Chapter 70

ECONOMIC INEQUALITIES IN INDIA

A pertinent question that has often emerged in the context of Indian economic planning is: Whether the gap between the haves and have-nots has narrowed or widened since the launching of the planned economic development in India? To examine this, a number of governmental, institutional and individual studies have been made from time to time. All studies have arrived at the conclusion that this gap has actually widened and there has been a concentration of wealth and economic power in a few hands to the detriment of the underprivileged and the common people. Before we analyse the findings of these studies, the causes of the perpetuation of inequalities, and suggestions to overcome them, it is instructive to have a theoretical interlude on the compatibility of growth and equality (or income distribution).

GROWTH VERSUS EQUALITY

According to western economic thought, the goals of economic growth and income distribution are incompatible. It emphasizes the maximisation of the growth rate of the economy leaving the distribution of income untouched. To use Professor Lewis' metaphor, it is like riding the horse of economic development and leaving the horse of economic equality to feed for itself. This had been the experience of 18th century England, 19th century Western Europe and early 20th century Japan where wealth and income inequalities led to large savings on the part of the wealthy classes who used them for productive investments.

Earlier, the classical economists were also in favour of income inequality. According to them, income equality discourages savings. Income equality means a higher income for the working classes and a rise in their consumption. This, in turn, means a rise in population. The classicals, therefore, believed that inequalities of incomes were necessary to provide the incentive for economic growth.

But Marx thought otherwise. According to him, it was income inequality that would bring the doom of capitalism. He argued that income inequality meant less consumption for the poor masses. This would lead to unsold stocks of goods and to a stop of further production. In this way, there would be cumulative over-production and under-

Scanned with CamScanner

consumption and the capitalist economy would move towards secular stagnation.

It was Lord Keynes who pleaded for income equality to sustain economic growth. He wrote: "In contemporary conditions the growth of wealth far from being dependent on the abstinence of the rich as is commonly supposed, is more likely to be imposed by it. One of the chief social justifications of great inequality of wealth is, therefore, removed." According to Keynes, a society which saves more due to inequalities of income and wealth, brings secular stagnation, because inequalities would reduce its consumption capacity and bring contraction in demand. Ultimately, it would lead to fall in production and slowing down the economic activity. Keynes, therefore, favoured income equality which might lead to sustained economic growth via the multiplier effect.

Of the post-Keynesian economists, Professor Kurihara has carried Keynes' views further. Keynes believed that encouraging consumption is alternative to saving. But Kurihara shows that they are complementary. When there is income inequality it leads to excessive thriftness and fall in inducement to invest as a result of declining marginal efficiency of capital. Economic growth requires the balancing of the two forces which is possible in a "high-wage, low-profit economy, and investment-free society."

In the 1950s and 1960s, the thinking on income equality and growth was influenced by Kuznets' U-shaped Curve. Kuznets suggested on the experience of the developed countries that historically there was a tendency for income inequalities to increase first, and then to be reduced as countries developed from a low level. Accordingly, it was believed that a high degree of inequality in the distribution of income had a favourable effect on economic growth in the early stages of development and as development gained momentum, its benefits would automatically "trickle down" to the lower income groups over the long run. So this approach emphasised the maximisation of the growth rate of the economy by building up capital, infrastructure and productive capacity of the economy, and leaving the income distribution untouched.

Lewis was the principal supporter of this view. He outlined the process through which income inequalities led to the economic growth of the 18th century England, the 19th century Western Europe and the early 20th century Japan. He advocates the same for underdeveloped countries. Lewis contends that voluntary savings form a significantly large share of national income only where inequality of income distribution is such that profits are a relatively large share of national income. When growth is taking place, the modern sector grows faster

Scanned with CamScanner

than the traditional sector and the relative share of profits in national income also increases. This tends to prepetuate income inequalities. In the long run, however, when employment opportunities increase all round and the traditional sector also develops, the distribution of income tends to stabilise. But this is an automatic process and is only a side-effect of the growth of the economy.

According to Lewis, the share of profits in national income should be increased by expanding the capitalist sector of the economy deliberately. For this, he suggests that those who lived on unearned incomes, particularly ground rents, should be taxed heavily and the proceeds given to capitalists who live on profits. Profits can also be increased by giving subsidies and tax rebates by providing adequate supplies of raw materials and capital equipment, by restricting imports of competitive products, by controlling wages and trade unions, and by government purchases of the goods of the industries. Thus it is contended that larger profits accruing to the capitalist sector will mean larger savings which will be invested for larger capital formation and higher growth rates.

But this is not a correct view in the context of developing countries. Perpetuation of income inequalities is no condition for rapid economic growth. Unlike the developed countries, the conditions in developing countries are such that income inequalities are not necessary for their economic development. A number of arguments are given in support of this view.

Perpetuation of income inequalities is not feasible under the system of parliamentary democracy and the political climate prevailing in such countries. The policy of raising profits to increase savings for capital formation may lead to social unrest and may even fail to produce socially desirable investment since the profit-making classes are not necessarily increased in the welfare of the masses.[1] Thus income inequalities may hamper economic development.

The policy of increasing profits of the capitalist sector through subsidies, tax rebates, controlling wages and trade unions, etc. creates vested interests and leads to maldistribution of resources within a developing economy.

Moreover, there is no guarantee that the wealthy classes in such economies will utilize their savings in productive channels. Rather, businessmen, landlords and other rich elites spend much of their incomes on conspicuous consumption, gold hoards, jewellery, estates and expensive houses, speculation, foreign travel, etc. In certain cases, it leads to the flight of capital in the form of deposits in bank abroad and hoardings of foreign currencies and gold in the safe vaults of Western

[1]D.R. [illegible] Development, p. 181.

banks. Thus such savings and investments do not serve any fruitful purpose. They do not add to the productive resources of the economy but are a drain on them.

On the other hand, the perpetuation of income inequalities brings more harm to the economy. Inequalities retard development. Therefore, prudence demands that efforts should be made to raise the incomes of the majority of the people who are poor.

Further, inequalities lead to great economic waste. The waste is caused by inefficient management. Businessmen who are rich may be efficient entrepreneurs themselves, but their children who inherit their wealth may not be as efficient as their fathers. Thus starts a process of inefficient management thereby lowering the rate of economic development.

Another cause of economic waste due to inequalities is loss of human capital. As the majority of the people are poor with low levels of income and low levels of living, they cannot provide themselves with nutritional diet, formal education and training. Consequently, their productive efficiency is low which, in turn, leads to a slower growth of the economy. Thus the reduction of inequalities and raising the incomes and levels of living to the poor would raise not only their productive efficiency but also that of the economy.

Again, with the increase in the income levels of the poor the demand for such locally produced necessities as food products, clothes, etc. will increase. This increased demand for local products shall encourage their production thereby leading to larger investment and higher capital formation and economic development within the economy.

Thus the belief that income inequalities propel the engine of economic growth does not hold in the context of the developing countries aiming at a welfare state. The widening gap between the rich and poor can no longer be left to the market forces. It has to be narrowed by deliberate state action in five ways: *First*, maximising the growth of GNP through raising savings and resources more efficiently, with benefits to all groups in society. *Second*, redirecting investment to the poor in the form of education, access to credit, public facilities, etc. *Third*, redistributing income to the poor through the fiscal system or through direct allocation of consumer goods. The policy of tax-financed transfers from the rich to the poor may raise the income of the poor, but if it reduces savings and capital accumulation by the rich; it may ultimately lower the incomes of the poor. *Fourth*, a transfer of existing assets to the poor, as in the form of land reforms. *Fifth*, a long-term population policy has important influence on both the distribution of incomes and consumption levels of the poor. Investments in the health, education and economic development of the poor contributes to a

Scanned with CamScanner

reduction in fertility and hence indirectly to better income distribution.[2] Whatever policy measures may be adopted, there has to be a compromise between the objectives of growth and equality. In other words, if the developing countries wish to ride simultaneously the two horses of economic development and economic equality, they have to move cautiously.

The achievement of these twin objectives has been one of the main planks of economic policy in India. One of the directive principles of the Constitution of India lays down that "the state shall, in particular, direct its policy towards securing that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment." This principle of reduction in inequalities became one of the objectives in the subsequent Five-Year Plans for the economic development of the country.

Estimates of Inequalities in India

The various estimates with regard to the distribution of national income reveal that the inequalities of income and wealth have widened rather than narrowed as a consequence of planned economic development in India.

The Mahalanobis Committee on *Distribution of Income and Levels of Living* (1964) revealed the following pattern of income distribution in the country based on the estimates of the Reserve Bank of India, of Iyengar and Mukherjee and of the National Council of Applied and Economic Research.

The RBI estimates show that during the period 1953-54 to 1956-57 the top 5 per cent of the total households shared 20 per cent of the national income and the bottom 20 per cent only 8 per cent of households. In addition, the rural and urban breakdown shows that the degree of inequality is greater in urban than in the rural sector. The estimates of Iyengar and Mukherjee also reveal wide disparities between the bottom 20 per cent and the top 10 per cent and 5 per cent of the total households, the respective shares in national income being 8.5 per cent, 25 per cent and 17.5 per cent for 1956-57. The NCAER estimates for 1960 shows that the gap between the top and the bottom had widened much. In the urban sector, the bottom 20 per cent shared 4 per cent of the national income while the top 10 per cent and 5 per cent received 42.4 per cent and 31 per cent of national income respectively. In the rural sector, the share of the bottom 20 per cent was the same as for the urban sector (4 per cent) while the top 10 per cent had 33.6 per cent of the national income. This again revealed that the degree of inequality

[2] ... Growth, 1974.

was somewhat less in rural than in the urban sector.

The *Mahalanobis Committee* further revealed on the basis of the data prepared by the NCAER about the share of households in aggregate *income before tax* for 1960 that the share of the bottom 10 per cent of households in aggregate income was only 1.3 per cent in the urban sector and 0.7 per cent in the rural sector; while that of the top 10 per cent of households was 42.4 per cent in the urban and 33.6 per cent in the rural sector. Further, the lower 50 per cent of the households had 17.5 per cent share in aggregate income in the urban sector, while the top 50 per cent of the households had 82.5 per cent of the aggregate income. The comparative figures for the rural sector for the two fractile groups were 20.7 per cent and 79.3 per cent respectively. The Mahalanobis Committee concluded on the basis of these findings: "The wide range of variation that one finds between the top and the bottom tenths of population clearly reveals the existence of concentration of economic power in the country in its generalised form...*And*, the conclusion seems justified that even after ten years of planning and despite fairly heavy schemes of taxation on the upper incomes, there is a considerable measure of concentration in urban areas. This would also hold good for rural incomes as, in their cases, even the burden of taxation is not heavy on the higher ranges of incomes."[3]

Another estimate of the growth of inequality in India has been made by Dandekar and Rath for the period 1960-61 to 1967-68 on the basis of the *per capita consumer expenditure*. Their study revealed that the per capita *national* consumer expenditure increased by 3.9 per cent over the period 1960-61 to 1967-68, the per capita *urban* consumer expenditure increased by 2.4 per cent, and the per capita rural consumer expenditure by 3.8 per cent. To take the different sections of the *rural* population first, over the period of the study the per capita consumption of the 20 per cent poorest increased by less than 2 per cent and that of the poorest 5 per cent actually declined by about one per cent. The consumption of the *lower middle* sections (20 to 40 per cent) increased by 2.2 to 2.6 per cent, that of the *middle* sections (40 to 60 per cent) increased by 3.7 to 4.1 per cent, and of *upper* middle and the richer sections (40 per cent of population) increased by 4.4 per cent. Thus the process of development during the period 1960-61 to 1967-68 affected different sections of the rural population differently. It benefited the upper middle and the richer sections much more than the middle, the lower middle and poorer sections. Thus Dandekar and Rath observed, "Under the circumstances, a certain amount of growth of inequality is inevitable." To take

Scanned with CamScanner