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Website: www.aarf.asia Email : editor@aarf.asia , editoraarf@gmail.com

IMPACT OF ECONOMIC GROWTH ON INCOME INEQUALITIES: AN OVERVIEW

Dastgir Alam

Assistant Professor

Department of Economics
Aligarh Muslim University Aligarh
Aligarh- 202002, India.

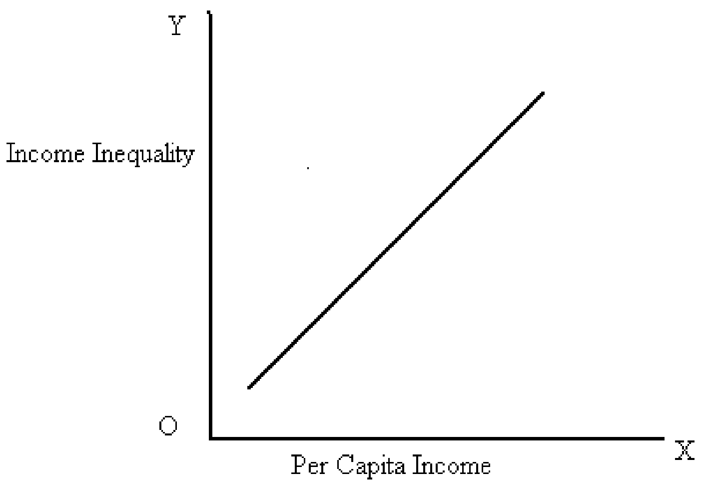
Introduction:

In economics, income is regarded as the reward for the participation in the economic activities. The distribution of income is therefore meant for the extent of contribution of a person or groups in the economy (Viner, J. 1953). The distribution of income has been assumed to be a sign of level of social and economic welfare of the masses in any region. If there is an equal distribution of income and wealth, then society will be more affluent and prosperous and vice-versa (Kuznets, S., 1955). Keeping in view of these things India has started the process of economic planning in 1950. The broad objectives of the plans have mainly two aspects, that are economic and social and in its economic aspect, planning seeks higher rate of growth, greater balance between industry and agriculture, better harnessing of natural and human resources and employment opportunities at a reasonable level of income for the entire labour force on the one hand, and social planning has broader goals like creation of conducive environment of equal opportunity for each and every citizen for equal distribution income and wealth for a better life of the people on the other (Ojha, P.D., 1985).

The Planning Commission (PC) was working with a view that the income of economy must increase before it would be utilized for solving other problems like poverty etc. The perception was that after registering a substantial growth rate in the economy, emphasis would be given on its distribution. To understand, therefore, the impact and responsiveness of growth and development of the economy on the distribution of income and wealth it becomes important to investigate how the gains of economic growth in our country have been distributed. The present paper will try to find out, which section of the society has been benefited more from the increase of the national income and wealth and whether the distribution of income has improved or not after crossing more than 55 years of planning particularly after the economic reforms when India registered exceptionally high growth.

Theoretical Background:

The study about the linkages between growth of income and distribution of income and wealth has always been in the centre of discussion among the economists, social scientists and other social groups. Marx (1990) believes that the distribution of income and wealth must be based on individual needs rather than his ability to produce but accepted that inequalities in distribution of income and wealth (Yi) is necessary for growth of income (Yg) because inequalities in income and wealth improves the propensity to save and capital accumulation which is a pre requisite of economic growth. Diagrammatically it can be explained as;



The same view is shared by Classical economists (Kaldor, Nicoals 1955). They also believed that inequality has positive impact on the growth of an economy. Wealth (W) is positively related with savings and every increase in this increases the marginal propensity to save (MPS).

MPS = f (W)

Inequalities in wealth increases the savings (S) as rich people have more power to save which helps in capital accumulation (K) and ultimately the economic growth. This relationship may be represented as;

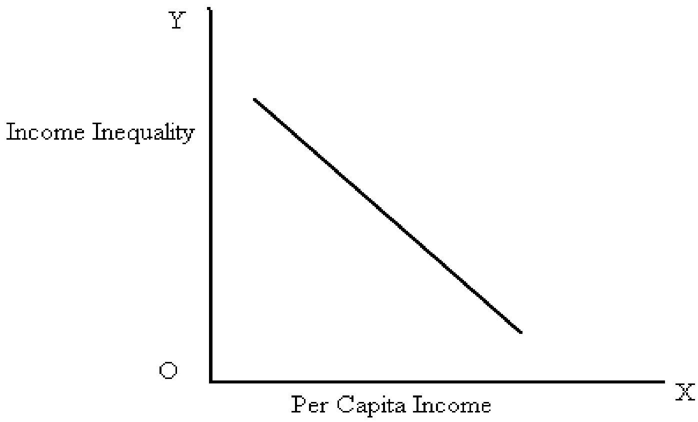
Yi →↑ MPS →↑ S →↑ K→↑ Yg

Contrary to this Neoclassical theory ignores the relevance of inequalities on economic growth and states that inequality is irrelevant for the macroeconomic analysis (Kaldor, Nicoals, 1955). Inequality is not a cause but a consequence of growth process and changed the very relationship between Yi and Yg from

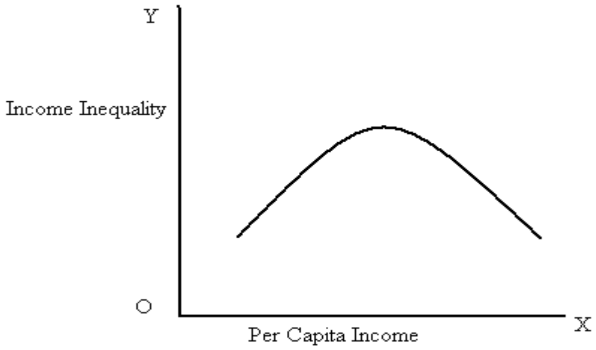
Yg = f (Yi) to

Yi = f (Yg)

Keynes (1936) and Modern theorists (Galor & Zeira, 1993, Alesian & Rodrik 1994, Persson & Tabellini, 1994 and Perotti, 1996) are of the opinion that inequality is not good for economic growth because it reduces the aggregate demand since rich people have low marginal propensity to consume (MPC) and the relationship between them turns as;



Later Koznets (1955) in his study tried to identify the contribution of economic growth in improving income distribution by giving inverse U shape relationship between inequality and per capita income (PCI) growth.



He said that initially growth in PCI has positive relationship but after some time further increase in PCI reduces income inequality. But consequent studies conducted by Ahluwalia (1976), Saith (1983), Papanek and Kyn (1986), Ram (1988), Anand and Kanbur (1993), Campano and Salvatore (1988) and Deininger and Squire (1998) find little support for the Kuznets hypothesis.

Indian Scenario:

The documents of the Indian plans have shown the deepest concern towards the problem of inequality in the distribution of income and wealth. This can be easily observed from the statement released by the approach paper of the Second Five year Plan. The benefit of economic development must access more and more to the relatively less privileged classes of the society, and there should be a progressive reduction in the concentration of income, wealth and economic power (Second Five year Plan, 1956). Since the inception, the PC has been working with the view of balanced development that could ensure economic growth and a steady improvement in the standard of living of masses made through improvement in income distribution. The visionary planners felt that the root cause behind the unequal distribution of income and wealth is the presence of unemployment and under-employment (Lydall, F.H. 1960). This perception forced the members of the PC to go for the development of heavy and basic industries during the Second Five Year Plan. To give further more and more emphasis on reduction in inequalities, the Government of India socialised the Indian economy in its industrial policy of 1956. Extending their sincerity towards the removal of inequalities the Indian planners gave the slogans of 'Garibi Hatao' and 'Growth with Justice' in later plans.

During the first two decades of planning era, the planners concentrated mainly on growth of the economy. Their presumption was that the unemployment and poverty can not be cured without growth. The failure of ‘trickle down’ theory convinced the policy makers to accept the growing notion that the growth of economy can not do justice with the poor and thus there is a need of the government interference to distribute the fruits of growth among the poor. To do the same, the government introduced a number of poverty alleviation and employment generation programmes to check the persisting inequalities.

The growth performance of Indian economy is now available for the period of more than 60 years since 1950-55 at 1993-94 prices. According to the present national income estimate the Indian economy has recorded an annual average growth rate of more than 4.00 percent. The growth performance does not seem to be too unsatisfactory; however, in terms of the growth rate of other developing countries, it is very distress. The growth rate of 1980s shows a distinctly higher growth rate than the previous decades.

The following table 1 gives information about the rate of economic growth (at factor cost) and measure of unequal distribution of income and wealth (in terms of gini-coefficient) for rural and urban areas. In 1963-64 the value of gini-coefficient for rural areas was 29.01 which show a high concentration of income and wealth in a few hands. The year 1973-74 shows some relief in terms of inequality reduction than the previous year as revealed by the table. The negative view on the success of trickle-down theory can easily be observed in

Table 1

Economic Growth and Distribution of Income

Year	**Gini-Coefficient**		**GDP Growth (1999-00 price)**			
	Rural	**Urban**	**GDP at Factor Cost**	**Agriculture & Allied**	**Industry**	**Services**
1963-64	29.01	36.54	5.06	2.3	9.04	6.9
1973-74	28.30	31.50	4.78	7.2	3.92	2.23
1983-84	30.10	33.70	7.85	10.1	8.97	5.58
1986-87	30.15	35.60	4.31	-0.4	6.79	6.87
1987-88	30.16	35.57	3.53	-1.6	5.59	6.3

1989-90	28.23	35.59	6.13	1.2	9.57	8.53
1990-91	27.71	33.95	5.28	4.0	5.71	5.94
Pre-Reform Average	**29.09**	**34.63**	**5.28**	**3.26**	**7.08**	**6.05**
1992-93	29.8	35.55	5.36	6.7	3.25	5.4
1993-94	28.50	34.50	5.68	3.3	7.46	6.44
1994-95	29.19	33.43	6.39	4.7	10.44	5.83
1995-96	28.97	35.36	7.28	-0.7	13.15	9.62
1997-98	30.11	36.12	4.3	-2.6	2.01	8.99
1999-00	25.8	34.1	6.44	2.7	3.5	9.34
2004-05	30.0	37.0	7.46	9.96	8.5	9.86
Post-Reform Average	**28.91**	**35.15**	**6.13**	**3.44**	**6.90**	**7.92**

Sources : (1) IGIDR, Estimates as reported in Jha (1999), 'Reducing Poverty and Inequality in India', Has Liberalisation Helped?, Mumbai.

(2) Government of India (2003), Economic Survey, Ministry of Finance, New Delhi, p. S-10.

(3) www.Indiastat.com

(4) www.rbi.org.in

1983-84 when a growth rate of 7.85 per cent failed to stop the growth in inequalities and thus the high rate of growth was totally distributed among few and the value of gini-coefficient rose to 30.10 in the rural areas. In 1986-87, growth rate of GDP decreased to 4.3 per cent mainly due to a sharp decline in agriculture sector. Though the growth rate of economy reduced to nearly half that of 1983-84, gini-coefficient increased by only 0.05 in the rural areas. In 1989-90, the gini-coefficient for the rural areas decreased to 28.23, the lowest in the decade when the economy assumed a high growth rate of 6.13 per cent. A decline in the coefficient in the rural areas was recorded against a massive growth rate of agriculture in the previous year. Overall the decade of 1980s has shown a declining tendency in inequalities. The period of 1983-84 to 1987-88 have a meagre increase in the distribution of income and wealth despite an average growth rate of 5 per cent per annum, perhaps due to a very low rate of growth of the agricultural sector by an average of 2 per cent.

But the growth of agriculture sector has shown its effect on the distribution of income during 1988-89 to 1990-91 when the economy grew by 5.28 percent (backed by nearly equal growth rate of 4.3 percent in agriculture sector). The incidence of inequality in the rural areas, therefore, was associated with the agriculture sector rather than overall growth for period of 1980s.

An economic growth of 5.6 per cent in India supported by a 4.27 per cent growth in agriculture sector produced a favourable result in the context of the income distribution during 1990-91. The value of gini coefficient touches its bottom till then and decreased to 27.71 in the rural areas.

After the introduction of economic reforms, the distribution of income shows an incremental trend in inequalities. The value of gini-coefficient increased to 29.88 in 1992-93 from 27.71 in 1990-91, while economy recognised an average growth rate of 4 per cent with the equal growth rate in agriculture sector. Recording a growth rate of 5.3 per cent, the income distribution improved in 1993-94, but immediately next year the value of gini-coefficient increased to 29.19 despite an impressive growth of 5.68 per cent in aggregate and 3.17 per cent in agriculture sector in particular. The coefficient increased again to 30.11 in 1997-98 though the economy grew by 4.3 per cent per annum. The growth of the agriculture sector, therefore, failed in reducing the income inequalities in rural areas after the adoption of new economic reform. The incidence of income inequality once again touched the level of 1963-64 in 1997-98, though it has recorded a decline during 1980s. After two years in 1999-00, the value of gini-coefficient declined to 25.8 and therefore the distribution of income and wealth get improved but next survey of 2004-05 shows an increase in inequality and gini coefficient increased to 30.0.

The perpetuation of inequality in the urban areas is more severe than the rural areas as it is clear from the table. The year of 1963-64 has a value of gini-coefficient equal to 36.54 in urban region, showing a glaring existence of inequality in the income distribution. After one decade, in 1973-74 an improvement in the income distribution was recorded and the coefficient decreased to 31.50. A massive growth was experienced by the economy in 1983-84 due to a convincingly high growth rate in all the three sectors of the economy. This growth rate of 7.5 per cent did not give accompany to the reduction in income disparities in the urban areas and gini-coefficient increased to 33.70. The gap between the rich and the poor in the urban areas further widened in 1986-87 when the economy grew by 4.3 per cent and thus the reduction in the growth rate produced its devil effect on income distribution. One interesting thing that emerged from the sectoral growth of the economy is that, in this period economy had to face a lop-sided growth. The growth of the financial and services sector was nearly double of the manufacturing sector. The inequality in the urban areas remains stagnant for the period of 1986-87 to 1989-90.

During these years the distribution of income was highly inequitable as represented by the value of gini-coefficient i.e. on average nearly 35.5. We can not blame the economic conditions for this, because during this period economic growth was 6.25 per cent annually. The gap between the growth rate of the manufacturing sector and the finance and services sector was also not very high. In the very next year our economy achieved an aggregate growth rate of 5.6 per cent with nearly equal contribution from the manufacturing sector (7.4 per cent) and the finance and services sector (7.7 per cent). This might be a cause for the reduction of inequalities since the equal growth in the manufacturing sector provided opportunity for unskilled and semi-skilled labourers in the urban areas.

The growing fiscal deficit of the union budget pressurised the economy for the adoption of new economic reforms. The reform packages produced a negative impact on the economic growth in aggregate during 1991-92. The economy grew only by 1.3 per cent with a negative growth in both agriculture sector and manufacturing sector. But the finance and services sector recorded an impressive growth of 12.0 per cent. The negative growth of the manufacturing sector and a mounting growth in the finance and services sector have widened the gap between the rich and the poor once again in the urban areas during 1992-93 despite a growth rate of 5.36 per cent in aggregate. The consequent two years after 1992-93 have provided some relief and income distribution improved for these two years and thus the growth rate of nearly 6.0 per cent has shown some healing impact. For this period the value of gini-coefficient slipped to 33.43. But again in 1995-96 gini coefficient registered an increment with the value of 35.36 despite a considerably high growth of 7.3 per cent in the economy as whole and 12.3 per cent in the manufacturing sector. Once again a high growth in finance and services sector, nearly triple than the growth in manufacturing sector, worsened the condition of income distribution. The economic growth of 4.3 per cent failed to help the growing inequality in urban areas and the value of inequality measure become 36.12 in 1997-98. This high value of gini-coefficient dragged us more or less at the same position as we were in 1963-64. The most important fact revealed from the analysis is that it is not the growth of the economy as whole which is responsible for the distribution of income and wealth in the urban areas. It is differential growth in manufacturing construction electricity, gas and water supply and finance, insurance, real estates, business and services that are the real causes for the variation in income distribution in urban areas. The growth performance of the economy has shown its effectiveness in reducing the inequalities in the distribution of income and wealth in 1999-00. When economy registered a growth rate of 6.44 per cent at factor cost the inequalities in the distribution of income and wealth reduced but again increased to 37.0 in 2004-05 though economy grew by 7.46 per cent.

Results and Discussion:

From the above analysis it can be clearly observed that the relationship between growth of income and income distribution is opposite to the Kuznets. The relationship is like U shape which explains that the increase in income has firstly made positive impact on distribution of income and inequalities in income distribution has fallen. But after reaching to a minimum point it has once again increased. This is the same in rural as well as urban areas. One important fact that we can realise is the impact of economic reform on income distribution. The trends have clearly shown that in the pre reform period inequalities in income distribution has reduced but in the post reform period it has increasing trend.

It can be further observed that a comparatively low growth of GDP in pre reform period than the post reform period proved to be effective in reducing inequalities in income distribution. This may be because of the change in the composition of growth of GDP when in the post reform period growth rate of services has been more than the pre reform period. However it can be assess that in the pre reform period on average the persistence of inequalities both in rural and urban areas has been low in comparison to post reform period. This may be observed from the following figure 4 and 5.

Figure.4

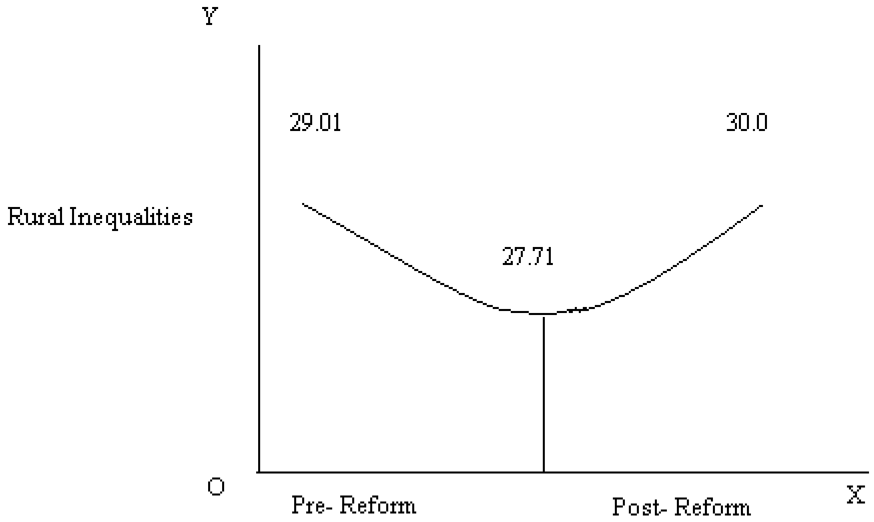
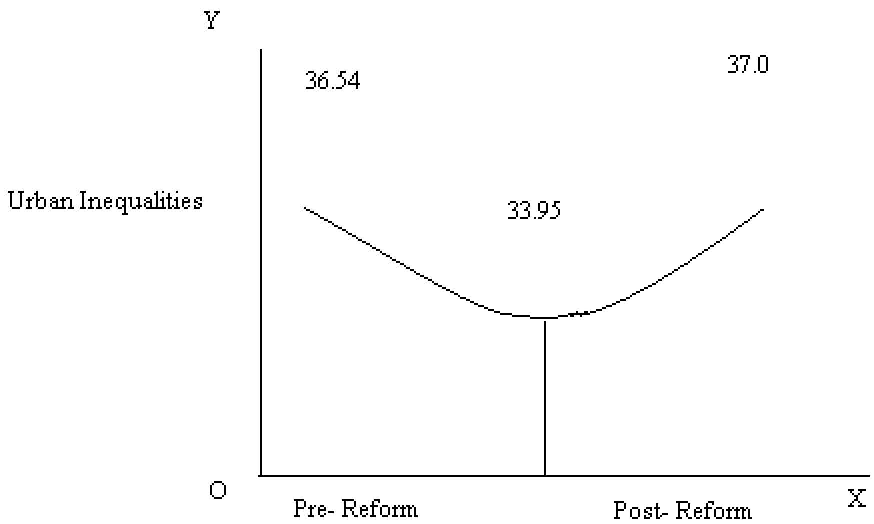


Figure.5



The mixed character of Indian economy provides an opportunity of private ownership to each and every individual to possess land and other properties. Since the British rule in India, there was concentration of land in few hands due to the prevailed zamindari system. Though land reforms were introduced by the Government of India in 1950 to distribute land among the small and marginal farmers with the view to reduce inequality but achievement was not satisfactory. This is one of the dominant factors for the unequal distribution of income and wealth particularly in the rural areas. The Green Revolution was introduced in 1960s with the use of high yielding varieties of seeds, chemical fertilizers insecticides and pesticides and appropriate level of irrigation. The revolution though improved the agricultural productivity and overall agricultural produce but the main beneficiaries were only landlords and big farmers, because the inputs used in the new method of cultivation were very costly and out of reach of the small and marginal farmers. This shifted the advantage of the Green Revolution in the favour of big farmers. The facilities of agricultural finance provided by the union and state government are so restrictive and complex in nature that only big farmers get benefit from it.

In urban areas the capitalist group and individuals having an access in capital market easily manage to obtain loans at a very favourable rate of interest, whereas the poor masses of small entrepreneur and artisans depend heavily on unorganised banking system at a very high rate of interest. The persisting trends of such type of finance in India give more opportunity for unbalance distribution of income and wealth. Again after the adoption of new economic reforms, Government of India is continuously reducing the amount of subsidies on chemical fertilizers and high yield varieties of seeds. Consequently the period after the 1991 economic reforms has witnessed the widening gap between the productivity of farms of landlords and marginal farmers, provided the space for growing inequalities in income distribution. The absence of cooperative farming, works as a catalyst in widening the gap between the income of the big farmers and smaller ones.

During harvesting period, the supply of agricultural produce increases in the rural market due to lack of storage and marketing facilities. The increased supply reduces the prices of produce. The middlemen and big farmers buy in bulk and hoard and kept in storage. After sometime when prices rise, they sell these produce at a higher prices in same market as well as transported it to the urban market, getting more profit than the rural market. To reduce inequalities particularly in rural areas government provides many facilities for a conducive environment of agricultural exports. But these facilities are mostly availed by a particular class which is of the rich, since the processing of agricultural products for exports requires a large amount of investment.

The theory of individualism, allowed the existence of private ownership in India. The legitimacy of private ownership of industries, trade and building provides the opportunity to acquire and control over vast assets that provide an opportunity for emergence of capitalist class. This group has all facilities and accumulated more and more property by hook and crook that raises the gap between the rich and poor. The inappropriate educational facilities and vocational training in the rural areas always caused a gap between the income of the rural labour force and the urban labour force. The members of elite families only get the chance to have access to higher and professional education. Therefore, the incomes earned by businessman, technocrats, bureaucrats and other professionals are always higher than the others. The constitutional validity of law of inheritance empowers a person to retain the property of his/her father with himself. The son of a capitalist becomes a capitalist and a son of an agricultural labour becomes an agricultural labour, and thus the gap between a capitalist and a labourer remains untouched.

The redistributive effect of inflation (biased toward high income groups) has greatly accentuated the unequal distribution of income and wealth. Since 1950s the price level has been rising continuously more quickly after the economic reforms. This made an average impact on the real income of the working class while capitalist traders and big farmers have been benefited a great. Today more than 60 per cent of population lives in the rural areas, but 70 per cent of private investment is made in urban areas. This urban biased investment takes the form of highly mechanised projects in which the share of wages in value added is relatively low (Lipton, M. 1977). Naturally this leads to inequality in income distribution. The new economic policy initiated in 1991, comprises three packages i.e. 'globalisation', 'liberalisation' and 'privatisation'. The policy of globalisation and privatisation open the door for foreign products. Due to this the competition in product market increased. The increased competition forced this economy to adopt capital intensive techniques of production. These techniques of production need highly skilled and trained labourers. Thus, after the reforms whatever the jobs have been created, it is fully availed by only a few who belong to a sound economic background. Besides, these reasons unemployment, growing population, presence of subsistence agriculture and above all lack of political and administrative will towards reducing inequalities are some other factors which are responsible for the existence of income inequalities in the Indian society.

Conclusion:

The efforts made by the government in the form of land reforms and different programmes to reduce the glaring problem of inequality in income distribution, yet the condition is the same as it was during 1960s and 1970s. The pattern of inequality also did not change after passing a period of 60 years of our independence. The level of inequality in income distribution is low in the rural areas in comparison to urban areas. At aggregate level the growth of the economy, particularly after 1991 does not show any impressive impact on the distribution of income. To a certain extent the ups and downs in the growth rate of agricultural sector affects the rural areas, whereas the gap between the growth rate of the secondary sector and the tertiary sector can be regarded as the most important factor for the continuation of the inequalities in the urban areas.

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