Beyond Piketty: on income inequality

With the Gujarat State elections barely a few weeks away, the debate on the Indian economy has become increasingly polarised. While the official view of demonetisation unleashed in November 2016 elevates it to a moral and ethical imperative, the chaos caused by the goods and services tax **(GST) launched on July 1, 2017**, is dismissed as a short-run transitional hiccup. Both policies, it is asserted, are guaranteed to yield long-term benefits, unmindful of large-scale hardships, loss of livelihoods, closure of small and medium enterprises and slowdown of agriculture. Critics of course reject these claims lock, stock and barrel. Lack of robust evidence is as much a problem for the official proponents of these policies as it is for the critics. Hence the debate continues unabated with frequent hostile overtones.

Tracking income inequality

Beneath the debate are deep questions of inequality and its association with poverty. Thomas Piketty produced a monumental treatise, *Capital in the Twenty-First Century*, demonstrating that rising income inequality is a by-product of growth in the developed world. More recently, **Lucas Chancel and Piketty (2017), in 'Indian income inequality, 1922-2014: From British Raj to Billionaire Raj?'**, offer a rich and unique description of evolution of income inequality in terms of income shares and incomes in the bottom 50%, the middle 40% and top 10% (as well as top 1%, 0.1%, and 0.001%), combining household survey data, tax returns and other specialised surveys.

Some of the principal findings are: one, the share of national income accruing to the top 1% income earners is now at its highest level since the launch of the Indian Income Tax Act in 1922. The top 1% of earners captured less than 21% of total income in the late 1930s, before dropping to 6% in the early 1980s and rising to 22% today. Two, over the 1951-1980 period, the bottom 50% captured 28% of total growth and incomes of this group grew faster than the average, while the top 0.1% incomes decreased. Three, over the 1980-2014 period, the situation was reversed; the top 0.1% of earners captured a higher share of total growth than the bottom 50% (12% v. 11%), while the top 1% received a higher share of total growth than the middle 40% (29% v. 23%).

Entering the age of GST

True to its modest objective, it offers a rich and insightful description of how income distribution, especially in the upper tail, and inequality have evolved.

Sharp reduction in the top marginal tax rate, and transition to a more pro-business environment had a positive impact on top incomes, in line with rent-seeking behaviour.

India's wealth gain

According to Credit Suisse Global Wealth Report 2017, the number of millionaires in India is expected to reach 3,72,000 while the total household income is likely to grow by 7.5% annually to touch $7.1 trillion by 2022. Since 2000, wealth in India has grown at 9.2% per annum, faster than the global average of 6% even after taking into account population growth of 2.2% annually. However, not everyone has shared the rapid growth of wealth.

Our research, based on the India Human Development Survey 2005-12, focusses on a detailed

disaggregation of income inequality, along the lines of Chancel and Piketty, recognising that incomes in the upper tail are under-reported; and examines the links between poverty and income inequality, especially in the upper tail, state affluence, and prices of cereals.

Equality for what?

Our analysis points to a rise in income inequality. A high Gini coefficient of per capita income distribution, a widely used measure of income inequality, in 2005 became higher in 2012. The share of the bottom 50% fell while those of the top 5% and top 1% rose. The gap between the share of the top 1% and the bottom 50% narrowed considerably.

More glaring is the disparity in ratios of per capita income of the top 1% and bottom 50%. The ratio shot up from 27 in 2005 to 39 in 2012. Far more glaring is the disparity in the highest incomes in these percentiles. The ratio of highest income in the top 1% to that of the bottom 50% nearly doubled, from a high of 175 to 346.

All poverty indices including the head-count ratio fell but slightly.

Poverty and inequality

Higher incomes reduced poverty substantially. Inequality measured in terms of share of income of the top 10% increased poverty sharply but only in the more affluent States. Somewhat surprisingly, higher cereal prices did not have a significant positive effect on poverty. Similar results are obtained if the share of the top 10% is replaced with the Gini coefficient as a measure of inequality.

The selfish way to combat inequality

It is plausible that poverty reduction slowed in 2016-17 because of deceleration of income growth; and huge shocks of demonetisation and the GST to the informal sector have aggravated income inequality. Indeed, depending on the magnitudes of these shocks, poverty could have risen during this period.

In sum, regardless of the longer-term outlook and presumed but dubious benefits of the policy shocks, the immiseration of large segments of the Indian population was avoidable.

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The definition of harassment needs to be constantly updated, and the process for justice made more robust

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