of consumption explaining the behaviour of consumption expenditure in an economy. The value of 'a' is expected to be positive.

The Estimated Relationship: The estimated relationship between national income and consumption expenditure on the basis of the data in

Table I is found to be as follows, with the standard errors of the estimates shown respectively below them within brackets:

$$C = 68613.87 + 0.664\ Y \qquad R^2 = 0.996$$
$$(76581.98)\ \ (0.0125) \qquad N = 14$$

The estimated values of the parameters are found to be positive as theoretically expected and the value of 'b' is found to be highly significant. The high value of R^2, the coefficient of determination, shows that as high as 99.6 per cent of the variation in consumption expenditure in the Indian economy during the period to which this paper pertains was explained by variation in national income.

The value of 'b', 0.664, shows that the marginal propensity to consume of the Indian economy was 66.4 per cent during the period to which this study is confined.

The result of the analysis, thus, highlights the important role of income in financing consumption expenditure in the Indian economy.

Debt-financed Consumption Expenditure: While income is naturally, and has been traditionally, the main form of meeting consumption expenditure of individuals and households, another form of meeting consumption expenditure that is increasingly becoming popular in India, as in other countries, is debt-financing of consumption expenditure.

Meaning: The phrase 'debt-financed consumption expenditure' is used to mean the practice of consumers of meeting their present consumption expenditure using borrowed money, either from individuals, businessmen, business corporations or banks. The increasing practice of the commercial banks of extending consumption credit in India in recent years has led to increasing recourse of consumers in the country to debt-financed consumption expenditure in recent years using bank credit. The arrangement of consumer credit by the suppliers of the products by themselves, with a view to promote sales, has added a new dimension to debt-financed consumer expenditure in the country at present.

Borrowing for meeting consumption expenditure of large size, which is of an unexpected or unplanned nature, is not new to the Indian economy and has been traditionally in existence in the country. People often borrow to meet unexpected expenditure such as meeting the medical expenses that arises when a member of the family falls ill or needs immediate hospital treatment, or for meeting expenses of arranging the marriages of daughters, or for meeting unplanned consumption expenses that suddenly arise and cannot be postponed.

Financing of present consumption expenditure with borrowed money is an aspect of time-preference, that individuals psychologically prefer present consumption to equally certain future consumption. It is not only a psychological behaviour, but it also makes good economic sense during a period of inflation and rising prices, since it sometimes becomes cheaper to purchase a consumer item at present, even with borrowed money, instead of postponing its consumption, since the escalation in the prices of the products in future leads to loss to the consumers, in spite of the expenses on interest involved on consumer credit.

The increasing practice of banks of lending for the purchase of costly consumer items like motor vehicles, buying or building houses, or other items has resulted in increasing practice of consumers of borrowing from banks for consumption purposes. While, from the point of view of the consumers, this represents using their anticipated income for present consumption, from the point of view of the banks, it represents imparting present liquidity to future income of the consumers. It is an aspect of provision of present liquidity to expected future income and opens up growing scope for bank lending.

The Methodology: The methodology adopted in this analysis of debt-financed consumption expenditure or debt-financed consumer expenditure is to consider the amount of consumer credit extended by banks in India as debt-financed consumer expenditure in the country. Since bank credit provides the consumers or borrowers with purchasing power to purchase consumer goods or to meet other forms of consumption expenditure, the amount of consumer credit extended by the banks is treated as consumer expenditure financed by debt or bank credit in the economy. It should, however, be added that consumers raise credit for meeting consumption expenditure from many other non-bank sources. This analysis is, however, confined to debt-financed consumer expenditure financed by banks only owing to non-availability of secondary data on such consumer expenditure in the country using credit raised for consumption from other non-bank sources.

The analysis that follows examines the long term trend in consumer expenditure financed by banks in India by examining the relationship between aggregate bank credit and consumer credit in India during the period from 2004 to 2014-15.

The study assumes that consumer credit extended by banks is a function of the volume of the aggregate credit extended by them, and the relationship between them is analysed by regressing, linearly, the volume of consumer credit on aggregate bank credit. The linear regression equation used above, while studying the relationship between national income and consumption expenditure, is used, in this context also, for assessing the strength of the relationship between aggregate bank credit and consumer credit, considering 'Y' as consumer credit and 'X' as aggregate bank credit. The volume of consumer credit is treated as the dependent or explained variable 'Y' and the volume of aggregate bank credit is treated as the independent or explanatory variable.

The data used for the purpose are presented in Table-II. The data are drawn from the different issues of the Report on Trend ad Progress of Banking in India published annually by the Reserve Bank of India and the Handbook of Statistics on Indian Economy 2014-15 published by the Reserve Bank of India.

The data in Table II show that the aggregate amount of bank credit extended by the scheduled commercial banks in India increased from Rs. 864271 crore in 2004 to Rs. 6002952 crore in 2014-15, forming an increase of 594.57 per cent over 2004. Aggregate amount of consumer credit extended by the scheduled commercial banks in India increased from Rs. 189041 crore to Rs.1166348 crore, forming an increase of 516.98 per cent, during the same period.

The regression result is found to be as follows:

$$Y = 105175.75 + 0.168\,X \quad R^2 = 0.976$$

$$(29619.84) \quad (0.0083) \quad N = 12$$

Table II
Amount of Aggregate Credit and Consumer Credit of Scheduled Commercial Banks in India (In Rs. Crore)

Year	*Aggregate Credit of SCBs*	*Amount of Consumer Credit*
2004	864271	189041
2005	1125056	266610
2006	1473723	375683
2007	1893775	487860
2008	2332032	570776
2008-09	2601825	562479
2009-10	3039615	585633
2010-11	3667354	687944
2011-12	4289745	782835
2012-13	4869563	897584
2013-14	5529602	1009689
2014-15	6002952	1166348
Increase Over 2004	5138681	977307
Percentage Increase	594.57	516.98

Source: i) From 2004 to 2008: Reserve Bank of India- Report on Trend and Progress of Banking in India, different issues.
ii) From 2008-09 and onwards: Reserve Bank of India- Handbook of Statistics on Indian Economy, 2014-15, Table-49.

Note: SCBs: Scheduled Commercial Banks.

The parameter estimates have the expected positive sign and the estimated value of 'b' is found to be highly significant at 1 per cent level of significance. With 0.168 as the estimated value of 'b', the result shows that during the period to which this analysis pertains, 16.8 per cent of aggregate bank credit was being used for debt-financed consumption expenditure in the country.

Implications of the findings of the Study: The following can be pointed out as the implications of the study:

i) While current income forms the basis of current consumption expenditure, the possibility of consumption expenditure using borrowed money or credit, debt-financed consumption expenditure, acts as supplementary consumption expenditure that can act as corrective to insufficient income-financed consumption expenditure.

ii) Consumption expenditure or consumer expenditure forms the major part of aggregate demand in an economy. Hence, increasing consumption expenditure in an economy, either financed by current income or by debt, is conducive to rising level of investment and productive activity in an economy. The rising level of consumption expenditure that is being observed in the Indian economy at present through bank credit is, therefore, conducive to rising level of investment, productive activity and employment at the macro level of the economy.

iii) Increasing consumption expenditure, income financed or debt financed, has the effect of raising the standard of living of the individuals at the micro level, the basic objective of economic activity.

iv) While income–financed consumption expenditure is constrained by the level of the current income of individuals, debt-financed consumption expenditure has no such constraint and can be very elastic in nature, capable of high rate of expansion. Financing consumer expenditure, therefore, provides the banks with a growing market for credit expansion in the country. A credit policy of the banks that encourages consumption expenditure in the economy can increase the volume of consumer expenditure and raise the level of aggregate demand in the economy, thereby supporting rising level of productive activity and employment in the economy.

v) From the point of view of the banks, increasing debt-financed consumption expenditure in the country offers a lucrative field for bank lending in the country. Banks can and should exploit this opportunity by devising new ways of financing consumption expenditure. Care should, however, be taken to ensure that increasing consumer financing does not result in increasing nonperforming assets (NPAs) for the banks, through a careful watch on the debt servicing and repaying behaviour of the borrowers. This is especially important at present when the Indian banking system is facing an increasing burden of NPAs, the gross NPAs of scheduled commercial banks in India forming 3.8 per cent of their gross advances in 2013-14 as reported by the Reserve Bank of India in its Handbook of Statistics on Indian Economy, 2014-15, Table-65.

SUMMARY AND CONCLUSION

The foregoing analysis of consumer expenditure or consumption expenditure in the Indian economy in recent years reveals an increasing trend of consumer expenditure, both income-financed and debt-financed, in the economy. This is favourable to rising levels of investment and productive activity and employment in the economy. The Indian economy has entered a stage of consumption-led or market-driven economic growth. Expanding domestic market is crucial in this context for sustaining the high rate of growth that is being registered by the Indian economy at present. Expanding domestic market is particularly relevant to the Indian economy at present, as well as in the future, since the country cannot unduly depend on foreign market for selling its output. Besides, with its large and growing population there is enormous scope for the expansion of the domestic market in the Indian economy as it grows. The banks have an important role in expanding the domestic market by devising appropriate schemes for financing consumption expenditure in the country that suit the differing levels of income and consumption needs of individuals. Besides the macro gains of such financing schemes, they also offer the banks enormous scope for lucrative credit expansion in the country and for the investment of their funds.

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