INEQUALITY AND GROWTH

ANNUAL INCREASE IN GINI COEFFICIENT
1900-2000 (in %)

*Lao People's Democratic Republic

Source: ADB

ESTIMATES OF INEQUALITY FROM NSSO CONSUMPTION EXPENDITURE SURVEYS
Gini of consumption expenditure (x100)

	1983	1993-94	2004-05	2009-10	2011-12
Rural Gini	27.10	25.80	28.10	28.40	28.70
Urban Gini	31.40	31.90	36.40	38.10	37.70
All India Gini	29.80	30.00	34.70	35.80	35.90

Note: All estimates are based on mixed recall period estimates of consumption expenditure.

Source: Computed by the author from NSSO unit-level data

EXPERT VIEW

SUDIPTO MUNDLE

Respond to this column at **feedback@livemint.com**

Economists don't write bestsellers. But when Thomas Piketty published *Capital in the Twenty First Century*, his treatise on the inherent tendency of rising inequality under capitalism, it instantly became a runaway success. Angus Deaton, for whom inequality—including in India—has been a major focus of research, was given the Nobel Prize for economics last week. The World Economic Forum, which is the pre-eminent club of business and political leaders from the world's richest countries, and not a "bleeding heart" forum for the "have-nots", continues to cite rising inequality as a major global risk in its annual Global Risk Report. Why all this recent attention to inequality studies? Why the great concern about rising inequality?

I return to this question further below, but first a review of the facts. Is inequality indeed rising?

Piketty verified his theory empirically with data largely drawn from Europe and the US. But the tendency of rising inequality is also firmly confirmed by trends in Asia. Using data from the Asian Development Bank's 2012 Asian Development Outlook, economists Juzhong Zhuang, Ravi Kanbur, and Changyong Rhee demonstrate that from the 1990s to the 2000s, income (or consumption) inequality distinctly increased in 12 major countries of the region, covering 80% of the Asian population (see chart).

The increase in inequality varied across countries and was most prominent in China. The rise in inequality there was about four times that in Taiwan, where it rose the least. Inequality also increased in India. But the increase was moderate compared with China, Indonesia, Korea, and some other countries. Inequality estimates for India may be underestimates as they are based on consumption expenditure not income. But whether that should effect increases in inequality is not clear.

In a recent study dealing specifically with India (*mintne.ws/1Llxss0*), economist Himanshu shows that inequality has been rising in rural India, but much less than in urban India. Thus, between 1993-94 and 2011- 2012 the Gini coefficient (x100), a standard measure of inequality, increased from 25.8 to 28.7 in rural India compared with an increase from 31.9 to 35.9 in urban India (see table). For the country as a whole, the Gini coefficient (x100) went up from 30 to 35.9 over the same period.

Why is inequality rising?

There are three broad mutually reinforcing forces at work that drive the rise in inequality.

The first is technological change. Every wave of innovation in the modern era, triggered by the steam engine, electricity, the motor car, the transistor, the computer and the IT revolution, etc., has resulted in the rising capital intensity of technology. That, in turn, has shifted demand in favour of capital vis-a-vis labour, thereby raising the share of profits relative to wages. It has also shifted demand in favour of more skilled workers relative to less skilled workers, thereby raising wage differential between skilled work, including the work of managers, and unskilled work. Both these trends have, in turn, raised inequality.

The capital intensification of technology has been reinforced by the massive growth in global trade and the globalized system of production, communication and finance. Capital can now source labour and locate production wherever it needs to in order to minimize the cost of labour.

Consider miniaturization, a technical change that has combined room sized computers, bulky television sets and landline telephones into a single smartphone. But supporting that little phone is an awesome system of global infrastructure: supply chains, robotized factories, power production and delivery systems, and the network of terrestrial communication systems integrated with satellite communication systems and trans-continental fibre optic cables under the sea.

All of this raises the demand for capital inexorably. It reinforces the shift of demand in favour of capital vis-a-vis labour, and in favour of skilled work as opposed to unskilled work. These, in turn, intensify the rise in inequality.

The trend of rising inequality is further strengthened by liberalization reforms that free up markets in developing countries. Free markets better reflect scarcity values as demand shifts in favour of capital vis-a-vis labour and skilled work vis-a-vis unskilled work, thereby accelerating the rise in inequality.

I now return to my original question, why is rising inequality such a concern for the World Economic Forum?

Traditionally, the relationship between inequality and growth was seen in a rather static, zero-sum framework. Should we redistribute the existing pie, thereby compromising growth, or should we focus on growth, ignoring inequality? After all, a rising tide will lift all boats.

It is now recognized that the forces that drive growth are also the forces that raise inequality as discussed above, i.e., technical change, globalization and liberalizing policy reforms (Juzhong Zhuang, Ravi Kanbur, and Changyong Rhee 2014). They are two sides of the same coin. Moreover, there are negative feedback effects from rising inequality that adversely effect growth. So the search for growth can no longer ignore the challenge of rising inequality.

Consider a poor country where large sections of the working-age people are at the base of the income pyramid. They do not have access to the required minimum levels of nutrition and healthcare. They also lack access to the education and skill training required to equip themselves as skilled workers. Such a country will be trapped at levels of productivity and growth that are well below its potential.

> It is now recognized that the forces that drive growth are also the forces that raise inequality

However, countries can be trapped below their potential even without extreme deprivation if rising aspirations clash with the rise in inequality. The growing mass of people at the lower quintiles of income may not be hungry any more. But if they lack the means to fulfil their aspirations, that too can generate a great deal of anger and social tension. Such tensions are heightened in our times by consumerism and 24x7 television. Even poor people living in remote villages are exposed to the lifestyles and consumption of the rich, developing aspirations they may never be able to fulfil.

As the WEF's 2015 Global Risk Report points out, rising inequality stokes the fires of social unrest and instability. Once instability takes hold of a society, normal governance, peace and security, the rule of law, all fall by the wayside.

In Angus Deaton's words: "...there are also terrible dangers of inequality, if those who have escaped from destitution use their wealth to block those who are still imprisoned in it".

The evolution of the crisis thereafter can take two different paths.

If the crisis takes an extreme form, it could be beyond the capacity of the government to cope. Governance could break down, and eventually there could be a failed state. There are several such examples around the world, including in our own neighbourhood. Growth is not even on the agenda in this scenario.

Alternatively, a government may be unable or unwilling to tackle the roots of rising inequality, but it may try to contain social unrest. It will do so through palliative entitlement policies and accommodation of identity politics. We are seeing this path unfold in India.

The Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), the Right to Food, the Right to Education are all examples of such palliatives policies adopted to cope with the consequences of rising inequality. These policies do not contain rising inequality, but merely moderate its adverse social consequences. And they do so at a large cost, compressing the fiscal space for public infrastructure investment, thereby also compromising growth.

These palliative policies are combined with policies of appeasement towards identity politics in the context of scarce employment opportunities. Reservations and quotas in everything from *panchayats*, to college admissions to jobs rule the day. The Hardik Patel episode is a good example. Here is a community that is by no means poor. Yet it wants reservations, simply because others have it. We may soon see a day when all jobs will be allocated by quotas. Meanwhile, merit is going out of the window. Productivity and growth potential are being compromised.

Is there a better way forward? Some ingredients of inclusive growth are well known. Public provisioning of quality education, skill development and health services for the poor. Ensuring transparency and fair competition in land and other asset markets, preventing regulatory capture. A level playing field between employers and employees in the labour market. Competitive product markets. A prudent fiscal strategy that combines restraint on tax expenditures along with targeting of subsidies.

Will all of this yield growth without rising inequality? We won't know till we have tried it. Successive Union governments have sworn allegiance to inclusive growth but never delivered. It would take a statesman, not an ordinary politician, to rise above short-term political expediency, and the usual pulls and pressures of power, to walk down this path. Meanwhile, it may be instructive to look around and see which country, if any, has managed to contain the rise in inequality without compromising growth.

The author is emeritus professor at the National Institute of Public Finance and Policy and a senior visiting fellow at the Centre for Public Affairs and Critical Theory, Shiv Nadar University, New Delhi.