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Reducing Income Inequality: India's Challenges and Prospects

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ABSTRACT

The Sustainable Development Goal (SDG) Target 10 aims at reducing inequalities in different aspects. The Niti Aayog of India has been monitoring progress achieved by different states and sets out a collaborative agenda. This paper specifically looks at the trends in Gini coefficient in different states, impact of high-income inequality on index of health in developed economies and how political ideology and progressive taxation policy can play a decisive role in thwarting the present disturbing trends. The paper brings out how income share of the 40% middle class in national GDP has come down after economic liberalization, while the share of top 10% has gone up significantly. In developed countries, acute income inequality seems to dampen the index of health and general well-being. The paper looks at Kuznet's inverted U curve hypothesis, which contends that after achievement of a high level of per capita income, inequality will come down, was proved to be un-true by Thomas Piketty. The paper brings out, how the Laffer Curve (1986) mooted by Arthur Laffer provided the economic justification for bringing down tax rate on top rich from 71% to 35% in the USA. The paper rebuts the general assumption that high tax rates would disincentive investment. The author recognizes that substantial increase in tax rates and high wealth tax in a market oriented political economy may not be a feasible proposition. In order to achieve distributive justice, greater attention to tools like progressive taxation, increasing investment in merit goods and ensuring shared prosperity must be seriously addressed. Also, a more proactive approach towards tax collection, rather than increasing borrowing would help to reduce income inequality.

Keywords: SDG, Laffer Curve, Inverted U Curve, Merit Goods, Gini Coefficient

Introduction

The Millennium Development Goals did not address the concern of growing inequalities in income in both developed and developing economies. Sustainable Development Goals (Goal 10) attempts to look at the concern of inequalities in different dimensions holistically and set out an action agenda to minimize them drastically by 2030. It includes income inequalities, promotion of universal economic, social and political inclusion (10.2), ensuring equal opportunities and ending discrimination (10.3), adapting fiscal and social policies that promote equality (10.4). Besides it aims at improving regulation of global financial market and institution, enhanced representation for LDCs in financial institutions, and encouraging financial assistance from ODAs and promoting investment (FDI) to least developed countries. This is in the back drop of global realization that the share of bottom 40% of population as a % of total wealth is shrinking in most countries. Socio-political-economic inclusion of vulnerable sectors of the society is not happening at the rate envisaged and absence of equal opportunity has been stifling achievement of full human development capability. The Niti Aayog in India has been monitoring progress achieved by different states against the detailed targets and the collaborative effort required.

This paper brings out trends in (a) economic inequality amongst different states and globally, (b) impact of high-income economic inequality on index of health, (c) role of ideology on income inequality and (d) impact of pandemic on inequality amongst the vulnerable.

Trends in Global and Inter State Income Inequality

Modern inequality, many analysts believe, is the byproduct of a freely chosen process, in which everyone has equal access to the market and to property. Such meritocratic narrative is looking more and more fragile. Socio-economic inequality has 'accentuated' in all regions of the world since the 1980s. A high chasm divides the meritocratic discourse from the reality of equal access to education and wealth for society's least advantaged and most vulnerable class. The trend is Global Income Equality since 1980s is plotted below:

The consequential impact of high inequality on human development Index as plotted below:

It would be seen from the above that the increases in wealth have been unequally shared in developed western European countries like France, Germany, USA while the increase in rather modest in case of countries like Norway and Japan. In case of India, the increase in Gini Coefficient is rather sharp after economic liberalization in 1991.

The following table will bring out how the income of bottom 40% varies between 10.4% in Brazil to 23.2% in Sweden, while income share of top 10% is around 30% in countries like USA, China and India. The respective Gini Coefficient has contributed to this hiatus in wealth distribution between top 10% and bottom 40% of the population.

Analysts also look at Palma ratio; i.e. ratio of the richest 10% of population's gross GNI to poorest 40% share of that nation. The position is as under:

It would be seen from the above that while it is less oppressive in countries like Germany and India, it is very high in USA (100 times) and four times in Brazil. India and China are almost at par (1.7).

The trend in share of top deciles of a few countries/ continents is given at Table 2.

Quite clearly the increases are very sharp in India, China, Russia and USA, during (1980-2018), while it is rather modest in case of European countries as a whole as shown in Figure-1 Inequality in share of income in India between bottom 50%, middle 40% and top 10% shows interesting trends in the sense that the middle 40%, (middle class) which had maintained its share around 40% till 1990, after it has pummeled to 30% in 2014. Absence of tax relief to the middle class after economic liberalization is a major reason for this as also income increase not keeping pace with prices rise. The bottom 50% (poor) has become poorer; from a share of around 20% in 1990 it has now come down to 15%. The top 10%, who used to connect 38% of total

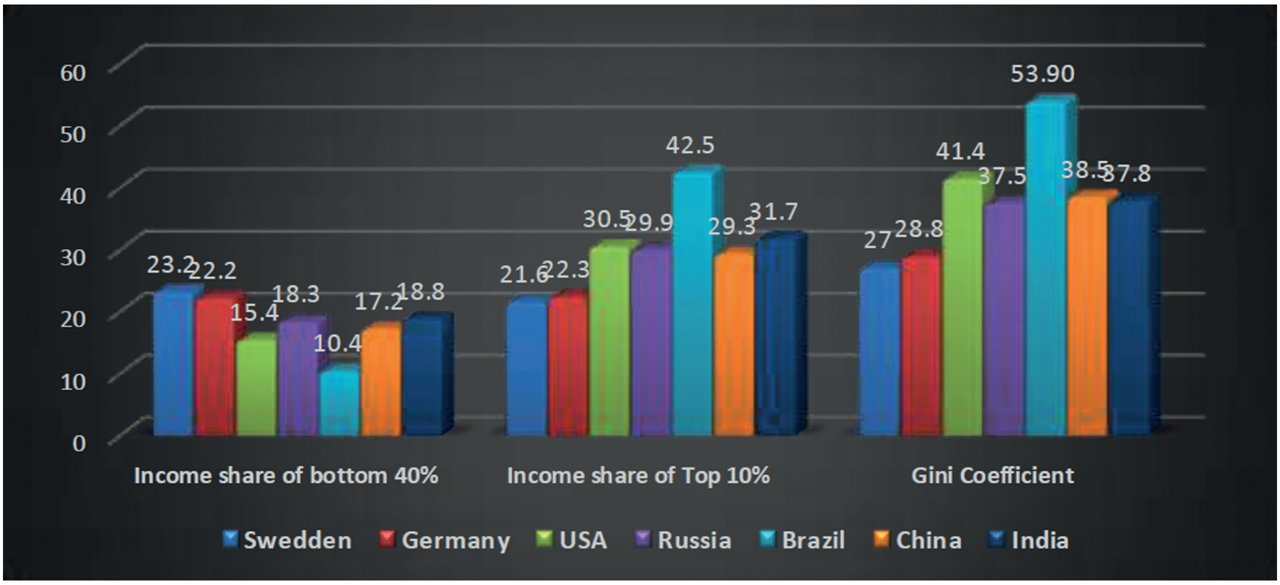

Figure 1: Global Trends in Income Share.
Source: The Great Leveler: Walter Scheidel

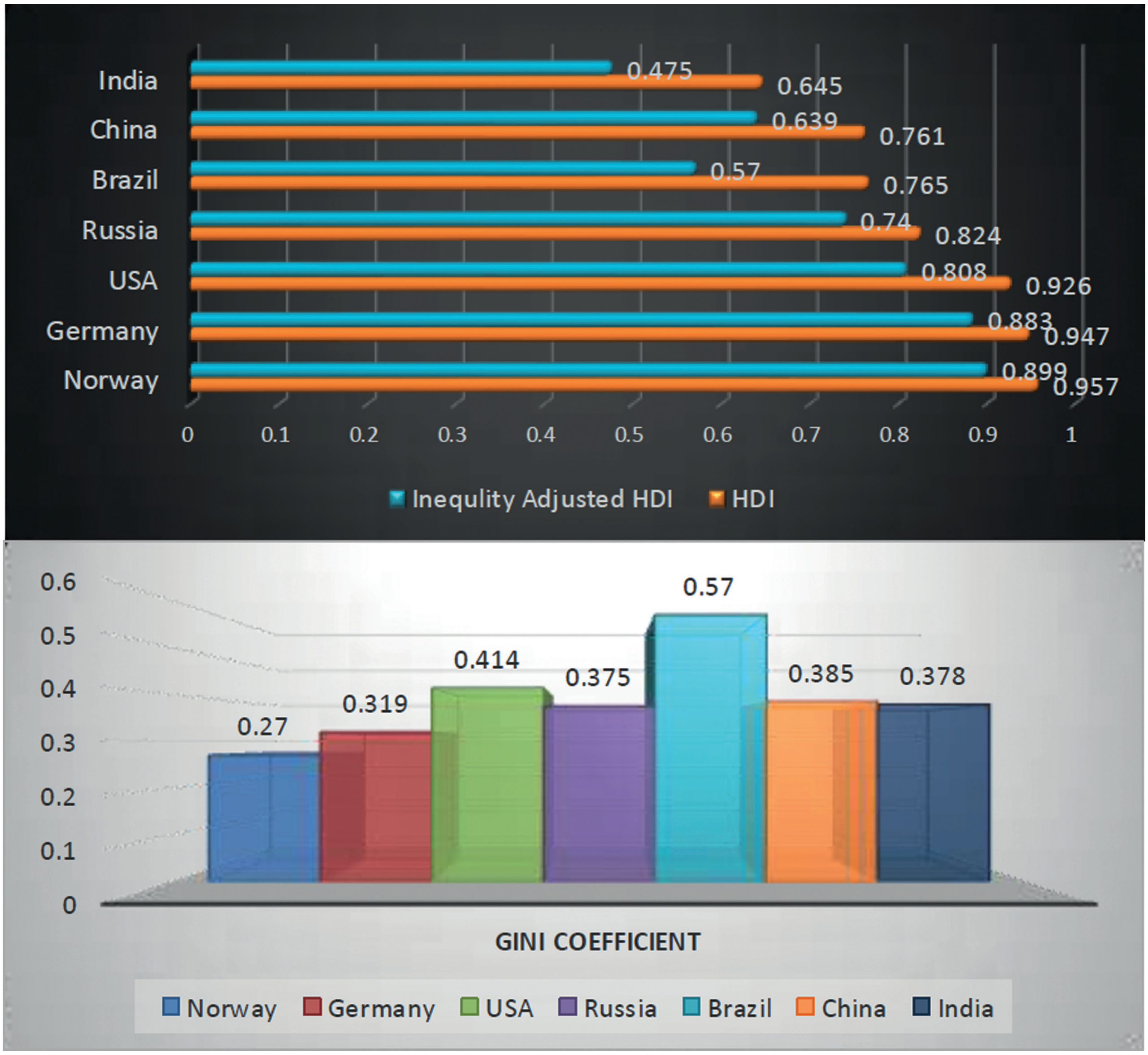

Figure 2: Gini Co-efficient and Human Development Index.
Source: Human Development Report 2021

Table 1: Trends in Global Inequality

Country	1980	1990	2010
France	36.4	42.6	46.1
Germany	34.4	42.2	48.2
Japan	28.3	31.3	36.3
Norway	33.8	36.8	36.9
USA	38.6	43.3	46.9
India	28.9	30.1	36.2

Source: The Great Leveler: Walter Scheidel

national income, account for nearly 55% of national wealth. The pro rich taxation polity, pro-corporate fiscal measures crony capitalism has provided the fuel for such whooping disparity between different economic classes after economic liberalization. Instead of becoming pro-market, the fiscal policy of the Government has tended to become pro-business (Figure-1) inviting a charge of crony capitalism.

However, the income inequality in India reveals sharp dichotomy between rural India that is home to 70% of Indians and Urban India which accounts for 30% of India's population (Figure 5).

It would be seen that the Gini co-efficient has inched up slowly in India (25.8 to 28.8), whereas for Urban Indian's it has been far sharper from (31.9 to 38.2). This is largely due to the stagnancy in income share of rural areas which has seen very little sectoral transformation in terms of provision of higher irrigation facility, industrialization or sharp improvement in agricultural productivity after the green resolution in the 1960s. In contrast, urban India is far more privileged in terms of infrastructure, education

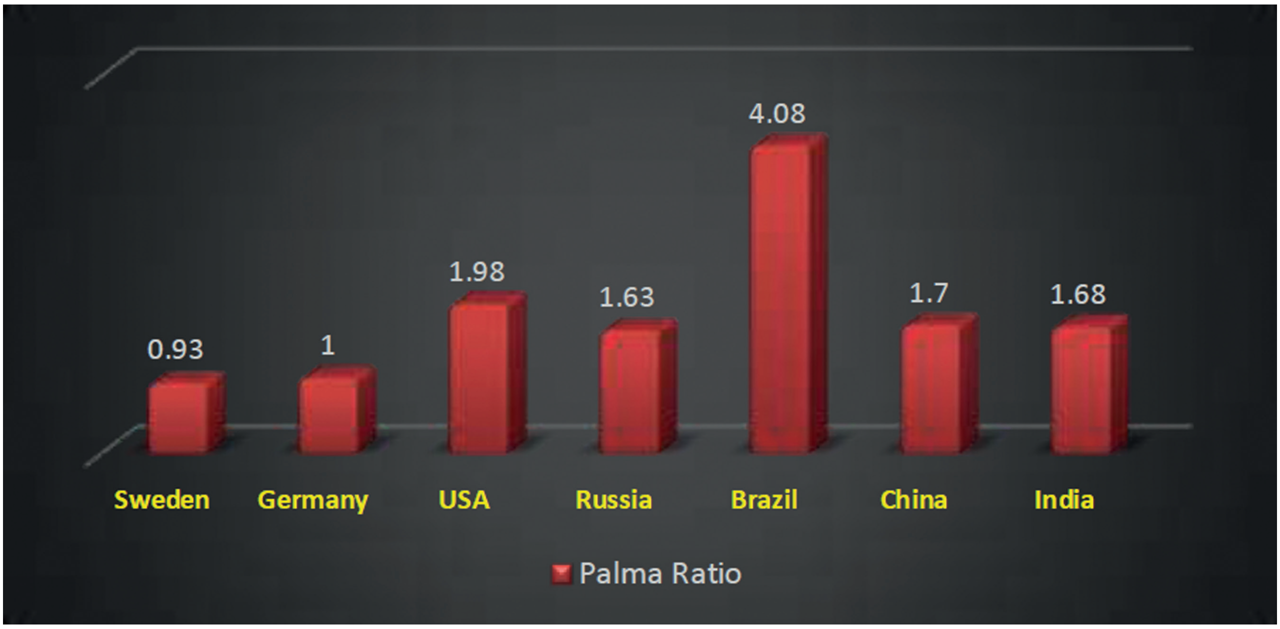

Figure 3: Global Trends in Palma Ratio.
Source: The Great Leveler: Walter Scheidel

Table 2: Share of Top Deciles

Country	1980	2018
India	32	55
China	25	42
USA	34	45
Russia	27	45
Europe	28	34

Source: The Great Leveler: Walter Scheidel

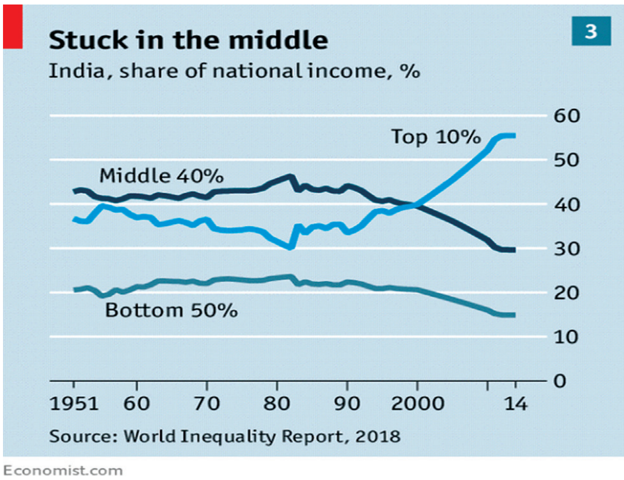

Figure-4: Trends in Income Share (1951–2014).
Source: World Inequality Report 2018

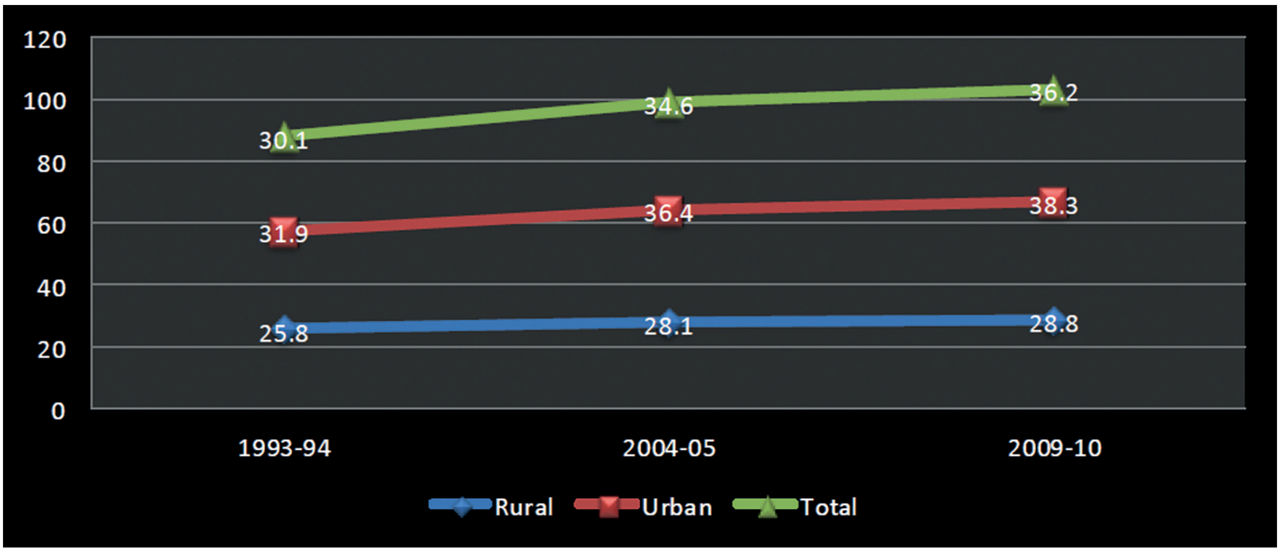

Figure-5: Trends in Income Inequality of Rural and Urban India.
Source: Jean Dreze and Atkinson

and has been naturally attractive place for migration to jobs in industry and services sector engagement 'which provides better pay offs.

The interstate inequality reveals sharp variations; with states like Kerala and Punjab having very low level of inequality in largest 40% wealth category (3-5%), whereas states like Odisha have the dubious reputation of having close to 64% languishing in the lowest level quintile.

Impact of Income Inequality on Health Index

In a remarkable book "The Spirit Level" Richard Wilkinson and Kate Pickett brings out how when index of health is linked to GNI per capita, it's not possible to decipher to what extent index of health like tendency for homicide, trust, mental health are affected by per capita income level.

However, when the same health index is correlated with Gini Coefficient, one clearly notices the very high levels of low health index for countries like USA enjoying high per capita income, while countries like Japan, Sweden, and Netherland with low levels of income inequality have a far better health index. This clearly shows that acute inequality can be deeply corrosive in terms of moral quotient of a society.

Ideology and Inequality

There has been riveting ideological war on the impact of tax rate on income inequality. Prof. Simon Kuznets, the

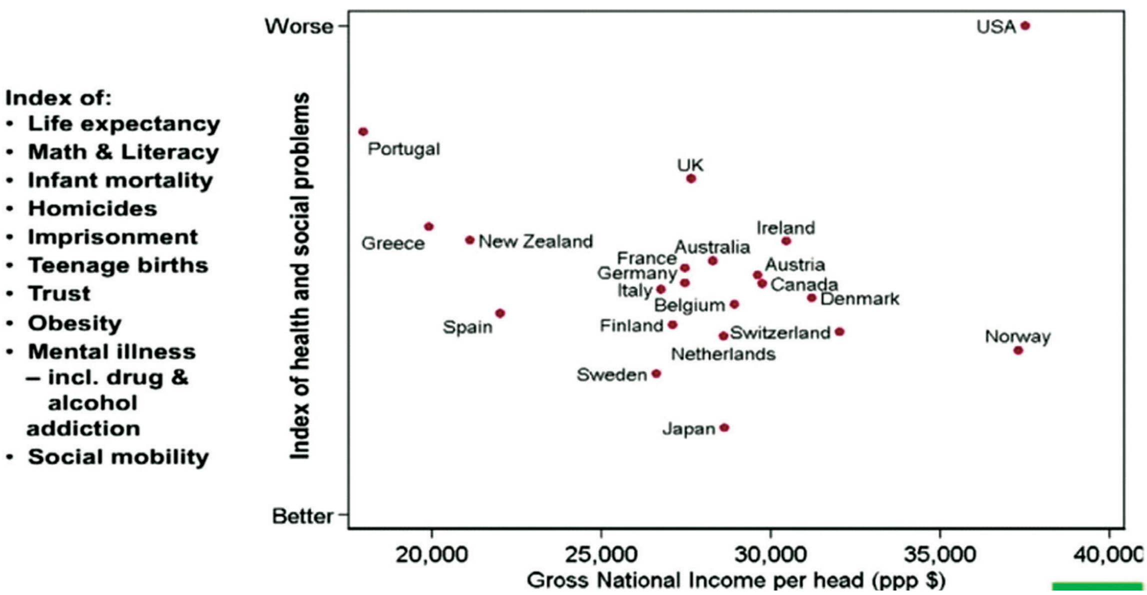

Figure-6: GNI and Index of Health.
Source: The Spirit Level: Why Greater Equality Makes Societies Stronger

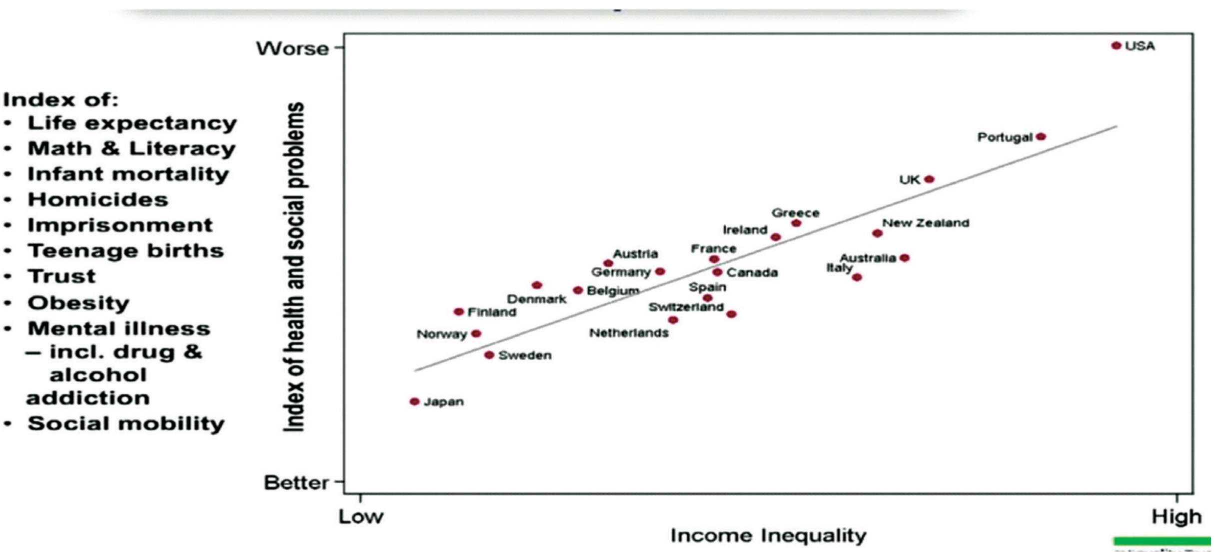

Figure-7: Income Inequality and Index of Health.
Source: The Spirit Level: Why Greater Equality Makes Societies Stronger

Nobel Laureate brought up at inverted U curve model, as per which as countries move up in terms of per capita income, in equality will increase. However, after a certain point of high per capita income, inequality would start decelerating model is as under:

Prof. Kuznets had observed that "his findings are 5% empirical and 95% speculative, some of it tainted by wishful thinking!" However, Kuznet's inverted 'U' curve provided the intellectual foundation for a widely held view that highly developed economies would be less unequal.

Thomas Piketty provided the counter point to such baneful impact capitalism, when he showed conclusively that during the century spanning (1910-2010), inequality actually decreased during the 1930s and 40s in the USA. This was the time when the New Deal program of FDR provided a slew of employment programs and salvaged the US economy from the quagmire of economic depression and made the society less unequal. FDR introduced key minimum wage law that was struck down by the Supreme Court initially. Subsequently the Court relented and saw the wisdom of FDR's minimum wage law as "a principle of natural justice based on non-regressively. Piketty 'U' curve is demonstrated below:

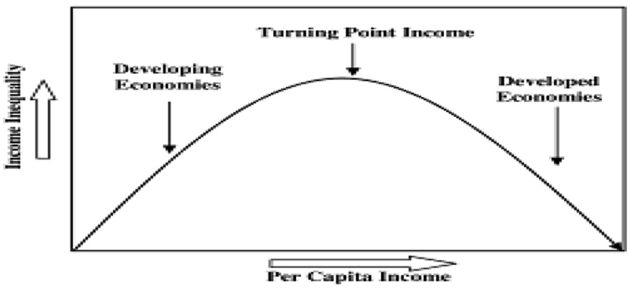

Figure 8: Kuznets Inverted 'U' Curve.
Source: Kuznets Inverted 'U' Curve

It would be clearly seen that after the top tax rates on the rich were significantly reduced from 70% (1980) to 31% in 1981, the inequality sharply increased in the American society till 2011. Such tax policy was also embraced by Prime Minister Margaret Thatcher in UK, who went in for massive privatization of public sector companies.

Piketty's other concern was in the area of wealth tax where countries like France were soft towards rich inheritors of wealth. He famously observed that a just society is not about regulating the market, but "minimizing lottery by birth" and preventive 'patrimonial capitalism'. Frances Bourguigon had also pointed that tax rate on top 1% had come down from 42% to 27% and wealth tax from 54% to 40% in most European Countries during (1980-2013). This was based on the Lafferian theory that tax rates beyond and certain point (70%) is counterproductive. Aurthur Laffer's contention is presented in the following curve:

The above curve provided the ideological justification for policy makers in the USA and Europe to substantially decrease the tax rates at the top. In India also after economic liberalization in 1991, the top tax rates have witnessed sharp reductions after 1996-97, from 96.5% (1970s) to 30% now.

Prof. Atkinson brings out that a survey in 2005 revealed that a 10% decrease in tax rate leads to significant revenue loss. Further, a survey of 2012 reveals that nearly 70% of the economists disagreed with Laffer's theory. An IMF study (2014) also clearly brings out that increase in tax rate upto say 50% has negligible impact on investment. For Joseph Stiglitz, in his book 'Price of Inequality' avers that Regan's policy of favouring the top income earner and not giving commensurate relief to the middle class have been the prime cause for accentuating inequality in the USA. Paul Krugman, another Novel Laureate, called the 1980s a period of double jeopardy

Figure 9: Income Inequality in USA (1910–2010).
Source: Capital in the Twenty-First Century

when tax rates favouring the top corporates and union bashing leading to significant weakening of the bargaining power of labourers to demand a just wage. Thomas Piketty had brought out how in the economic prospects noticed in US and France, the higher gainers were the capitalists and the lowest, the 'wage earners'.

In a significant book 'The Great Leveler' Walter Scheidel has succinctly thumb nailed the major reasons for increased inequality. He discovers that attempts towards land reforms in several countries have been generally unsuccessful in alleviating inequality in land holding. In India also, movements like Bhoodan movement by Binobha Bhave has become a cropper. He cites a study by Acemoglu where they had taken up 184 countries (1960-2010) as per which equalization is impeded, if democracy is captured by powerful constituencies. In the India's context, it would be seen that the corporate lobby and crony capitalism have developed close nexus with the party in power, which has helped in wealth maximization of a few billionaires. The constitution was amended in 1976 providing for a clause Art 38(2) as per which the state to reduce income inequality. As brought out earlier in the Figure-4, the state has shown no inclination to achieve this constitutional mandate of reducing income inequality.

Scheidel opines that after globalization has struck firm roots, elites have trended to benefit disproportionately and there is a premium on skill, particularly in financial globalization. He also observes that there has been a fall in union membership from 34% to 8% in Europe and US in the 1980s; leading to erosion of minimum wage. However, Scheidel has been realistic enough to observe that peaceful policy reforms will not prove equal to the growing challenge of inequality. The Economist in an editorial had observed that one of the reasons why Brexit happened was because the poorer segments of the society believed that liberal democracy has only sub-served the interests of the elite and their access to better schooling, health care and employment has not happened.

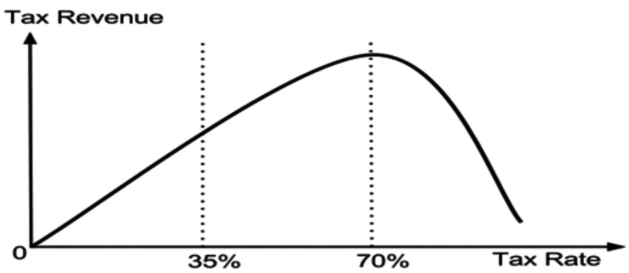

Figure 10: Laffer Curve.
Source: Arthur Laffer

Impact of Pandemic on Inequality amongst the Vulnerable

The Covid-19, as is well known, has devastated life and livelihood, as never before. The digital divide between the haves and have nots has further widened and equal opportunity and ending discrimination of those who are disabled has particularly accentuated significantly. The major goal of Targets 10.3 in SDG is to ensure equal opportunity and end discrimination.

In a study made by ASER-2021 during September 2020 they have found that while 18% of students from private schools attended on time classes, only 4% of poor students had this benefit of outline learning. Education of parents is a major proxy for educational attainment of their children. The ASER survey brings out how children of 23% uneducated parents is being hugely affected during Covid-19.

As per WHO (2011), 1 trillion are disabled, consistently 15% of the global population of the 1.2 lakh school children in Odisha, Dr. Sruti Mohapatra, CEO of Swabhiman in a survey has brought out how 50% of them are struggling and 77% struggling to cope up with on-line learning. Further, Arman Ali, ED, Centre for Employment of the Disabled has brought out how 67% of the disabled children are being deprived of doorstep of essential food stuff.

Table 3: Borrowing, Fiscal & Revenue Deficit: Trends

Borrowing, Fiscal & Revenue Deficit: Trends				
Parameter	**2019-20**	**2021-21 (RE)**	**2021-22 (RE)**	**2022-23 (BE)**
Borrowing (Rs. Lakh Crore)	9.3	18.2	15.9	16.6
Revenue Deficit	3.3	4.8	4.7	3.8
Fiscal Deficit	4.6	9.2	6.9	6.4
Tax Revenue (Rs. Lakh Crore)	13.5	13.4	20.7	22

Source: Budget 2022–23

Covid-19 and Tendency to Borrow Humongous

The Covid-19 pandemic has witnessed significant increase in market borrowing by the government. Table 3 below would reveal the position.

In the FRBM Act (2003), the government set a target to bring down revenue deficit to zero and fiscal deficit to 3% by 2008. However, due to the U.S. financial crisis (2007-08), the targets were slipped. When this was on, Covid-19 forced government's hand to resort to massive borrowing to bail out poor people migrant workers and SMEs out of the quagmire of economic disaster. However, as the economy recovered by 2021-22, with tax collections improving significantly government has set a very target of only 6% increase in tax collection during 2022-23. India's record in tax collection increase in around 15% with GDP growth during 2022-23 likely to increase around 9%, the government should have targeted a much higher tax collection and low borrowing than what has been projected by the Finance Minister in budget 2022-23.

This clearly shows a very soft approach of the state towards IT payers; more so when the tax/GDP has been stagnating around 11% of GDP over the last few years. Prof. Kenneth Rogoff had brought out in a paper titled "Growth in a time of Debt" (2010), that when total fiscal deficit is more 90% of the GDP, the economy is likely to witness low growth and high inflation. Since India's total debt burden (Centre plus States) is around 90% now, there is a need to impose higher marginal tax on the super-rich to reduce income inequality in India

Way Forward

In his book "Capital and Ideology" (2020) Thomas Piketty believes that early intervention in primary education is the best way to correct inequality between students from different backgrounds. He also contends that steep progressive taxation on property, income tax should be used to pay for social insurance expenditure and ensuring universal basic income for all. In an article jointly written with Prof. Abhijit Banerjee (2019), he laments that Indians vote on caste and religious issues and not on adequacy of social spending. To quote "voters seem to be less driven by straight forward economic interests than by sectarian economic interest and cultural priorities. In India, political conflicts have become increasingly focused on identity and religious, ethnic conflict rather than a tangible material benefits and class-based redistribution. The failure of land reforms and redistribution initiatives and quest for Ram Mandir rather than quality education and health care are manifestation of the above assessment."

India thus needs to spend much more on basic foundational education and improve the quality of education and skilling. NEP (2020) strikes the right note by putting premium on "Early childhood care and education", which remains highly neglected, the way it is handled presently in the Anganwadi centres through the ICDS scheme. Provision of merit goods, as Prof. Richard Musgrave had rightly observed, has to be the primary remit of the government. It must provide quality health care at affordable cost, quality public school education for the age 3 to 16 and ensure that sanitation and nutrition which are the real culprits for unacceptably high number of stunted children, and anemic adolescent girls, in contained in a time bound manner. The budget allocation has to be significantly increased for 5% to 10% in various social sector schemes. The Poshan Abhiyan (2018) should not be waylaid by rhetoric but effective action. Progressive IT on the super-rich along with wealth tax, basic minimum income for all, health care, and nutrition as a fundamental right would be the right recipe for reducing income inequality in the long run and usher in just equitable society, based on the principle of shared prosperity. There is a need to abdicate to present tendency of debt fueled growth and instead propel tax collection by increasing marginal tax rates on the superrich. That will go a long way in reducing yawning and increasing trend of income inequality in India.

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Professor Satya Narayan Misra has been a civil servant for 36 years before joining KIIT University as Professor of Economics in the School of law. He has 122 articles in reputed research journals. He also has written 5 books, including a well acclaimed book, 'Beyond the Iceberg'. Twelve research scholars have been conferred PhD under his supervision and presently he is guiding 6 scholars.

He became a Professor Emeritus from 1st July 2022.

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