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L.K. DESHPANDE MEMORIAL AND IHD SILVER JUBILEE LECTURE

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Hyderabad, Telangana | 28 March 2024

Growing Apart? Growth, Poverty, and Inequality in Post-Liberalization India

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at

By

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Growing Apart? Growth, Poverty, and Inequality in Post-Liberalization India[1]

Maitreesh Ghatak[2]

Has the growth pattern in India since liberalisation been inclusive? In this paper I use data on inequality and growth statistics to calculate growth rates of different income groups and conclude that there is evidence for "inequality of growth" which feeds into the "growth of inequality" despite more than three decades of relatively high average growth. I also review evidence from the labour market and poverty statistics that suggest that while there have been some improvements in the economic status of the poorer sections, it has not been significant relative to overall growth. To interpret these findings I outline a conceptual framework that connects growth with inequality via the demand pattern and the induced demand for factors of production.

1. INTRODUCTION

Discussions about the Indian economy in the post-liberalisation era seems to move around three broad themes: growth and rising levels of per capita income, reflected in India's growing importance as a global

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1. Preliminary draft of the IHD Silver Jubilee and L.K. Deshpande Memorial Lecture to be delivered at the 64th Annual Conference of the Indian Society of Labour Economics (ISLE) to be held in the University of Hyderabad. Please do not circulate without permission. I thank Mrinalini Jha, Rishabh Kumar, Jitendra Singh, and Linchuan Xu for many helpful discussions on these topics, and for allowing me to draw from our recent collaborative work on different projects relating to the themes covered here. I would also like to thank Pranab Bardhan, Parikshit Ghosh, Ashok Kotwal (who, sadly, is no longer with us), Dilip Mookherjee, and Debraj Ray for helpful discussions on the topic.

2. London School of Economics

economic power, rise in inequality, and despite some decline, persistence of poverty. Depending on which one(s) we focus on, we could come away with very different views about the state of the economy and the way forward.

Starting with the premise that the state of the economy is ultimately about the lives of ordinary people, in this lecture I will try to provide a conceptual framework to understand the interrelationship between these three dimensions. I will focus on two aspects: first, the relative distribution of benefits from growth – to what extent growth has been inclusive, and second, whether there have been sufficient improvements in absolute standards of living of the poorer sections of the population.

For the first, I will look at the relationship between growth and inequality, combining data on national income and income and wealth distribution to examine "growth of inequality" and "inequality of growth (rates)" and to what extent India's growth experience has been inclusive. Other than the normative point -- what is growth good for, unless it raises the standard of living of the masses -- we will also argue that unless growth is broad-based it would have an inherent tendency to peter out. For the second point, I will look at trends in the rate of poverty, i.e., the percentage of people below a certain minimum level of consumption.

2. GROWTH

The growth rate of GDP as well as GDP per capita did go up after liberalisation -- for example, over 1960 to 1990, GDP per capita increased by 1.75 times but over 1990-2019 it increased by 3.63 times (3.67 times if we take 2021, with 2020 being dropped being the pandemic year). The growth rate was particularly high in the decade starting the early 2000s. However, the growth rate appears to have slowed down during the last decade.

Some would point to the rise in India's overall economic status in the world, poised to be third largest economy by 2030 and view the focus on

inequality and poverty as left-wing naysaying. Leaving aside the normative question – what is the ranking of total or per capita GDP good for if it is not spread widely and reduces poverty for a moment -- it is still an interesting question as to why India's rank in overall GDP rose from 17 in the early 1990s to 5th at present while its rank in per capita GDP has stagnated (161st in the early 1990s, and 159th at present).

It is not population growth that mechanically boosted total GDP – after all India's relative position in terms of population remained the second largest (after China) in the world almost throughout this period and its population growth didn't significantly differ from the world average during the period under discussion, and in fact, over time, has decreased. Moreover, the level of per capita GDP did increase (between 1991 and 2021, it increased more than seven times, real GDP per capita has increased almost four times) but clearly not enough to improve the ranking much.

The answer lies in the "population multiplier" -- any economy that raises its per capita income will achieve a greater boost in its total GDP the larger is its population. Suppose the per capita GDP of a country doubles in a decade -- there may not be much difference in its relative position compared to other countries, if those countries already have a much higher average per capita GDP, or if they are also growing at reasonably high rates. But the larger the population of that country, the higher the total GDP value will be proportionally -- for example, if its population were to double, total GDP would increase four times -- we call this the population multiplier effect.

The combination of a large population and a high rate of growth of per capita GDP consistently over several decades is behind India's improvement in the GDP ranking. Let us compare it with China. Between 1991 and 2021, China's rank rose from 11th to 2nd in GDP, and its position in average per capita income rose from 158 to 75. Its GDP per capita grew 38 times during this period, while India's GDP per capita grew only seven times. Because China has a larger population, the effect of the population multiplier is greater, but they have been able to increase

average per capita income many times more, so their relative position in both total income and per capita income has improved much more.

As we will see in the next section, during this period there has been a sharp rise in inequality and this, we argue, suggests that India's economic prominence in the global setting given the size of its GDP is not merely a statistical illusion. Indeed, the economic significance of this tension between India's rank in total GDP vs per capita GDP is that the rising prosperity of even a small fraction of the population would make it an attractive market given India's population (UK or France's population is only 4-5% of that of India). That is why the GDP ranking does attract attention internationally despite the low per capita GDP ranking. However, a natural question that arises is, can the growth process sustain itself if its gains disproportionately go a small fraction of the population?

3. INEQUALITY

3.1 Inclusive Growth

The notion of inclusive growth is frequently used in academic and policy discussions, but we still need a precise definition of growth inclusiveness, as well as to understand what makes economic growth more inclusive. In general, the transmission of growth relies on two key linkages: the demand side linkage implies that those whose income grows will demand more goods and services from others; moreover, as the classic Engel curves often suggest, demand patterns move to more high value goods and services as households become richer. On the other hand, the fact that the higher demands for factors of production raises prices (e.g., wages), as well as the higher returns to skill acquisition constitute the supply side linkage. Such income growth from the supply side further feeds into higher demand, which then spread growth throughout the economy.

The transmission of economic growth often takes place via the following specific channels: one key channel is migration, as people move across sectors and from rural to urban areas. Remittances could also help to spread out the benefits of growth as those in urban areas send money

back to rural areas. Another channel is that firms anticipate the future growth in demand, and hence will increase investment in human and physical capital. Furthermore, the growth in tax revenue implies that the government will increase investment in public health, education as well as safety net, which benefit a wider population via public goods provision. Lastly, individuals accumulate wealth through saving and investing in financial and human capital, which facilitates economic growth to spread over a longer-term horizon.

3.2 Sources of Demand

Signs of slackening demand are apparent over the last decade. The investment to GDP ratio, one of the key specific channels of transmission of growth as we mentioned earlier, increased from around 20% in 1980 to 35% prior to the global financial crisis, but has been declining ever since. It reduced to around 28% in 2020, on par with the investment to GDP ratio in the early 2000s.

Despite many supply-side remedies that would increase the profitability of investment introduced by the government (reduction in corporate tax, the Make in India initiative, the Phased Manufacturing Programme, introduction of Production Linked Incentive Schemes in various Ministries, etc.), many corporates have shown a great deal of hesitation in making new investments, coming from the perception of investors that they see only lacklustre growth in the demand for their products. There could be demand-based explanation as was spelled out in an article with Ashok Kotwal and Bharat Ramaswami (The India Forum, August 13, 2020).

Whichever sector is experiencing an exogenous growth spurt (e.g., infrastructure and construction, software exports, segments of the manufacturing sector such as pharmaceuticals and auto parts), those whose incomes are directly affected still constitute a small part of the overall labour force. Therefore, any possible transmission of growth impulse depends on how the thin layer of initial beneficiaries from

the increased demand for their services spent their higher incomes: for example, do they spend them on goods and services produced by low-skilled and poor workers? This question has profound implications for whether higher income experienced by certain groups of households could lead to inclusive growth. After all, when most of the growth accrues goes to a thin top layer of the population, the demand for an existing industry does not grow that much. When a software engineer experiences a substantial wage hike, she graduates from a two-wheeler to a car. But when her salary moves up further, she does not necessarily go out and buy another car. She would likely save much of the increase or probably plan a trip to Europe.

Data from the Centre for Monitoring the Indian Economy's (CMIE) consumer pyramids show that even after nearly two decades of relatively high growth in India, 60% of India's consumer expenditure is on food and energy. For the bottom half of the population, this proportion is 70%. The domestic market for goods and services beyond these essentials is still quite limited in India.

3.3 Growth of Inequality versus Inequality of Growth

The richer a household, the higher its savings rate, so when incomes grow for a higher rather than a lower income household, a significant part goes toward savings rather than consumption demand. Expenditure elasticities for the richer consumers (the top two urban deciles) are lower than for the bottom 50% of rural consumers for all goods and services, other than appliances and EMIs, recreation, restaurants, bills and rent, and education. These items clearly have a greater value added by skilled workers and are typically produced in the organized sector. The bottom five rural deciles have far greater expenditure elasticities on all foods, clothing, intoxicants, cosmetics, transport, communications, health, and miscellaneous items. This implies that despite the remarkable growth experienced by the top income groups over the years which generate more demand for goods produced by formal and skilled workers and benefit certain sectors, the living standards of the unskilled poor may could remain the same.

But why aren't they spending more? To answer this, in ongoing work with Linchuan Xu, we look at the pattern of income and wealth inequality using the WID to understand what is happening to people in different economic classes. Our hypothesis is that higher economic inequality implies slack domestic demand, which then leads to slowdown of economic growth.

Economic inequality in India has witnessed drastic increase over the past decades. According to our calculations based on the WID, starting from the 1990s, the income shares of the top 1% and top 10% of the Indian population have seen rapid increase, which is contrasted with the decline of the bottom 50% share of national income. In 1990, the top 10% of the population obtained around 35% of the national income, and the bottom 50%'s income share was around 20%. However, in 2015, the top 10% received nearly 60% of the national income, whereas the bottom 50% share reduced to 15%. Wealth inequality in India has witnessed similar trends: the top 10% share of the total wealth increased from around 55% to around 65% in the past 15 years, while the bottom 50% owned less than 10% of the total wealth in the nation. For an international comparison, the increase of the top 1% wealth shares in India from 2012 to 2018 is larger than the World average, the Asian average, as well as US and China. In the meantime, the share of vulnerable employment in total employment, as well as the share of undernourished in the Indian population, have remained nearly unchanged for the past two decades.

How different economic classes have experienced economic growth differently? In our ongoing work, we develop a simple methodology to calculate specific growth rates for different income groups: since the WID provides income shares of specific income groups annually, one can find this out using their change along with the average growth rate. In most of the time periods (especially during 1995-2005), top-1% experienced the highest growth rates compared to other groups. There is also an ever-increasing gap between the top income group with the rest of the population. On the other hand, the bottom-50% and the middle-40% witnessed very similar growth rates, which were below the average growth

rate – the relative economic status of the bottom-90% has not changed much despite the rapid economic growth experienced by the top-10%.

Is India's growth pattern common? We conduct a comparison of the Indian economic growth with China, which grew at a much faster rate since the 1990s in terms of the average growth rate. However, when we look at the annualized growth rates by income group, an interesting pattern emerges – while in China income of all groups rose at a faster rate, the gap is particularly noticeable for the bottom 50% as well as the middle 40% (excluding the top 10% and the bottom 50%). Over 1994-2004, the rich economic classes in India and China (i.e., the top 1% and the top 10%) grew at the much similar rate of 9%; but the middle 40% and bottom 50% in India experienced growth rates of only around 4.8%, whereas the counterparts in China saw their income grow at respectively 7.7% and 6.8%. This implies that if one seeks to explain the difference of economic growth between China and India, he or she really needs to take a close examination of what happened to the middle class and the poor in these two countries.

4. POVERTY

Whatever welfare criteria one uses, what is happening to the lower tail of the distribution in terms of income or consumption, is of great significance. If growth is inclusive, then inequality can still go up being a relative measure and depending on the difference in the growth rates of different income groups, but the absolute level of standard of living should increase for everyone and that should translate into a reduction in poverty. However, if growth is not inclusive, for example, due to the demand and supply-side linkages not being strong enough, that can lead to stagnant incomes for the bottom half of the population and low rates of poverty reduction.

In recent work (Ghatak, Jha, and Singh, 2024) we have examined the trends in the labour market in terms of labour force participation, unemployment, the components of employment, and their earnings

that suggest that growth process has not been generating enough "good jobs" to facilitate upward mobility and the vast majority of workers are engaged in activities that provide little or no job security, no employment benefits, no social protection, and low earnings. In the decade following liberalisation the rise in overall employment kept pace with the rise in population, a trend that then slowed down in the next decade, with an uptick in employment in more recent years (since 2017-18). However, if we look at the kind of jobs that are created more than 50% of the employed have remained self-employed (as opposed to having salaried jobs or being casual workers) throughout the three decades following liberalisation, and among the self-employed, the overwhelming majority are either own-account workers or unpaid family help – those who employ others and can be assumed to be better off than these two sub-categories of the self-employed, have never exceeded 5% of the total pool of the self-employed.

Salaried workers on average earn the highest among the three categories. The fact that the percentage of salaries workers have gone up in the last three decades but not at a pace (they have increased from 14% in 1993-94 to 22% in 2021-22) one would expect after three decades of growth is a fact that should make us concerned. Moreover, throughout these three decades around three-fourth of the workforce is either engaged as a casual worker or self-employed but not employing anyone, should raise flags about whether growth is able to push up labour demand sufficiently. The only positive news in recent years is while between 2017-18 and 2021-22, average real daily earnings show a 4% increase, for casual workers, the lowest paid category among the three major category of the employed, experienced about a 20% increase. However, one must put this in context – even if we assume a 30-day work month, casual workers were earning Rs 6000 per month at 2010 prices (or Rs. 11,520 in 2021 prices), it is barely above the poverty line of Rs. 4400 per month (in 2011-12 prices).

Moreover, in another recent paper (Ghatak and Kumar, 2024) we examine the evidence on the trend in poverty, subject to the data limitations given that we do not have reliable national level estimates of poverty since

2011-12. We look at cross-country evidence on how poverty reduction is correlated with the share of agriculture in the economy and the share of "vulnerable employment" and argue that they are not consistent with a sharp decline in poverty as some recent estimates based on "synthetic" data would tend to suggest. The patterns of growth across different states within India also tend to raise doubts about a sharp decline in poverty. Our own estimates with "synthetic" data based on the Periodic Labour Force Surveys (PLFS) suggest relatively little decrease in poverty over the last decade. Given the higher propensity to spend of the poorer sections, their stagnant earnings also do not augur well for the demand-side of the economy.

5. CONCLUDING REMARKS

Growth is undoubtedly important, if nothing for its instrumental value in terms of raising living standards of all but being an "average" measure, it is at a best an incomplete or partial measure, at worst a misleading one especially if one looks at income-group specific growth rates. In this essay I have tried to outline a sketch of a conceptual framework of "inclusive growth", the building blocks of which involve the two-way relationship between income distribution and the demand pattern, via the induced demand for factors of production and their earnings, which in turn feeds into income distribution. The interplay of these two forces could lead to segregation of the economy in terms of income or wealth with limited mobility, i.e., divergence as opposed to convergence. We provide suggestive evidence that there could be forces at work in the growth process of the Indian economy since liberalisation that resemble this, but a lot more work is needed to provide a rigorous connection between the growth process and the resulting income distribution, via supply and demand-side linkages.

Research papers on which this essay draws on

Ghatak, Maitreesh, Mrinalini Jha, and Jitendra Singh (2024): "Quantity vs Quality: Long-term Trends in Job Creation in the Indian Labour Market", *The India Forum*, January 31, 2024.

Ghatak, Maitreesh, Ashok Kotwal, and Bharat Ramaswami (2020): "What Would Make India's Growth Sustainable?", *The India Forum*, August 13, 2020.

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Ghatak, Maitreesh, and Linchuan Xu (2024): "Inequality of Growth and Growth of Inequality: When is Growth Inclusive?", Unpublished Working Paper, LSE.

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