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Why Worry about Inequality in the Booming Indian Economy?

THOMAS E WEISSKOPF

This paper makes the case that, even in a poor country such as India, decision-makers should aim not only to eradicate poverty but also to reduce economic inequality. After providing an overview of various dimensions of economic inequality in India, it is argued that such inequalities – both among individuals and between identity groups – are a matter of concern even independently of their implications for the extent of poverty. It is discussed as to how government economic policies can be oriented to reduce economic inequality without reducing economic growth.

This paper is about how economic policies can be oriented to reduce inequality..

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Over the last two decades India has emerged on the global scene as a rising economic power. Although still a relatively poor country, India's huge population and its rapid rate of economic growth since the early 1990s have combined to make it an important player in the world economy.[1] More significantly for the Indian people, the higher rate of economic growth in recent decades has contributed to a decline in the proportion of the population living below a very modest poverty line. While there is much dispute over the precise extent of poverty in India, it is indisputable that standards of living have improved for a significant share of India's poor during the period of rapid economic growth since the early 1990s.

In the context of a booming Indian economy, in which poverty is being reduced, concerns about inequalities in the distribution of income and wealth have taken a back seat. Why should it matter if the gains of economic growth are being unequally distributed, so long as significant headway is being made in combating poverty? My objective in this paper is to answer this question. I will try to make the case that, even in a poor country such as India, we should indeed be very concerned about economic inequality.

For many, especially in the academic arena, the injustice of a high degree of economic inequality is self-evident, just as the injustice of a high incidence of poverty is self-evident; so one should aim at reducing both. Among economists, however, it is commonly suggested that there is a trade-off between growth and equity: increasing inequality is seen as a necessary concomitant – if not an actual contributor – to economic growth, and efforts to curb inequality are seen as likely to retard the pace of growth and thereby impede the effort to reduce poverty.[2] In arguing against this position, I will try to make my case persuasive to sceptics.

Economic Inequality among Individuals

Whereas poverty involves absolute deprivation in terms of economic resources such as income, wealth, and access to public services, economic inequality involves relative deprivation – i e, where one stands in relation to others in one's society. The arguments for limiting economic inequality that I find compelling are of four broad kinds: moral, political, economic and social. I will characterise each argument in terms of the societal goal to which greater economic equality is likely to contribute.

Moral Arguments

People differ greatly with respect to what they consider a fair distribution of income or wealth. There is quite widespread agreement,

Wiesskopf divides the arguments of limiting economics inequality into 4 parts - moral, political, economic, social.

Moral - Treatment of people fundamentally equally and people with high resorces are given undue favourr & to promote equality of opportunity.
Political - to limit the role of money in politics that can result from inherent aristocracy & To promote cohesion in the society.

however, on the importance of the following two goals for a good society:

(1) To ensure that all citizens are respected and treated as fundamentally equal: But how one is treated depends a great deal on one's economic status and resources. People with far fewer economic resources than the societal average are likely to be disrespected and disfavoured in a variety of ways, whereas people with far more resources than the societal average will tend to be treated with undue deference and granted undue favours.

(2) To promote equality of opportunity: But highly unequal economic resource endowments result in corresponding inequalities of opportunity. Much evidence suggests that the degree of social and economic mobility in a society is inversely correlated with the degree of economic inequality,[3] arguably because opportunities for advancement depend significantly on initial economic resources.

Political Arguments

There is widespread agreement that a good society needs to be democratic – i e, it needs to have a political system in which citizens have reasonably equal opportunity to influence governmental decision-making and therefore have reason to accept the legitimacy of governmental power. This implies the following societal goals:

(1) To limit the role of money in politics: Democracy is undermined if some people can deploy enormous economic resources to influence political decisions, while others cannot. Great wealth passed on across generations – whether in physical or in financial assets – limits social mobility and leads to a hereditary aristocracy, which is antithetical to democracy.[4]

(2) To promote societal cohesion: A political system – and the power it vests in the government – will only be respected as legitimate if people have a real sense of community with one another as fellow members of the larger society. Substantial economic disparities between individuals, however, inhibit the development of such a sense of community; the resultant lack of societal cohesion tends to undermine the legitimacy of the political system and the governmental power it entails.[5]

Economic Arguments

In a variety of ways economic inequalities generate significant economic costs for a society, which could be curtailed – if not eliminated – by a more equal distribution of economic resources. Greater economic equality can promote greater economic efficiency by contributing to the achievement of the following goals:

(1) To improve the allocation and development of human resources: The greater the degree of economic inequality, the less likely it is that full advantage can be taken of people's innate capacities to make productive contributions. Many poor people with considerable innate talent, ability and drive will be consigned to a poor education and to jobs of little responsibility; and many rich people with little innate talent, ability and drive will nonetheless be able to get a good education and access to positions of responsibility in society. Moreover, a more equal distribution of economic resources will improve the nutrition, health, and education of the poor, thereby increasing not only their well-being but also their productive potential.

(2) To reduce social tensions and political instability: Economically deprived and socially disrespected people are often tempted to challenge the established order in a variety of disturbing and sometimes violent ways – such as strikes, protests, sabotage, and crime. The resultant tensions and instability can easily render property rights less secure and is likely to give rise to costly efforts to combat disturbances and to pay for security systems, prisons, etc.

(3) To reduce popular opposition to needed economic reforms: A high degree of inequality is likely to generate suspicions that growth-oriented reforms will only benefit the rich at the expense of the poor, thereby intensifying popular opposition to such reforms.[6] This is especially true of reforms that increase the scope of market forces, which are likely to increase allocative efficiency but also to distribute the resultant gains in a disequalising fashion – absent systematic efforts to limit economic inequality.

(4) To foster cooperation as a basis for low-cost solutions to "coordination failures": Ordinary market transactions, as well as complex multi-party economic projects, work much more smoothly when the individuals and groups involved can count on one another's honesty, trustworthiness, and cooperative behaviour. In the absence of widespread norms of trust and cooperation, substantial resources must be devoted to monitoring, supervision, and contract enforcement in order to assure that the terms of a market transaction are respected or that inter-related economic activities are well coordinated. But it is difficult to develop and maintain norms of trust and cooperation in a society characterised by large economic disparities between the rich and the poor.[7]

Social Arguments

There are a number of respects in which economic inequalities generate significant social costs for all members of society, in ways that are not reflected in conventional measures of economic well-being. Greater economic equality can reduce such social costs by contributing to the achievement of the following goals:

(1) To improve health throughout the population: There is much evidence that not only those who are the most economically deprived, but all segments of society, suffer from worse health outcomes the greater is the overall degree of economic inequality.[8] This evidence identifies stress as an important variable affecting health outcomes and shows that stress levels throughout all strata of a population tend to vary positively with the degree of economic inequality. Moreover, the ability of a society to limit the spread of disease and other public health problems is impaired to the extent that a relatively poor segment of the population lacks access to good nutrition and health facilities.

(2) To promote a better quality of life by reducing competitive consumerism: The desire to improve one's relative position tends to drive consumers into a competition in which the purchase of more and more goods ends up at best just maintaining one's relative position – a kind of "arms race" that adds little to overall well-being.[9] Less economic inequality, and hence a smaller gap between the consumption norms of the rich and the consumption levels of the bulk of the population, would reduce the salience of competitive consumerism and permit a shift of resources towards goods, or

indeed leisure activities, that do more to improve the quality of people's lives. Moreover, a shift from a quantitative to a more qualitative pattern of economic growth would reduce the pace of natural resource destruction, waste product disposal, and air and water pollution, thereby promoting greater environmental sustainability.[10]

Economic Inequality among Identity Groups

An identity group is a community of people who share characteristics that are physical or cultural and rarely alterable.[11] Economic inequality between identity groups – each treated as a single collective entity, with economic characteristics reflecting those of the average member of the group – is at least as likely as economic inequality among individuals to impede the achievement of some of the key societal goals referenced in arguments raised in the previous section. Most of the same arguments made for reducing inter-individual inequality can be made persuasively for reducing inter-group inequality, but in the latter context the following have a somewhat different character.

To Promote Equality of Opportunity: In the case of members of an identity group that has been historically marginalised by group-based negative discrimination, ensuring equal opportunity by eliminating all such discrimination may well prove insufficient to erode historically-generated differences in outcomes – differences that have nothing to do with individual choices and actions by group members. Economic decisions made in an unbiased and non-discriminatory market context are unable to overcome past negative discrimination when there is a tendency towards clustering and social segregation in associational behaviour, whereby members of a particular identity group prefer to intermarry, to live in the same residential neighbourhoods, and to join the same community institutions.[12] This is because the acquisition of productive characteristics and skills by an individual child depends significantly on the richness of upbringing that parents can offer her/him and on the quality of the quasi-public resources – such as neighbours, peers and schools – that local communities can offer to children. These parental and community influences convey advantages or disadvantages that cannot be equalised by market forces; so full equality of opportunity requires that compensatory steps be taken to reduce economic disparities between groups and thereby provide more equal access to important non-market resources and social networks.

To Promote Societal Cohesion: A political system – and the power it vests in the government – will only be respected as legitimate if people have a real sense of community with one another as fellow members of the larger society. However, if some identity groups are far more highly represented than other groups in powerful and prestigious decision-making positions in a society (within and outside of government), the legitimacy of the political system and of the governmental power it entails will tend to be undermined for members of the latter groups. The integrity of a political system will thus benefit from reduction of inequalities between groups and, in particular, by efforts to make the group composition of the societal elite more broadly representative of the population as a whole.[13]

To Improve the Allocation and Development of Human Resources: If some identity groups are far better represented than others in the upper echelons of a society, then many members of the poorly represented groups may lack sufficient motivation (due to doubt about their ability to succeed) or sufficient opportunity (due to lack of access to useful connections) to develop and apply their capacity to make productive contributions. Such constraints on truly meritocratic human resource allocation are likely to result in a significant loss of economic potential.

To Reduce Social Tensions and Political Instability: Inequalities between members of different identity groups within the same society are likely to some extent to be attributable to – and (even more so) to be seen as explained by – discrimination against members of less-well-off groups. As a consequence, inter-group inequalities in a society are considerably more likely to evoke strong feelings about the unfairness of the social order, and are considerably more likely to lead to social and political tensions and divisions, than inter-class inequalities. Even when negative discrimination has largely been curbed, ongoing inter-group inequalities can reasonably be seen as attributable in part to past negative discrimination; and the failure to address the unequal consequences of such past discrimination can pose a continuing challenge to social and political stability. Members of relatively deprived groups in a society are therefore likely to challenge the system in a variety of ways that are costly to all.

To Reduce Popular Opposition to Needed Economic Reforms: A high degree of inequality between identity groups fortifies suspicions that growth-oriented reforms will benefit more powerful groups at the expense of less favoured groups, thereby generating opposition to such reforms on the part of the latter.

To Foster Cooperation as a Basis for Low-Cost Solutions to "Coordination Failures": It is more difficult to develop and maintain widespread norms of trust and cooperation in a society characterised by multiple identity groups than in a culturally more homogeneous society. The difficulty is compounded if there are large economic disparities between identity groups, whose members are then all the more likely to distrust or disrespect members of other groups.

Focus on Inequality Over Poverty

Where poverty is a problem of huge proportions – as in India – rapid economic growth is a compelling objective, for growth does generate resources with which to alleviate mass poverty. But there are two major reasons why a focus on spurring economic growth, to the exclusion of reducing economic inequality, is ill-advised.

The Independent Benefits of Inequality Reduction: In most contemporary nations – certainly including India – the current degree of economic inequality is too inequitable, in the sense that a reduction in economic disparities would contribute positively to overall societal welfare along lines elaborated earlier on. If economic growth were increased and poverty were reduced without a concomitant reduction in inequality, then the overall gains would be far less substantial than if inequality were simultaneously reduced. A few of the goals of reduced inequality might be met simply by a reduction in poverty – e g, goals (the first moral argument, the fourth economic argument and the first social argument). However, poverty reduction without inequality reduction can contribute little or nothing to the achievement of most of the other goals of inequality listed earlier.

It is worth noting too that inequality is usually measured in strictly relative terms – e g, as shares or ratios of consumption, income or wealth as between different economic classes or social groups. But if such shares or ratios remain unchanged during a period of overall economic growth, then the absolute size of the disparities actually increases – and what happens to absolute disparities over the course of time is arguably more salient to people than what happens to relative disparities.[14] This implies there must be some reduction in conventionally-measured inequality in order to avoid setbacks to the achievement of the various goals served by reduced inequality.

The Prospect That Inequality Reduction Can Boost Economic Growth: Economists often assert that, at least in the early stages of economic development, rapid economic growth cannot be achieved without a rise in economic inequality. Some argue that government efforts to reduce inequality in the context of economic growth will restrain the rate of economic growth and thus hamper efforts to reduce poverty. The potential costs most often cited by critics of redistributive policies are that they will (a) reduce short-run economic efficiency (for example by reducing individual incentives to work, or by generating administrative costs and creating more opportunities for corruption), and (b) reduce long-run economic growth (for example by reducing incentives to save and to invest in enhancing personal capabilities or in societal capital accumulation).

Certainly, some kinds of government redistributive policy are likely to have adverse effects on aggregate output and overall economic growth. Examples are policies that impose a high tax rate on business profits in order to raise resources to transfer directly to the poor, or policies that limit flows of capital and productive activity from one locality or region to another in an effort to limit geographical disparities. But there is no iron law that requires a trade-off between achieving more rapid growth and reducing inequality. For one thing, statistical studies of trends in growth and inequality across developing economies do not support the notion that more rapid growth in output is correlated with increases in inequality.[15] Furthermore, there is a growing scholarly literature that distinguishes between bad inequalities (or "unproductive disparities"), which hinder economic growth, and good inequalities (or "productive disparities"), which promote economic growth.[16] Bad inequalities are rooted in market failures, or coordination failures, or governance failures that have the effect of impeding economic efficiency as they limit the ability of poor and marginalised people to improve their economic well-being in productive ways – e g, by investing in human or physical capital. Good inequalities incentivise and reward economic dynamism on the part of individuals (both rich and poor) in the private and in the public sector.

If inequality is reduced primarily by policies that remove unproductive disparities, it follows that reducing inequality can actually contribute to economic growth and thereby contribute both directly (via the reduction in inequality) and indirectly (via more rapid economic growth) to the reduction of poverty. But it is critical, in considering ways to reduce inequality, to identify and promote those redistributive policies that cut back on unproductive disparities, while avoiding redistributive policies that inhibit truly productive disparities.

Economic Inequality in India

I aim here to review the available evidence on several different kinds of economic inequality in contemporary India.[17] I will draw attention here to trends in inequality over time since Indian Independence, focusing on differences between the period before and after the adoption of a market-oriented reform policy of controlled liberalisation in 1991.[18]

By any measure of income distribution, India is currently neither among the most economically unequal countries of the world nor among the most equal. The most equal include most of the nations of western and central Europe, Canada and Australia – all relatively affluent countries. As compared to other developing countries of substantial size, India is certainly less unequal than South Africa and Brazil and probably less unequal than China. Income inequality in India is more comparable to that in Argentina, Russia, Indonesia, Nigeria, Pakistan and Turkey.[19] Wealth inequality in India appears to be less unequal than in the United States, but more unequal than in most other affluent countries and China – especially in the distribution of land.[20]

Brief Summary

Throughout the last 50 years inequalities of income and of consumption expenditure by individuals have been greater in urban than in rural India. In the pre-reform period the urban/rural gap fell at times and rose at times; but after 1991 it widened in most of the Indian states as well as in India as a whole. Within rural areas inequality appears to have declined, slowly and unsteadily, from the late 1950s to the early 1990s; it then rose considerably in the post-reform period. In urban areas inequality declined a bit, also unsteadily, from the late 1950s to the early 1990s; and it rose sharply thereafter. The ratio of consumption in urban areas to that in rural areas did not differ much as between the poor and the rich in the pre-reform period, but in the post-reform period the ratio was significantly higher for the rich than for the poor. There is clear evidence that in the post-reform period disproportionate shares of consumption gains have gone to better off urban residents.

In the late 1980s, when the degree of economic inequality was considerably lower than it is now, the top 1% of consumers in India are estimated to have enjoyed on average about 25 times as much real consumption per person than the bottom 1%;[21] the gap in income was much higher. One of the few studies of trends among the richest Indians found that the income share of the richest 1% declined from above 10% in the late 1950s to about 5% in the early 1990s and then rose again to roughly 10% by 2000.[22] There can be little doubt that it has increased further since then.

For the distribution of wealth among individuals in India there are no reliable data prior to the early 1990s; and the available data are widely recognised to understate significantly the amount of wealth held by the rich. The most extensive study yet done estimated that in both the early 1990s and the early 2000s the wealthiest 10% of wealth-holders held at least 50% of total assets, while the least wealthy 10% held at most 0.4% of total assets and 0.2% of net worth.[23] Land is the most important single asset in India, and it is more unequally distributed than wealth as a whole. The ownership of financial assets is even more concentrated, as almost all financial wealth is held by well below 1% of the population. The limited evidence available on trends over time points to increasing inequality in the distribution of wealth in India since the early 1990s.

Data on economic inequalities across religious and caste groups in India are considerably sparser than data on inequalities among individuals, but in recent decades more information has become available. In the rural areas of India there is a clear hierarchy of economic inequality across social groups. Hindu "forward castes" (H-FCS) fare much better than the national average; Hindu "backward castes" are close to the average; Muslims are somewhat worse off; dalits and adivasis are by far the worst off. In urban areas H-FCS are even more dominant, Hindu backward castes are still close to the national average, but Muslims are a little worse off than urban dalits and adivasis. At the all-India level, the hierarchy of social groups is similar to that of the rural sector, but the differences between groups are greater. Starting from the lowest levels, dalits and adivasis as a group have recorded from the 1980s to the late 1990s the most rapid growth in earnings and in the proportion of college graduates among persons in their 20s; Muslims have recorded the slowest growth in these respects.

Class Inequalities

The kind of economic inequality most often discussed by economists is that of the distribution of income across households or individuals. In India, however, the inequality data collected most frequently and most systematically – by the National Sample Survey (NSS) – involve the distribution of expenditure on consumption rather than income. Because the rich tend to save a significant fraction of their income, while the poor tend to use all of their income – and often some borrowed money as well – for consumption, the distribution of consumption is considerably less unequal than that of income. Furthermore, the NSS has a practice of oversampling the poor and undersampling the rich (often missing the super-rich altogether), so its survey results tend to understate the degree of inequality even of consumption. Thus measures of inequality calculated for consumption in India significantly understate the actual degree of inequality in income.[24] Because economic growth in India in recent decades has spawned an increasing number of super-rich,[25] the understatement of the degree of inequality in consumption and in income is most likely to have become more serious over time, resulting in an understatement of the growth in these economic inequalities as well.

Table 1 presents a series of estimates of Gini coefficients[26] measuring the degree of inequality in consumption in rural India,

Table 1: Data on Class Inequality – Gini Coefficients (%) of Per Capita Consumer Expenditure

Rural	Year	1957-58	1963-64	1968-69	1970-71	1973-74	1977-78	1983-84	1987-88	1990-91	1993-94	1997-98	2004-05	1973-91	1991-97
Jha (2005)		33.7	29.0	30.7		28.3	31.2	30.1	30.2	27.7	28.5	30.1			
Dreze and Sen (2002)		1960-61:	32.5		28.8	28.5	30.9	30.1	29.4	27.7	28.6	30.6			
Jain and Tendulkar (1989, 1992)*					28.7	28.1	31.1	33.1	30.2						
Datt (1999)						28.5	30.9	30.1	29.4	27.7	28.6	30.6		27.98	29.5
Himanshu (2007)**								30.4	29.9		28.6		30.5		
Dev and Ravi (2007)**								30.8			28.6		30.5		
Topalova (2008)								31.2†	30.1		28.5		29.8		
Sarkar and Mehta (2010)								31.9			29.8		32.0		
Urban	**Year**	**1957-58**	**1963-64**	**1968-69**	**1970-71**	**1973-74**	**1977-78**	**1983-84**	**1987-88**	**1990-91**	**1993-94**	**1997-98**	**2004-05**	**1973-91**	**1991-97**
Jha (2005)		35.9	36.5	32.9		31.5	33.7	33.4	35.6	34.0	34.5	36.1			
Dreze and Sen (2002)		1960-61:	35.6		35.7	30.8	34.7	34.1	34.6	34.0	34.3	36.5			
Jain and Tendulkar (1989, 1992)*					34.4	31.6	33.7	33.4	35.6						
Datt (1999)						30.8	34.7	34.1	34.6	34.0	34.5	36.6		34.79	36.04
Himanshu (2007)**								33.9	30.5		34.4		37.6		
Dev and Ravi (2007)**								34.1			34.3		37.5		
Topalova (2008)								34.0†	34.9		34.3		37.8		
Sarkar and Mehta (2010)								36.7			35.7		38.9		
All-India	**Year**	**1957-58**	**1963-64**	**1968-69**	**1970-71**	**1973-74**	**1977-78**	**1983-84**	**1987-88**	**1990-91**	**1993-94**	**1997-98**	**2004-05**	**1983-88**	**1994-97**
Ravallion (2000)								32.06	33.08	31.21	31.52	37.83		32.94	35.67
Topalova (2008)								31.9	31.3		30.3		32.5		
Sarkar and Mehta (2010)								33.7			34.7		37.6		
Vakulabharanam (2010)											32.6		36.3		

* Fractile-price-adjusted data; ** Uniform recall period; † 1982-83

Sources: Jha 2005	Table 4
Dreze and Sen 2002	Table A.6
Jain and Tendulkar 1989	Table 3
Jain and Tendulkar 1992	Table 6
Datt 1999	Table 1
Himanshu 2007	Tables 1 and 2.
Dev and Ravi 2007	Table 3
Topalova 2008	Table 3
Sarkar and Mehta 2010	Table 6
Ravallion 2000	Table (un-numbered)
Vakulabharanam 2010	Table 3

For full bibliographical citations, see the list of References.

urban India, and India as a whole, for various years from the late 1950s to the mid-2000s and over the two periods 1973-91 and 1991-97. All these estimates are based on NSS surveys, which are done separately for rural and urban India (representing on average roughly three-fourths and one-fourth of the total Indian population over the five-decades under consideration). All-India estimates are also included in the table; these are less often calculated because to do so requires complex integration of primary data from the rural and the urban areas.[27] There are several reasons why the estimated Gini coefficients for any given year differ from one another. For one thing, there are often inconsistencies in the questions asked from one survey round to another, and different analysts make different kinds of adjustments to deal with that problem. For another, to get figures comparable across time periods and regions, it is necessary to adjust for differential changes in the prices of commodities consumed; and this may be done by different analysts in different ways. In principle, one also ought to take account of different prices faced by consumers in different fractile groups; but this is rarely done.[28] With these caveats in mind, one may summarise the evidence in the table – supplemented by some key studies[29] whose findings cannot be fitted into the format of Table 1.

The Gini coefficient of inequality in rural consumption has averaged about 30% over the whole five-decade period. It appears to have declined from the late 1950s through the early 1970s, then risen in the early 1980s, then declined to reach a low point in the early 1990s, and finally risen again through the mid-2000s. It has been higher in the post-reform period since 1991 than in the two previous decades. Sen and Himanshu (2004) found a slow decline in rural consumption inequality from the late 1970s to the early 1990s, followed by a sharp rise in the early 2000s. Looking at the rate of growth of real consumer expenditure in the 1990s by the poorest 40% of consumers, they found that per capita consumption by the rural poor increased only one-fifth as much as the average increase in national per capita consumption. Sarkar and Mehta (2010), comparing growth rates of consumer expenditure before and after the 1991 reforms, estimated that in the pre-reform period the poorer fractile groups registered a faster rate of growth than the richer fractile groups, whereas in the post-reform period consumption growth rates were significantly higher for the top 20% than for the rest of the rural population.

The Gini coefficient of inequality in urban consumption has averaged about 35% over the whole five-decade period – reflecting a significantly higher degree of inequality than in the rural sector. It appears to have declined a bit from the late 1950s through the mid-1970s, then risen a bit in the early 1980s, then changed little until the early 1990s, and then risen noticeably through the mid-2000s. As in the rural sector, urban inequality has been higher in the post-reform period than in the two decades prior to 1991. Sen and Himanshu (2004) found that in the 1990s, per capita consumption by the urban poor increased only half as much as the per capita national average rate of growth of consumer expenditure. Sarkar and Mehta (2010), comparing growth rates of real consumer expenditure for the decade before and the decade after the liberalising reforms of the early 1990s, estimated that the average rate of growth for all urban consumers was 0.75% in the pre-reform period and 1.77% in the post-reform period. Comparing patterns of growth of consumer expenditure across fractile groups before and after 1991, they found that the pro-rich bias in the post-reform period was even more striking in the urban than in the rural sector.

The degree of inequality in consumption for all of India depends both on the degrees of inequality within the rural and urban sectors (just discussed) and on the degree of inequality between those two sectors. Numerous studies have found evidence that the latter has been rising in recent decades. Datt and Ravallion (2009) found that the ratio of average real per capita consumption in urban areas to that in rural areas fell from about 1.33 in the early 1950s to 1.17 in the early 1960s, then rose slowly to 1.25 by the mid-1990s and more rapidly to about 1.30 in the mid-2000s. Topalova (2008) reported that in the 1980s, and even more so in the 1990s, the urban/rural consumption gap widened in most of the Indian states as well as in India as a whole. Sarkar and Mehta (2010) investigated how the urban/rural ratio of average per capita consumption varies across different fractile groups. They found that this ratio did not differ much as between the poor and the rich in the pre-reform period, but that in the post-reform period the ratio was significantly higher for the richer than for the poorer groups – indicating that in the post-reform period a disproportionate share of the consumption gains went to better off urban residents.

Increasing Post-Reform Consumption Inequality

Gini coefficients for the degree of consumption inequality in India as a whole, which are available only for the post-1980 period, are presented at the bottom of Table 1. The estimates in the table show that all-India Gini coefficient averaged about 32% from the early 1980s through the early 1990s and then increased significantly in the post-reform period to a level of at least 35%.[30] Ravallion (2000) calculated decile shares of consumption in India from 1983 to 1997. He found that over this period the share of the poorest two deciles remained quite flat, the share of the middle deciles fluctuated around a slight downward trend, and the share of the richest two deciles showed a clear upward trend; within the 1990s the upward trend of the latter was even more marked. These findings were corroborated by Topalova (2008), who concluded that "all measures point to a significant increase in overall inequality in the 1990s, particularly in urban areas" and that "in the 1990s, the top of the population enjoyed a substantially larger share of the gains from economic growth compared to the previous decade". Even before the disequalising trend that began in the early 1990s, the degree of consumption inequality in India was substantial: in the late 1980s, when the all-India Gini coefficient was upwards of 30%, the top 1% of consumers are estimated to have consumed on average about 25 times as much as the bottom 1%.[31]

One study has attempted to compensate for the two major shortcomings of the NSS data – the focus on consumption rather than income and the undersampling of the rich. Banerjee and Piketty (2003) used data on individual income tax returns to chart the evolution of the share of top income earners in India from 1956 to 2000. They found that the income shares of the top 0.01%, the top 0.1% and the top 1% declined very substantially until the early-to-mid-1980s, but then rose again by the year 2000 to reach levels not far below those of the year 1956. The share of the top 1% of income earners dropped from roughly 13%

in the late 1950s to about 10% in the late 1960s and down to 5% in the early 1990s, then rose sharply to over 10% in the late 1990s.

I turn finally to some data recently compiled on the distribution of wealth in India. Wealth – whether measured as the total value of assets, or as net worth (assets minus liabilities) – is everywhere far more unequally distributed than income or consumption. Many people have no significant assets at all, or have liabilities that outweigh their assets; while a small number of people have been able to accumulate enormous holdings of wealth. Data on the distribution of wealth in India – as elsewhere – are subject to more shortcomings than data on income and consumption. Not only do the rich tend to be undersampled in surveys, but even when surveyed they have every incentive to under-report their wealth holdings, to report below-market values for their assets, and to hide illegitimately acquired wealth. The available data are thus bound to understate the full extent of inequality in the distribution of wealth; but at least they yield estimates of the lower bound of that inequality.

Data on the distribution of wealth ownership in India come primarily from two NSS household surveys of debt and investment throughout India, one in 1991-92 and the second in 2002-03. The most extensive study based on these surveys was carried out by Jayadev et al (2007);[32] they estimated Gini coefficients for all-India per capita total asset ownership of 64% in 1991-92 and 65% in 2002-03. The corresponding figures for net worth were almost identical: 64% and 66%. To express the degree of inequality in more easily comprehensible terms: in both years the wealthiest 10% of wealth-holders held roughly 50% of total assets and 50% of net worth, while the least wealthy 10% held roughly 0.4% of total assets and 0.2% of net worth. Land is the single most important asset for most Indian wealth-holders, and it is more unequally distributed than wealth as a whole – with a Gini coefficient of 73% in both years. The ownership of financial assets is even more concentrated, with an estimated Gini coefficient of 99% in both years; at most 5% of Indians participates in the stock market, and almost all financial wealth is held by just a fraction of 1% of the population.

There is little evidence from NSS surveys of any significant change in the degree of wealth inequality between 1991 and 2002. However, Ahya and Sheth (2007) have estimated that in the following four years there was a huge increase in wealth – more than the value of total Indian GDP – in financial equity, residential property and gold, and that most of this increase accrued to a relatively small segment of the population.

Group Inequalities

In a nation as multicultural as India, a great deal of interest attaches to inequalities between identity groups as well as inequalities across

Table 2: Data on Social Group Inequality (1999-2000 unless otherwise indicated)

		ST	SC	SC+ST	H-OBC	H-FC	Hindu	Muslim	All*
Rural (72% of total)									
% of the population		9.6%**	16.5%**		30.2%	19.3%	75.6%	17.3%	100%
% poor and % well-off***		50.9 2.7	42.9 3.4		33.7 6.1	16.9 14.0		37.5 5.5	33.6 7.3
% poor minus % well-off		48.2	39.5		27.6	2.9		32.0	26.3
MPCE	2004-05			86%	100%	129%		95%	100%
(as % of overall average)									
Gini coefficient	2004-05			23%	25%	28%		26%	28%
Urban (28% of total)									
% of the population		2.9%**	14.0%**		27.2%	38.3%	82.30%	12.0%	100%
% poor and % well-off***		42.6 5.7	43.1 2.0		36.0 3.7	4.9 17.1		46.5 2.5	28.5 7.8
% poor minus % well-off		36.9	41.1		32.3	-12.2		44.0	20.7
MPCE	2004-05			62%	73%	113%		62%	100%
(as % of overall average)									
Gini coefficient	2004-05			30%	32%	34%		32%	36%
All-India									
% of the population				24.4			80.5	13.4	100.0
MPCE	2004-05			74%	92%	144%		90%	100%
(as % of overall average)									
Growth in weekly earnings				4.72%			3.61%	3.38%	3.60%
(annual rate 1987-1999)									
% of professionals	1999-2000	5.7%	6.0%			15.4%****		11.5%	12.4%
(among household heads)									
College graduates									
% of persons aged 24-29	1983	0.8%	1.3%			6.5%		2.5%	
	1999-2000	3.0%	3.2%			11.7%		4.4%	

* Other religious groups (Christians, Sikhs, etc), amounting to 7.1%, 5.7% and 6.1% of the rural, urban and all-India populations, are not shown in the table.
** ST and SC figures were calculated by applying SC and ST proportions from the 2001 Census of India to the total SC+ST proportion from the Sachar Report.
*** rural/urban poor = below rural/urban poverty line; rural/urban well-off = above 775/1,500 rupees MPCE. **** Includes both H-OBC and H-FC.

Sources:

% of the population	Rural and Urban	GoI (2006) (Sachar Report), Table 1.1, except as indicated in note ** above.
	All-India	2001 Census of India.
% poor and % well-off	Rural and Urban	Deshpande S (2003), Tables 1 and 3.
MPCE (Monthly per capita expenditure)	Rural, Urban, All-India	GOI (2006) (Sachar Report), Figure 8.2 and related text.
Gini coefficient	Rural and Urban	GoI (2006) (Sachar Report), Figure 8.7.
Growth in weekly earnings	All-India	Bhaumik and Chakrabarty (2006), Table 1.
% of professionals (among household heads)	All-India	Desai and Kulkarni (2008), Table 1.
College graduates % of persons aged 24-29	All-India	Desai and Kulkarni (2008), Table 2 (average for males and females).

For full bibliographical citations, see the list of References.

households or individuals. Among the most salient identity groups in contemporary India are social groups distinguished by caste and/or religion.[33] Data on such social group inequalities are considerably sparser than data on household or individual inequalities; but in recent decades more attention has been paid to the former. Table 2 (p 47) presents relevant data on economic inequalities in India as between Hindus and Muslims and – among Hindus[34] – four major caste groups: adivasis or "scheduled tribes" (ST), dalits or "scheduled castes" (SC), Hindu "other backward classes" (H-OBC), and H-FCS. Before summarising some of the key findings reported in the Table 1 reiterate that, because most of the group data are based on NSS surveys that under-sample the rich, the data tend to understate the degree of inequality between richer and poorer groups.

In the rural areas of India there is a clear hierarchy of social groups when it comes to basic economic inequality. Whether one looks at the percentage of group members living below the official poverty line, or the difference between the percentage of those in poverty and the percentage of those labelled "well-off" (i e, middle-class or above), or average monthly per capita expenditure (MPCE), the pattern of group-wise economic inequality is the same: Hindu FCS fare much better than the national average, Hindu OBCS are close to the average, and Muslims somewhat worse off, while SCS and STS are by far the worst off. The Hindu FCS are even more dominant with respect to economic well-being in urban areas, but the hierarchy is somewhat different for the other groups. Urban Muslims are if anything a little worse off than urban SCS and STS in their economic well-being, while urban Hindu OBCS are still the closest to the national average. The Gini coefficient of within-group inequality is a bit lower for SC+STS than for other groups, and highest among Hindu FCS, both in the urban and in the rural sector – no doubt reflecting the lack of well-off people among SC+STS and the presence of many among Hindu FCS.

At the all-India level, the hierarchy of social groups in terms of average MPCE in 2004-05 is similar to that of the rural sector, but the differentiation between groups is sharper.[35] Hindu FCS are considerably further above the national average, Hindu OBCS and Muslims are both somewhat below that average, while SC+STS are by far the furthest below the average. Interestingly, however, the SC+ST group recorded the highest rate of growth in earnings between 1987 and 1999, while the Muslims as a group recorded the lowest. The pattern of inter-social-group inequality in the occupational and educational spheres is similar to that in the economic sphere: Hindu FCS and OBCS as a single group are far ahead, and SC and STS well behind, in both the proportion of professionals among household heads and the proportion of college graduates among persons 24 to 29 years of age. In the educational sphere it is again the SCS and STS who have advanced most rapidly (in relation to their low starting points), and the Muslims most slowly, from the 1980s to the end of the 1990s.

A limited amount of information is available on the distribution of wealth by social group, also based on the NSS investment and debt surveys of 1991-92 and 2002-03. Jayadev et al (2007) estimated that in 2002-03 Hindus had per capita asset holdings on average about 50% greater than Muslims, and that among Hindus FCS were much wealthier than SC+STS, with OBCS in the middle. Zacharias and Vakulabharanam (2009) compared per capita mean and median wealth holdings of urban and rural STS, SCS and Hindu "other castes" (OC = FC+OBC) in 1991-92 and 2002-03. They found that urban wealth levels were significantly higher than rural wealth levels for all groups in both years. Not surprisingly, urban and rural Hindu OCS occupied the top two positions. Rural SCS and STS occupied the bottom two positions at average wealth levels less than half of Hindu OCS, while urban SCS and STS had slightly higher wealth levels at a little more than half of Hindu OCS. Percentage changes between the two years were rather similar for all groups, except that the mean value of per capita wealth for urban STS rose at a significantly more rapid pace, even though the corresponding median value rose much more slowly – indicating that a relatively small number of urban STS with relatively high wealth-holdings made big gains over this period, though not enough to change their position in the rank ordering of the six groups.

Alternative Government Policies

The reduction of inequality requires a deliberate effort to limit the flow of economic gains to the relatively rich and to expand the flow of economic gains to the relatively poor. If such an effort is to be carried out on a large scale, it will have to be undertaken by governmental authorities with the power to implement policies that significantly affect the distribution of economic resources. Some policy measures taken to reduce economic inequality may impose costs in terms of reduced economic efficiency and dynamism. I seek therefore to identify below the kinds of inequality-reducing policies that are least likely to have such adverse effects on economic growth.

Limiting the Economic Gains of the Rich

(1) Progressive Taxation of Individual Income: Income tax rates that rise with the level of income are reasonably grounded, in that the ability to pay rises as income rises while the utility of additional untaxed income arguably falls as incomes rise. But tax rates on the well-to-do should not rise beyond the point where the supply of labour by the well-to-do is significantly impaired by the reduced after-tax return to labour.

(2) Progressive Taxation of Individual Wealth: Wealth taxes that rise with the level of wealth are justifiable on the same basis as income taxes, but it is analogously important in this case not to avoid reducing the after-tax return to saving to the point where it significantly reduces the incentive to save or invest. The best way to tax wealth is upon its inheritance, in the form of progressive taxation of estates or bequests, since the disincentives from such taxation are relatively indirect and thus less forceful.

(3) Taxation of Business Profits: This kind of taxation is less desirable than income or wealth taxation, because it directly impacts productive enterprises. If it is to be employed, it would be best to exempt reinvested profits and target distributed profits, so as to encourage further investment. On the other hand, where business profits are subsidised by government through various forms of "corporate welfare", the elimination of such subsidies will simultaneously promote economic efficiency and reduce economic inequality.[36]

(4) Expropriation of Productive Assets from the Wealthy: Expropriation of assets – for example land, plant and equipment, housing – reduces the incentive to invest and creates potentially damaging uncertainty in the business climate; so it is a policy that should be implemented, if at all, on a one-shot basis and with great care. However, if assets are initially distributed highly unequally (as is often the case with land), redistribution from large-holders to smallholders or non-holders can bring significant gains – as detailed under policy number 4 below.

(5) Antitrust Action to Reduce Monopoly Power: It is a fundamental tenet of economic theory that monopolies and near-monopolies generate both inequalities and inefficiencies by limiting market competition. Breaking up monopolies and near-monopolies, and encouraging more market competition, simultaneously reduces the monopoly profits of the rich and improves the allocation of resources as well as the incentive to invest productively.

(6) Limitation of the Inter-regional Movement of Capital: National governments are often tempted to limit or counter such movement, in order to reduce economic disparities between rich and poor regions of the country. Such disparities, however, may well reflect comparative advantage, or the dynamic advantage of agglomeration and clustering, or superior economic policymaking at the regional level. Rather than restricting inter-regional movement of capital, which may well reduce economic growth, it is better to address excessive regional economic differentials by using tax revenues to stimulate development in poorer areas.

Expanding Economic Gains of the Poor

(1) Cash or In-kind Transfers to the Poor: Such transfers are justifiable on humanitarian grounds, when people lack the resources for a decent standard of living through no fault of their own. Insofar as they improve the nutrition and health of the able-bodied poor, such transfers can increase not only their well-being but also their productive capacity. The transfers should be tailored, however, to avoid impairing to any significant extent the incentive to work.

(2) Labour Subsidies: In a poor country a large proportion of the poor are likely to be working in jobs or activities with very low remuneration. Transfers to the working poor, in the form of progressive negative income taxes whose size declines as incomes rise, increase the return to labour supplied by the poor.

(3) Improved and/or Subsidised Access of the Poor to Credit Markets: It is widely recognised that unequal access of the rich and the poor to credit markets leads to an inefficient allocation of capital (both human and physical).[37] Governmental efforts to reduce this inequality and to facilitate accumulation of productive assets by the poor are not costless, but they can yield a high return in more rapid growth through more efficient capital markets.

(4) Transfers of Expropriated Physical Assets to the Wealth-Poor: In the many contexts where all-encompassing contracts are hard to specify or to enforce, it is often more efficient for persons actually working productive assets to own those assets, and thus to have rights to the residual income generated from the assets, because those persons bear directly the consequences of decision-making about the assets.[38] For example, ownership of land by cultivators is often preferable to tenancy arrangements with absentee landowners in which the gains from increases (or the losses from decreases) in production do not accrue fully to the cultivators.

(5) Public Investments That Improve Labour Quality: Just as unequal access to credit markets leads to inefficient capital allocation, unequal access to public educational institutions (or subsidised private ones) leads to inefficient allocation of human resources. Government spending that expands educational opportunities and distributes them more widely and efficiently (according to innate potential rather than financial means) is arguably the form of public investment with the greatest simultaneous pay-off in economic growth and inequality reduction. A similar argument can be made with respect to public investment in healthcare facilities, especially where lack of sufficient nutrition and/or lack of adequate medical care impairs the capability to work of a substantial part of the population.

(6) Affirmative Action for Historically Marginalised Groups: Overt discrimination against members of marginalised groups both aggravates economic inequality and hinders economic efficiency and growth, so affirmative action policies that combat such discrimination are clearly desirable ways to reduce inequality between individuals and groups. The same is true of measures to ensure that information about educational, job and economic opportunities is made available to members of marginalised groups as widely as to others. More controversial are affirmative action policies that provide preferences to members of marginalised groups, for in this case it is arguable that such policies may interfere with economic efficiency by favouring less qualified candidates from the beneficiary groups over more qualified competitors, and that they may increase inequality within marginalised groups while reducing inequality between such groups and dominant groups. Yet the stronger form of affirmative action can nonetheless be justified by the fact that continued adherence to a group-blind standard cannot lead ultimately to outcomes that do not reflect prior discrimination.[39] It is especially appropriate to concentrate affirmative action policies on equalising educational and residential opportunities, for these are key arenas where historically discriminated-against minorities continue to face barriers to social and economic mobility from group clustering of the corresponding local public goods, which result in inefficient allocations of human and social capital.

Conclusions

There is much that the government of a poor country such as India can do to reduce economic inequalities while promoting economic growth and combating poverty. The most promising policies that limit the economic gains of the rich are those that tax their income and (especially) wealth progressively, that reduce "corporate welfare", that break up monopolistic market positions, and that shift ownership away from absentee asset-owners (especially of land). The most promising policies that expand the economic gains of the poor and the marginalised are those that improve their health, that increase their access to good-quality education institutions, that improve their access to credit markets, that promote higher employment, and that shift asset ownership to actual producers (especially cultivators). That the above policies are not pursued to a much greater extent nowadays is a sad commentary, not on any iron laws of economics, but on the current constellation of political power in most countries around the world.

The recent experience of Brazil demonstrates how rapid economic growth can indeed be combined with reduction of economic inequality. From 1950, when data on economic inequality began to become available, and up to the early 1990s, Brazil and South Africa were the most unequal of the major countries of the world. Like India, both Brazil and South Africa stepped up their integration into the international capitalist economy in the 1990s, and over the past two decades these countries have all achieved fairly rapid rates of economic growth. Unlike in India and South Africa, however, there is evidence of a significant decline in the degree of economic inequality in Brazil since the early 1990s. This decline can be explained in considerable part by policy changes introduced by the successive administrations of Brazilian presidents Fernando Cardoso (1995-2003) and Lula Da Silva (2003-11).[40]

NOTES

1 During the four decades from 1950 to 1990, the rate of growth of the Indian economy was relatively modest: gross domestic product (GDP) increased at an average annual rate of about 4%, and GDP per capita at about 2%. In the 1990s the corresponding figures increased by roughly two percentage points each, and in the 2000s they increased by another 2-3 percentage points.

2 See, for example, Tendulkar (2010). I am grateful to Suresh Tendulkar for a lengthy e-mail dialogue about many of the issues I address in this paper.

3 See Wilkinson and Pickett (2009), Chapter 12. On p 169 they conclude: "Bigger income differences seem to solidify the social structure and decrease the chances of upward mobility. Where there are greater inequalities of outcome, equal opportunity is a significantly more distant prospect."

4 The US Supreme Court Justice Brandeis put it well: "We can have concentrated wealth in the hands of a few or we can have democracy, but we can't have both" (quoted by Jeffrey Madrick in an op-ed column in the *New York Times*, 14 December 2010).

5 As Nicholas Kristof has written: "Economic polarisation also shatters our sense of national union and common purpose, fostering political polarisation as well" (op-ed column in the *New York Times*, 6 November 2010).

6 This point has been well made in the Indian context by, among many others, Chaudhuri and Ravallion (2006).

7 See Bardhan (2004), especially Chapter 2, "Distributive Conflicts and the Persistence of Inefficient Institutions".

8 See Wilkinson and Pickett (2009), Chapters 6 and 13.

9 This point has been made most forcefully by Robert Frank; see Frank (2007).

10 See Wilkinson and Pickett (2009), Chapter 15.

11 In this paper I consider identity groups based on race, caste, tribe, region of origin, mother tongue, religion, and/or cultural tradition, setting aside groups based on gender or sexual preference because these raise rather different issues.

12 See Loury (1987) for a convincing exposition of the argument presented in this paragraph.

13 Anderson (2002) has argued persuasively that this is the single-most important rationale for positive discrimination in favour of historically marginalised groups.

14 This point has been persuasively made, in the context of Indian economic development, by Ravallion (2005).

15 See, for example, Bruno, Ravallion and Squire (1999).

16 A good example is Chaudhuri and Ravallion (2006).

17 As Rohini Somanathan has reminded me, the data on economic inequality that I review in this appendix do not reflect the effects of taxation and public expenditures on individual economic well-being; this remains an under-researched issue.

18 Elements of the new reform policies were foreshadowed in the early 1980s, but it was not until the 1990s that a major shift was undertaken.

19 It is difficult to place India in a world rank order of income inequality, not only because data on income distribution in most countries vary greatly in terms of how inequality is defined and measured, but also because most distributional data collected in India are for consumption expenditure rather than for income received. The rough comparative information provided in this paragraph is drawn from standard UN and World Bank sources.

20 See Jayadev et al (2007) and Bardhan (2009).

21 These estimates are from Tendulkar and Jain (1995), who have done the most meticulous research on the distribution of consumption expenditure, adjusting carefully for different prices faced by consumers at different levels of consumption.

22 These estimates are from Banerjee and Piketty (2003).

23 All the figures mentioned in this paragraph are from Jayadev et al (2007).

24 The degree to which measures of consumption inequality understate income inequality in India may be gauged by comparing estimates of the Gini coefficient for all-India consumption in 2004-05, which average roughly 35% as shown in Table 1, with an estimated Gini coefficient of 54% for all-India income calculated by the Indian National Council for Applied Economic Research (NCAER) from a household survey carried out in the same year (as reported in Bardhan 2009).

25 See the list of India's wealthiest individuals at: http://en.wikipedia.org/wiki/List_of_Indians_by_net_worthon-line

26 The value of a Gini coefficient can range from 0 to 1, with higher values denoting greater inequality. The Gini coefficient is usually expressed in percentage terms; and it should be noted that a difference of just a few percentage points represents a considerable difference in the degree of inequality.

27 I could not find any detailed and methodologically transparent studies of the all-India distribution of consumer expenditure prior to the early 1980s.

28 To my knowledge only Jain and Tendulkar (1989, 1992) have adjusted consumption distribution data to take account of the different prices faced by consumers in different fractile groups.

29 Notably Sen and Himanshu (2004) and Sarkar and Mehta (2010), whose careful studies of trends in consumption inequality examined differences between the experiences of richer and poorer fractile groups; see also Topalova (2008).

30 Bhalla (2007, ch 11) reported that "in the low growth period 1950-1980, consumption inequality in India improved [i e, declined] by about 15 to 20%". It is not clear, however, what his sources were for this estimate. He went on to write that "since 1983, inequality levels have stayed within a tight 1 to 3 Gini point range around a mean of 31[%]." It is very hard to reconcile this assertion with all the evidence cited in this paper on the increase in rural, urban and all-India consumption inequality, as well as the evidence of a widening gap between average urban and rural consumption levels since the early 1990s.

31 These estimates are from Tendulkar and Jain (1995), who – as noted earlier – adjusted carefully for different prices faced by consumers in different fractile groups.

32 All the figures mentioned in this paragraph are from this study.

33 Gender is of course also an important basis for distinguishing identity groups; but measurement of economic inequalities between men and women raises complex issues that are beyond the scope of this paper.

34 Following a curious convention in Indian data on social groups, STs are included here within the Hindu population.

35 This reflects the fact that only Hindu-FCs constitute a higher proportion of urban dwellers than rural dwellers, and MPCEs are higher in urban than in rural areas.

36 I am indebted to Arthur MacEwan for stressing this point.

37 See, for example, Bruno, Ravallion and Squire (1996).

38 See Bardhan, Bowles and Gintis (2000). As the authors note, there may also be a loss of efficiency when ownership of productive assets shifts from wealthy owners to less wealthy operators, insofar as the latter are likely to be more risk-averse than the former. However, the authors conclude that asset redistribution from the wealthy to the non-wealthy is more often productivity-enhancing than the other way round.

39 As Loury (1987) has shown, only government action in favour of members of marginalised groups can hope to erase inter-group inequalities resulting from past discrimination.

40 For an analysis of the decline in economic inequality in Brazil since the early 1990s, see Ferreira et al (2006) and Seidman (2010).

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