**The Link Between Income Inequality and Consumer Expenditure And How It Influences Economic Growth?**

**Introduction**

Economic growth can stem from growth in aggregate demand (Tambunan, 2011). A component of aggregate demand is consumer expenditure. The share of consumption of Gross-Domestic Product (GDP) ranges from 70% to 75% in developing countries (P. K. Mishra, 2011). Therefore we can conclude that consumer expenditure is a mediating factor to economic growth. Thus, if consumer expenditure increases, aggregate demand increases, increasing GDP. Lower-income countries’ growth is fuelled by greater income inequality (M. Brueckner, 2017). This suggests that income inequality is another ‘overlooked’ factor that affects economic growth. Since income inequality affects economic growth and consumer expenditure affects economic growth, this may suggest that there may be a link between income inequality and consumer expenditure.

**Data Analysis**

I used the Gini co-efficient to represent income inequality. The Gini co-efficient ranges from 0 to 1 such that 0 indicates perfect equality, and 1 indicates extreme inequality. To calculate the Gini co-efficient for each country, I used data on income deciles from the Global Consumption and Income Project (2019). Using the income deciles, I worked out the cumulative income deciles and calculated the Gini co-efficient. To measure consumer expenditure per capita, I used the total consumer expenditure per country and divided it by the population of each country. I extracted data on the consumer expenditure per country, from the World Consumer Spending Project (1970-2022) and combined it with data on the population size of each country. Data on the population size of each country was also retrieved from the Consumption and Income Project (2019). As a measure of consumer expenditure per capita, purchasing power parity in US Dollars was used.

Figure 1 represents the relationship between consumer expenditure per capita (US$) and the Gini coefficient, where eat dot represents a country. Classification of countries into average income groups shows that there is a relationship between increasing a country’s GDP through increasing mean income, decreasing income inequality, and increasing consumer expenditure. Data on average income was obtained from the Consumption and Income Project (2019).

According to Kuznets’ theory, the increase in income per capita will lead to a fall in income inequality after a certain threshold is overcome. Hence we see that higher-income countries tend to have lower Gini co-efficients compared to lower-income countries, presented in Figure 1. But how does high-income inequality fuel economic growth?

For low-income countries, high-income inequality boosts economic growth (M. Bruckner et al., 2015). In Figure 1, we see that low-income countries tend to have higher income inequality levels than to middle and high-income countries. Thus, according to M. Bruckner, these low-income countries are on the path to achieving economic growth. People are more concerned about relative income rather than its absolute level (Layard. R, 2008) as we are trying to be someone consistent with our aspirations (Veblen). Therefore when there are high levels of income inequality, income and wealth becomes an indicator of social status (Walasek. L, Brown. G. D. A, 2016). Thus, due to high levels of income inequality in low-income countries, low-income earners may be more motivated to ‘Keep up with the Joneses’ and partake in conspicuous consumption to appear wealthier than the top decile income group. Consequently, the marginal propensity to save for low-income earners is smaller than that of rich people (Kaldor, 1960). To afford positional goods, low-income earners are willing to work longer hours in order to increase their income (Bowles & Park, 2005) and spend more, according to Kaldor. Hence this may explain why the share of consumption of Gross-Domestic Product (GDP) ranges from 70% to 75% in developing countries (P. K. Mishra, 2011). Further emphasising the importance of consumption for a developing country to grow. Subsequently, as mean incomes rise i.e., as economic growth occurs, there will be an increase in consumption and a decrease in income inequality. This is in line with Kuznets’ theory.

An application of how income inequality affects growth is that it may incentify low-income countries to increase levels of income inequality in order to boost growth and the marginal propensity to consume. Income inequality in low-income countries influences an increase in investment into human capital (M. Bruckner & D. Lederman, 2015). Investment into human capital, improves the effectiveness of schools and training in order to improve the skill set of the working population. Initially, some people may not choose to work as they may become reliant on government subsidies. However, high levels of income inequality may motivate the working population to work in order to improve their status through consuming positional goods. This complies with Kuznets’ theory because an increase in employment results in mean incomes to increase. Furthermore, since the working population are more qualified, this enables them to access higher skilled and higher paid jobs. This will further increase the mean income, influencing economic growth. As previous low-income earners’ are now accessing higher paid jobs, this will allow them to work alongside high-income earners’, reducing the income gap even further. This will initiate the ‘Snowball Effect’ that influences economic growth.

**Conclusion**

High levels of income inequality and consumption fuel economic growth in developing countries. This is because individuals in low-income countries believe income and the ability to buy positional goods indicates status in society. As a result, they will become more motivated to increase their incomes in order to increase spending on positional goods to appear wealthier. This will lead to the average income and consumption to increase, allowing for the country to transition from a low-income country to a high-income country. Finally this will lead to economic growth.

Investment into human capital, in a low-income country, can increase the rate of economic growth by improving the skill set of the working population. This ensures everyone can access a high paid job; reducing income inequality and increasing GDP per capita i.e. further economic growth.

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