

Growth Did Filter Down to the Poor

Rajesh Shukla: 7th March, 2011

For democratic growth, inequality-causing distortions need to be removed from the system



There are growing concerns across the world about rising inequality and how severely it can damage the social fabric of a nation. Concerns about obsession with double-digit growth and neglecting sharp inequalities, in the Indian context, have been voiced eloquently by Amartya Sen.

While most estimates of poverty and inequality are based on data till 2004-05, in this article, we focus on the period from 2004-05 to 2007-08 when the country achieved a spectacular 9% growth. While estimating the impact of growth on poverty reduction and on the direction of inequality, in addition to calculating inequality based on consumption expenditure, we study inequality based on wages as well. Also, as all-India estimates mask rising regional disparities, this article reveals the scenario at the state level.

Firstly, contrary to Mr Sen's assertion that high economic growth has largely benefitted the 'already-privileged', our analysis shows that it has also benefitted millions by uplifting them above the poverty line. Similarly, while Lanjouw and Murgai (2008) estimate that previous NSS rounds do not suggest rise in the pace of poverty reduction in rural India alongside the accelerated economic growth, our analysis, on the contrary, reveals a big reduction in rural poverty during the high-growth period. For instance, in the high-income states of Gujarat, Andhra Pradesh, Kerala, Karnataka and Tamil Nadu, rural poverty has declined at a faster pace than urban poverty. While farm output in all these states has risen significantly, among other explanations, a major expansion in non-farm employment in rural areas of these states could be an important reason for a sharp fall in rural poverty. In contrast, urban poverty declined at a faster pace in Bihar, Orissa and Chhattisgarh. One explanation could be that the immediate benefits of high growth in these states were mostly felt in the urban areas. Going forward, however, as incomes rise, a scenario, where the benefits of high growth percolate to the economically-backward rural sections, can be easily envisioned. Secondly, as popular liberal political and economic commentary uses a country's economic inequality as a rough measure of justice, employment opportunities, well-being, etc, it is important to understand and estimate it correctly.

Commentators like Bhalla (2003) have consistently argued a decline in inequality, while others like Sen and Himanshu (2005) and Deaton and Dreze (2002) have argued the opposite. According to our analysis, total inequality, as measured by GE (0), fell from 0.195 in 2004-05 to 0.190 in 2007-08. However, the all-India trajectory masks the widely-varying trends, with inequality rising sharply in Himachal Pradesh, Punjab, Rajasthan, Bihar, Orissa and Karnataka. Additionally, while total inequality has fallen, the 'Between Group Inequality' component has actually risen, implying that inequality between rural and urban areas has actually widened. However, it is important to note that inequality in Indian parlance is based on consumption spends and not income. In an influential paper, Krueger and Perri (2006) argued that the rise in income inequality in the US has been more pronounced than the corresponding rise in consumption inequality. Consumption inequality, according to them, remained substantially stable. Heatchote, Perri and Violente (2010) further state that, consistent with basic economic theory, consumption inequality is substantially lower than income inequality.

Another issue that is often highlighted is that the NSS CES data is often criticised for being unable to adequately capture data at the top end of the distribution. This then negates the exercise as the rise in income inequality is centred around the top end of the distribution. Additionally, suppose that the rich consume a relatively smaller portion of their additional income. Should we then conclude that the

economic inequality hasn't risen? The fact is that income not being spent doesn't make it irrelevant. To explore this aspect, we estimate inequality based on wages, using data obtained from NSS Employment and Unemployment surveys. Although wages is just one component of total income, it nonetheless serves as a useful estimator. For this exercise, wages for three categories, 'rural labour', 'urban labour' and 'urban salaried employment', have been estimated. In the rural labour category, while inequality rose in Himachal Pradesh, Haryana, Bihar, Karnataka and Assam, in the urban labour category, it rose in Himachal Pradesh, Punjab, Chandigarh, Delhi, Jharkhand, Orissa, Tamil Nadu and Karnataka. In the urban salaried employment category as well, inequality has sharply increased in Himachal Pradesh, Haryana, Uttar Pradesh, Bihar, Maharashtra and Karnataka. On comparing inequality estimates based on consumption spends with those based on wages, it is evident that there are sharp inter-state differences in both direction and magnitude. Orissa reported a rise in inequality based on consumption spends, but it witnessed a fall in inequality based on rural labour wages and salaried wage employment. Similarly, Rajasthan witnessed a rise in consumption expenditure-based inequality but a fall in inequality based on wages in all the three categories. Haryana, however, reported a rise in inequality in rural wage labour and salaried wage employment, but saw a fall in consumption expenditure-based inequality. Thus, while the importance of studying consumption expenditure cannot be denied, the results obtained need to be supplemented with additional information available from wage data.

The debate on growth and inequality is not about choosing one over the other. Growth is important as it not only provides employment opportunities, it also provides, through taxes, revenue to the government to finance expenditure on social welfare. The focus should be on removing the obstacles to social mobility. As The Economist puts it, "The issue of inequality is not of pulling down the rich. It is of pushing the bottom and the middle up." It is one of removing distortions and imperfections in the system that cause inequality and focus more on increasing social mobility. **(The author is director at NCAERCMCR. Ishan Bakshi and Palas Baruah helped in the analysis)**