

## Did liberalization lead to lower income growth for the poor?

One of the strongest justifications for the economic liberalization that began in the 1980s is that it not only raised growth rates, but that growth percolated down to the poorest people. True, liberalization has increased inequality, but that is rationalized as the price to pay for higher growth. After all, it wasn't just us staunch members of the bourgeoisie who said these things—even Comrade Deng Xiaoping advised the Chinese people to “let some people get rich first”.

Folks unimpressed by Deng may choose to believe economist Simon Kuznets instead, who said that inequality will increase initially as an economy develops, but will ultimately drop. The resultant Kuznets curve, as this depiction of the trajectory of inequality is named, is an inverted ‘U’. So a rise in inequality is perfectly fine, it's just the effect of high growth in the economy. Those of us who are in the best position to profit from that growth, either by virtue of higher initial wealth, or higher educational opportunities, benefit the most, of course. But the important point is that everyone gains, even the poorest.

The French economist Thomas Piketty had poured cold water over this argument in his best-selling book, *Capital in the Twenty First Century*, which debunked our cherished belief that a rising tide of economic growth will necessarily lift everybody's boats. Even so, we assumed that while this may be true for the developed economies as their factories are increasingly automated and their jobs vanish to emerging markets, it was different for developing economies. Surely, the evidence was all around us, as vast populations were able to move above the poverty line, thanks to the higher growth ushered in by liberalization? Surely the forest of satellite dishes in slums, the motorcycles parked in front of thatched huts, the ubiquity of mobile phones all pointed to rising prosperity even among the poor?

Apparently we were all deceived. A much-discussed recent paper by Piketty and Lucas Chancel titled *Indian income inequality, 1922-2014: from British Raj to Billionaire Raj?* denies that liberalization has been beneficial for the poor in India. Baldly stated, their paper finds that while average real annual per adult income growth for the bottom half of the population was 2.2% between 1951 and 1980, it fell to 1.94% between 1980 and 2014 (See chart 1). In other words, the bottom half of the population saw higher income growth in the decades before liberalization than in the decades after it. Sure, their incomes too have gone up after liberalization, but at a slower pace than earlier. Were those supposedly socialist decades really better for the poor?

Nor is the paper upbeat about the situation of the “middle class”. It finds that what it calls the middle 40% of the population (this is somewhat of a misnomer because it denotes individuals above the bottom 50% and below the top 10%) hasn't done too well from liberalization either.

Average annual real per adult income growth for this “middle 40%” was 1.9% during 1951 and 1980, which went up to 2.02% between 1980 and 2014. The increase was a mere 0.12% per year, an increment any self-respecting worker in the formal economy would laugh at. The saving grace is that growth has been above 2% from the middle of the last decade for the bottom half of the population and from around the year 2000 for the “middle 40%”.

Piketty and Chancel do not deny that overall growth went up after liberalization. According to the paper, average annual real per adult growth for the entire population in the 1951-1980 period was 1.7%, well below the 3.25% growth notched up in the 1980-2014 period.

So the question is: in spite of overall growth being so much higher, how is it that people in the lower 90% of the population saw a decline in income growth or just a minor improvement? The rather obvious answer is that the top 10% of the population hogged the lion's share of the growth

in income.

Of the total income growth between 1951 and 1980, the bottom 50% of the population captured 28%, the “middle 40%” got 49%, while the top 10% had to remain satisfied with appropriating 24% of the growth (See *chart 2*). But these proportions changed dramatically after liberalization began in the eighties. During 1980-2014, the bottom half of the population got a mere 11% of the growth, the middle 40% captured 23% and the top 10% of people captured two-thirds of growth. With the top 10% appropriating so much of the increase in income, it's little wonder that the rest of the population saw little benefit from liberalization. It's also worth noting that the top 1% of the population captured 29% of the growth in incomes between 1980 and 2014.

Interestingly, China, which too went in for liberalization after 1980, saw its middle 40% capture 43% of the growth in incomes between 1980 and 2014. Growth there has been much more egalitarian than in India, although this may partly be the legacy of the earlier Maoist era.

What is income inequality now in India? The paper has data for 2014, which shows that the average income of an adult in the top 1% is about 70 times the average of the bottom half and 35 times that of the “middle 40%”.

The paper concludes that “Shining India” corresponds to the top 10% of the population (approximately 80 million adult individuals in 2014) rather than the middle 40%. These findings will be very controversial as it upsets the established narrative on growth after liberalization. It is certain to start a lively and heated debate. The full paper can be accessed [here](#).

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