Income Inequality, Ideology and Indifference of our Times

Satya Narayan Misra* and Sanjaya Kumar Ghadai**

ABSTRACT

High Gini Coefficient has the potential of retarding Gross Domestic Product (GDP) of a country besides being socially corrosive. Piketty’s master piece ‘Capital’ (2014) has debunked the myth of Kuznets’ inverted ‘U’ curve hypothesis. A recent IMF note endorses his viewpoint and has strongly pitched for redistributive justice through tax policy. Joseph Stiglitz’s recent book ‘The Great Divide’ also brings out strongly the need for effective reforms in our democratic framework so that each country can legitimately be proud of their shared prosperity. This paper takes an overview of literature on inequality since Ricardo (1817) and provides a flavor of multiple dimensions of global inequality and India’s experience post License Quota Permit (LQP) Raj. The paper brings out the difference in the trends of rural-urban income inequality, and the multidimensional deprivations that a vast swathe of rural population suffer from. It strongly recommends a more progressive tax rate structure, imposition of high wealth tax and handsome investment in quality education. For democracy to function effectively it has to be accountable to all. The paper echoes the concerns expressed in the World Economic Forum and calls for elimination of extreme inequality as a national goal, reducing Palma Ratio as the ninth Millennium Development Goal and eschewing crony capitalism.

Keywords: Gini Coefficient, GDP, Inverted ‘U’ Curve, LQP, Palma Ratio.

1.0 Introduction

The French revolution conclusively demonstrated that “inequality is divisive and socially corrosive”. And yet the ‘market economists’ of all persuasion have been giving thumps up to the ‘trickledown theory of growth’, and overlook the need to take effective redistributive measures. However, lately a number of economists have been making strident call for more effective public policy intervention to minimise inequality.

*Director, School of Leadership, KIIT University, Bhubaneswar, Odisha.
**Executive, School of Leadership, KIIT University, Bhubaneswar, Odisha.
Piketty, a French Economist leads the pack with his seminal book ‘Capital’ (2014) where he has demonstrated how inequality has actually increased in USA after 1970s. This is a clear negation of Kuznets, Inverted ‘U’ Turn Hypothesis. Two other Nobel Laureates viz. Paul Krugman and Joseph Stiglitz flay ‘Reaganomics’ which celebrated crony capitalism and bring out impact of such political initiative in accentuating income divide. India’s growth story after liberalisation has been marred by sharply increasing urban inequality coupled with increased rural urban migration. India also provides a distressing cocktail of crony capitalism and squelching poverty; an ocean of poverty.

This paper tries to analyse:

a) The ideological underpinning that underlay inequality from the days of Ricardo.
b) The Contours Inequality globally and its trends in post liberal India.
c) The way forward for a less unequal world.

2.0 Ideological Underpinnings

While Ricardo (1817) was concerned with the high degree of inequality in England due to excessive rental income of the land lords, Marx was deeply critical of the exploitative mechanism in a capitalist system where a worker works on subsistence wage to “sustain & perpetuate his race”. His grand vision of a classless society was proved delusional as Simon Kuznets (1955) brought out how inequality would first increase and then decrease over the course of industrialization. The under mentioned inverted ‘U’ curve hypothesis (Figure 1) was based on data from 1910-1937 in USA.

**Figure 1: Kuznets Inverted U Curve Hypothesis**

![Inverted U Curve Hypothesis](Source: Kuznets (1968))
The data presented by Kuznets became a powerful political weapon to buttress the claim that mature capitalist economics are egalitarian in character. Piketty (2014) based on a wider database and longer timeframe (1910-2010) has, however, come to the conclusion that inequality shows an upward trajectory after 1972 in USA (Figure 2).

**Figure 2: Income Inequality in the US: 1910-2010**

For Piketty, the history of inequality is shaped by the way economic, social and political actor view what is just and what is not as well as the relative power of those actors and the collective choices that results. While diffusion of knowledge and skills have been a potent force for reducing inequality (convergence), it can be overwhelmed by powerful forces pushing it in the opposite direction towards greater inequality; i.e. forces of divergence. Piketty’s seminal contribution stems out of this analysis of the forces of divergence. He observes that the top earners quickly separate themselves from the rest by a wide margin. While income inequality remained a low 32% to 37% till 1970s, it has seen a rapid increase in 1980s and remains around 45%-50% of national income. The ‘U’ curve above for US clearly demolishes the inverted ‘U’ hypothesis of Kuznets’ as represented in Figure 1. The fundamental reason for this divergence is the sharp fluctuation in wealth distribution. While the capital to income ratio was 5:1 in the 19th century it decreased to 3 during 1914 to 1945. After the 1950s, however, there has been a sharp increase in the private wealth increasing the wealth to GDP ratio to 5-6. This is due to the reason that \( r \geq g \) where ‘\( r \)’ stands for average returns on capital (including profits, dividends etc.) and ‘\( g \)’ stands for rate of growth of economy. Piketty attributes this phenomenon to the huge concentration of wealth in a few hands. Paul
Krugman (2013) analysing US economy during 1970s brings out the orchestrated public policy to decrease the tax rates in the top income brackets and ‘bust the unions’. Krugman calls it ‘Double Jeopardy’ as the rich gains at the expense of the poor and the middle class. Politics thus bolstered the dramatic increase in inequality in USA to favour the corporates. The other interesting facet of Krugman’s analysis is the high disparity in income between similarly skilled personnel viz. hedge fund managers vs. teachers where the former earned nearly three times than the teachers. And the huge payments to executives unlinked with their productivity; coupled with low tax rates as brought out above.

Orkun (1962) had observed that societies cannot have both perfect equality and perfect efficiency but must choose how much to sacrifice for the other. Stiglitz in a very perceptive book “Price of Inequality” (2012) demonstrated that unregulated market tends to accumulate money and power in the hand of a few rather than engendering competition. His latest book “Great Divide” (2015) delves into the irresponsible policies like tax cuts for the rich that is accentuating income inequality further. Stiglitz believes that our choice is not between growth and fairness but with the right policies.

3.0 Contours of Inequality

The global income inequality is best represented by the fact that the richest 1% receive as much as the bottom 60% of the population pyramid (Human Development Report, 1992, UNDP). The position of global inequality in terms of Gini Coefficient as brought out by HDR, 2014 is brought out in Figure 3.

**Figure 3: Gini Coefficient: Global Picture**

![Gini Coefficient: Global Picture](source: HDR: 2014)
It can be seen from Figure 3 that while Scandinavian countries like Norway, Sweden and Germany have a reasonable inequality (25%), it's as high as 40% in both USA & communist countries like Russia and China. The trends of income inequality in India has been summarised in the section below.

4.0 Income Inequality: Post Liberalisation (India)

There is a perception that after liberalisation inequality has increased in India as per Dreze and Deaton (2002). Prof. Bhagwati believes that there is no significant deterioration. Studies by Prof. Ravalian (2001) and Topalova (2007) show that between 1993-1994 to 2004-2005 inequality has increased marginally from 0.3 to 0.37. However, the Figure 4 based on Census 2011, brings out the position on the trend of inequality in rural and urban India more succinctly from 1983 till 2010.

Figure 4: Gini Index of Inequality (1983-2010)

It would be seen from the Figure 4 above that while inequality has increased marginally in rural areas, the increase is very sharp in the urban areas. This is largely due to the fact that the opportunities for earning higher income is limited in the rural areas because of absence of adequate industrial base and the service sector where as in the urban areas the service sector has been the major driving factor for such increase in inequalities.

In this backdrop, it would be useful to go through the findings of the recent Socio Economic & Caste Census (SECC) 2011 Report which has surveyed around
895 million rural population. Besides, the *Rapid Survey on Children* (2013) also brings out the acute problem of about 30% children being malnourished. The SECC-2011 has come to the conclusion that 60% of rural population are deprived multi-dimensionally in terms of (a) landlessness (b) casual employment, (c) poor access to credit and literacy as indicated in Table 1. It would be clear that the land reform measures have not made any significant difference in rural India. Even the promise of financial inclusion for the poor farmers through *Kisan Credit Cards* and promises of improvement in regular employment opportunity show a distressing trend.

**Table 1: Major All India Findings (Rural)**

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Parameter</th>
<th>% of Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Land less</td>
<td>56%</td>
</tr>
<tr>
<td>2</td>
<td>Casual labour</td>
<td>81%</td>
</tr>
<tr>
<td>3</td>
<td>Salaried jobs</td>
<td>9.7%</td>
</tr>
<tr>
<td>4</td>
<td>Income Less than Rs.5000</td>
<td>74.5%</td>
</tr>
<tr>
<td>5</td>
<td>Access to Kisan Cards</td>
<td>3.6%</td>
</tr>
<tr>
<td>6</td>
<td>Illiterates</td>
<td>36%</td>
</tr>
</tbody>
</table>

*Source: SECC Report 2011*

5.0 **Relative Income and Social Wellbeing**

Prof. Richard Wilkins has brought out how there is no significant relationship between the high GNI of a country and its Social Well Being Index. Table 2 brings out the picture in respect of five highly developed economies.

**Table 2: Inequality and Social Health Trends**

<table>
<thead>
<tr>
<th>Country</th>
<th>GNI ($ at PPP)</th>
<th>Income inequality</th>
<th>Top 20% to Bottom 20%</th>
<th>Unicef Index of Child Well Being</th>
<th>Mental Illness %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>35116</td>
<td>25</td>
<td>4.0</td>
<td>Very High</td>
<td>10</td>
</tr>
<tr>
<td>Japan</td>
<td>36747</td>
<td>30</td>
<td>3.4</td>
<td>High</td>
<td>10</td>
</tr>
<tr>
<td>Germany</td>
<td>43049</td>
<td>28.3</td>
<td>5.2</td>
<td>High</td>
<td>10</td>
</tr>
<tr>
<td>UK</td>
<td>35002</td>
<td>36.0</td>
<td>7.2</td>
<td>Low</td>
<td>22</td>
</tr>
<tr>
<td>USA</td>
<td>52308</td>
<td>40.8</td>
<td>8.5</td>
<td>Low</td>
<td>25</td>
</tr>
</tbody>
</table>

*Source: HDR & Unicef Index*

It would be seen that those countries where Gini Coefficient is significantly low (25%-30%), and the share of top 20% of population to bottom 20% much less, fare better
in terms of Unicef Child Wellbeing Index and mental illness. Indeed, social health of a country is critically linked to the relative degree of inequality in a developed country. This lesson is equally applicable to a developing economy like India which is patronizing the corporates by scuttling social sector spend for the poor and vulnerable.

6.0 Policy Intervention

Prof. Musgrave has been a powerful proponent of “distributive justice” and for him, progressive taxation can be a major policy tool in the hands of government to serve this objective. The distributive justice concern through taxation have been looked at with different perspectives over the years. It was Arthur Laffer who sketched a Laffer Curve on a napkin to demonstrate how tax rates beyond a certain point are counterproductive.

Figure-6: Laffer Curve

![Laffer Curve](source: Laffer (1978))

This curve provided the justification to Regan administration to reduce corporate tax for 70% to 31% which doubled absolute revenue nearly twice. But it also reduced the share of tax/GDP marginally from 19% (1980) to 18.4% (1989). For Laffer, the primary problem is not demand but rather impediment like heavy taxation and regulatory burden”. John Rawls, (1971) a powerful political theorist of our times, is a strong proponent of proportional taxation. He believes that high rates of taxation stifles initiatives of business enterprise while it has the potential of making poor people who benefit from doles indolent. However, Ostry, Berg and Tsangrides (2014) have demonstrated that there is no stark efficiency equity trade off. Unless the rates are exorbitant, the efficiency retarding potential of corporate tax/wealth tax is exaggerated.
Piketty, however, takes a more progressive view. Based on taxes in vogue in different countries, he suggests imposition of 80% taxation on incomes above $1 million a year. He is sanguine that it would not reduce growth of US economy but would distribute fruits of growth more widely. The other major idea he has spawned is to introduce global tax on capital coupled with a very high level of international financial transparency. Such a tax would provide a way to ‘avoid an endless in egalitarian spiral with a view to controlling worrisome dynamics of global capital concentration’.

An IMF Paper of June 2015 suggests that countries should have ‘greater reliance on wealth and property taxes’ and reinforce the ‘redistributive role of fiscal policy’, thereby supporting Piketty’s recommendation. Norris et al. (2015) clearly underline the need to focus on poor and the middle class as widening income inequality is the defining challenge of our times. The note brings out that if the income share of the top 25% increases, then GDP growth declines over the medium term; while increase in income share of bottom 20% is associated with higher GDP growth. Technological progress and the resulting rise in the skill premium have contributed to inequality in both advanced and developing countries. Globalisation has played a reinforcing role in it. It is only through better access to education and health care and well directed social policy there will be a rise of income share of poor and middle class. The IMF note focuses on redistributive role of fiscal policy and suggests that can be reinforced by greater reliance on wealth and property taxes, more progressive income taxation and removing opportunities for tax avoidance and evasion.

Stiglitz (2015) in his latest book the ‘Great Divide’ brings out the central finding of Roosebelt Institute While Paper “Reforming Taxation to Promote Growth and Equity” (2014) as per which if the same taxes would have been imposed on capital that is imposed on those who work for a living, USA could have collected $2 trillion over the last decade. Further, loopholes do not adequately describe the flaws in the tax system; gaps might be a better term. Closing them will end this spectre of the very rich proudly disclosing that they pay a tax rate on their disclosed income at half the rate of those with less income, and that they keep their money in tax havens like the Cayman Islands. Stiglitz (2015) suggests that it is better to tax factors of production which have inelastic supply like tax on pollution in all its forms. It could raise hundreds of billions of dollar and would also usher in a better environment. Similarly, appropriately designed tax in the financial sector would not only raise considerable amount of money but also discourage banks from encouraging toxic mortgages. From the foregoing it is clear that there is an overwhelming body of opinion in favour of higher progressive taxation and imposition of high wealth tax and greater vigil over tax avoidance through dubious treaties and parking of moneys in tax heavens.
India presents a curious example where almost 50% of its foreign direct investment comes from such tax havens like Mauritius with whom we have a Double Tax Avoidance Agreement (DTAA). Through a mechanism called round tripping, the Shell companies in Mauritius, park the black money and defrauding the Indian financial system by avoiding payment of higher tax at source and then remitting money though the FDI route. It’s ironical that the last budget has decreased the corporate tax rate and abolished wreath tax, when there is strident call to increase them globally.

7.0 Concluding Thoughts

The Indian Constitution stipulates that “the state shall strive to minimize inequalities in income Article 38(2)”. Further it clearly mandates that ownership and control of material resources of the community are so distributed so as to sub serve common good and the operation of the economic system should not result in concentration of wealth (Article 39(b) & (c)). This is the grand vision that the people of India have set for themselves while scripting the Constitution on 27th November, 1949. The above directives are considered “fundamental in the governance in the country”. However, the stark reality is that the land reforms measures have been singularly ineffective in as much as 90% of land declared surplus are locked up in unending litigation. There are also innumerable loopholes in the land reforms legislation to favour the rich landed interest. These powerful lobbies have hijacked the objectives of asset distribution; though Article 31(c) was included in 1971 to sub serve socio economic justice without being fettered by individual rights under Article 14 & 19. Besides the laws to bring back black money from tax havens are singularly inept and lack in political will. The other disconcerting development is the unbridled celebration of Adam Smith’s, dictum that “Market forces, as if by an invisible hand, will bring well-being of all”. The global crisis (2008) has convincingly proved that unfettered markets will lead to more monopoly power & greater abuses of the financial sector. It will be only through reforms of our democracy-making government more accountable to all people, being more reflective of their interest, we will be able to heal the great divide and ensure shared prosperity. In a riveting paper Prof. Dayle writes that a ninth goal should be added to MDG: “Eliminate extreme inequality at the national level in each country. The best indicator is the Palma Ratio i.e. ratio of incomes at the very top 10% to 20% at the bottom”. Many Scandinavian countries have reached a ratio of 1. The just concluded World Economic Forum clearly chimes this message. A just society must move beyond the debate on trade off between efficiency and equity. Politics is the art of the possible;
reducing acute income inequality will need resolute political will by transcending tendency towards crony capitalism.

References


