# Chapter 4 - Inequality and Growth: Conflict or Convergence?

In this chapter, the Survey examines if inequality and growth conflict or converge in the Indian context in an effort to identify the correct policy objective for India.
By examining the correlation of inequality and per-capita income with a range of socio-economic indicators, the Survey highlights that both economic growth and inequality have similar relationships with socio-economic indicators. Unlike in advanced economies, in India economic growth and inequality converge in terms of their effects on socio-economic indicators. **This chapter finds that economic growth has a far greater impact on poverty alleviation than inequality**.

The Economic Survey suggests that given India's stage of development, India must continue to focus on economic growth to lift the poor out of poverty by expanding the overall pie. It notes that this policy focus does not imply that redistributive objectives are unimportant, but that redistribution is only feasible in a developing economy if the size of the economic pie grows.

- In the advanced economies, Data by Wilkinson and Pickett (2009), Atkinson (2014) and Piketty (2020) show that in the advanced economies, higher inequality leads to adverse socio-economic outcomes but income per capita, a measure that reflects the impact of economic growth, has little impact. Some commentary, especially in advanced economies post the Global Financial Crisis, argues that **inequality is** no accident but an **essential feature of capitalism**.

INEQUALITY AND SOCIO-ECONOMIC INDICATORS

- The index of health outcomes correlates positively with both inequality and income per capita across the Indian states. However, across the advanced economies, inequality correlates negatively with the index of health and social outcomes while income per capita correlates positively.
- Same result using the index of education, life expectancy, infant mortality and crime respectively.
- Data suggests that neither inequality nor income per capita among Indian states correlate strongly with drug usage; however, inequality correlates strongly with drug usage in the advanced economies.
- Inequality and income per capita correlate similarly with other socio-economic outcomes across the Indian states. While birth and fertility rates decline with inequality and income per capita, death rates do not correlate with either inequality or income per capita.

The Economic Survey suggests a **weak positive (0.33) relationship between the two inequalities in India**, I.e., the **inequality** in the **ownership of asset** (measured by the Gini coefficients based of assets) and **inequality** of **consumption** (measured by the consumption-based Gini). This implies that the states with greater consumption inequality are the ones facing greater asset inequality as well.

- In Indian states, asset inequality is much higher than consumption inequality.
- Inequality of consumption is what matters the most rather than inequality of assets or inequality of income. The permanent income hypothesis posits that individuals and households attempt to smooth their consumption over time by borrowing or saving. Thus, while the income of an individual varies from year to year, consumption is more permanent as individuals tend to smooth their consumption over time.

IS PERFECT EQUALITY OPTIMAL?

Having established that inequality and income per capita do not diverge in their relationship with socio-economic outcomes in India, now it is worth asking: is perfect equality optimal?

In most cases, **inequality of opportunity is much more objectionable than inequality of outcomes**, as individuals' opportunities are influenced by endowments that are related to parents and other adults, peers, and a variety of chance occurrences throughout their lifetimes.

- Perfect equalization of outcomes ex-post, i.e., after the efforts have been exerted to obtain those outcomes, can reduce individuals' incentives for work, innovation and wealth creation.
- For a developing country such as India, where the growth potential is high and the scope for poverty reduction is also significant, a **policy that lifts the poor out of poverty by expanding the overall pie is preferable as redistribution is only feasible if the size of the economic pie grows rapidly**.

INEQUALITY AND POVERTY – RELATIONSHIP

Inequality needs to be distinguished from poverty. Inequality refers to the degree of dispersion in the distribution of assets, income or consumption. Poverty refers to the assets, income or consumption of those at the bottom of the distribution.

- Poverty could be conceptualized in relative terms or in absolute terms. People feel themselves to be poor, and think others to be poor if they have substantially less than what is commonplace among others in their society. Poverty, in this view, is **relative deprivation.**
- If the poverty is conceptualized in **relative terms**, there is no need to distinguish it from inequality. A relative measure of poverty is indeed a measure of inequality.
- If poverty is conceptualized in an **absolute sense**, that is, focusing on the absolute levels of assets, income or consumption of those at the low end of the distribution, then increases in inequality may be accompanied by reduction in poverty.

**Distributive justice** – John Rawls argued that the most reasonable way to decide upon a fair distributive principle is to imagine that you must make this decision knowing you will be born into the world but not knowing anything about what your assets and characteristics – intelligence, personality traits, parents, neighborhood, gender, skin colour, etc. – will be. Rawls referred to this hypothetical scenario as the "original position."

- He suggested that in such a situation a rational person would choose a distributive principle requiring that any increase in inequality increase the income of those at the bottom.
- However, experimental evidence suggests that the maximin principle is not how people in the "original position" would choose. Most people do not choose based on this distributive principle. Instead, they choose a principle in which the average income is maximized with a floor under the incomes of those at the bottom.
- In this view, as long as the poor have "adequate" incomes, an increase in the incomes of the rich need not benefit the poor to be considered just. The results of such experiments suggest that **(absolute) poverty should be of greater concern than inequality**.

RELATIVE IMPACT OF ECONOMIC GROWTH AND INEQUALITY ON POVERTY IN INDIA

Given the above discussion, which highlights that poverty alleviation through growth must remain the economic focus for India, this section examines whether income per capita or inequality impacts poverty the most in India.

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- Statistical data shows that the association between MPI and poverty has been positive. It indicates that improvement in poverty also alleviates poverty measured along multiple dimensions and vice versa.
- World Bank (2000) find that India could achieve sustained decline in poverty during 1970s-1990s only when the GDP growth picked up from 3.5 per cent in the initial years.
- Rise in the growth of mean consumption was responsible for approximately 87 per cent of the cumulative decline in poverty, while redistribution contributed to only 13 per cent.
- Analyzing six decades of data from 1957 to 2012 for India, find that growth reduced poverty, and their association has acquired more strength after the 1991 reforms. It also finds that the pattern of growth has changed significantly after 1991.
- Poverty is concentrating more and more in urban areas, as now one-in-three poor is living in urban areas, which was about one-in-eight in the early 1950s. In the post-liberalisation period urban growth and non-agricultural growth has emerged as a major driver of national poverty reduction including rural poverty.

CHAPTER SUMMARY

- The relationship between inequality and socio-economic outcomes, on the one hand, and economic growth and socio-economic outcomes, on the other hand, is different in India from that observed in advanced economies.
- By examining the correlation of inequality and per-capita income with a range of socioeconomic indicators, including health, education, life expectancy, infant mortality, birth and death rates, fertility rates, crime, drug usage and mental health, the Survey highlights that both economic growth – as reflected in the income per capita at the state level –and inequality have similar relationships with socio-economic indicators.
- Unlike in advanced economies, economic growth and inequality converge in terms of their effects on socio-economic indicators in India.
- Economic growth has a far greater impact on poverty alleviation than inequality.
- Given India's stage of development, India must continue to focus on economic growth to lift the poor out of poverty by expanding the overall pie.
- Redistribution is only feasible in a developing economy if the size of the economic pie grows.