



# Inequality in India: Welcome or Worrisome?

**Prakash Loungani**

Assistant Director

Independent Evaluation Office, IMF

November 2020

**VIEWS EXPRESSED ARE THOSE OF THE PRESENTER AND SHOULD NOT BE ASCRIBED TO THE IEO OR TO IMF MANAGEMENT, STAFF OR EXECUTIVE BOARD.**

# Summary of talk

Question:

*Is inequality in India welcome or worrisome?*

Answer:

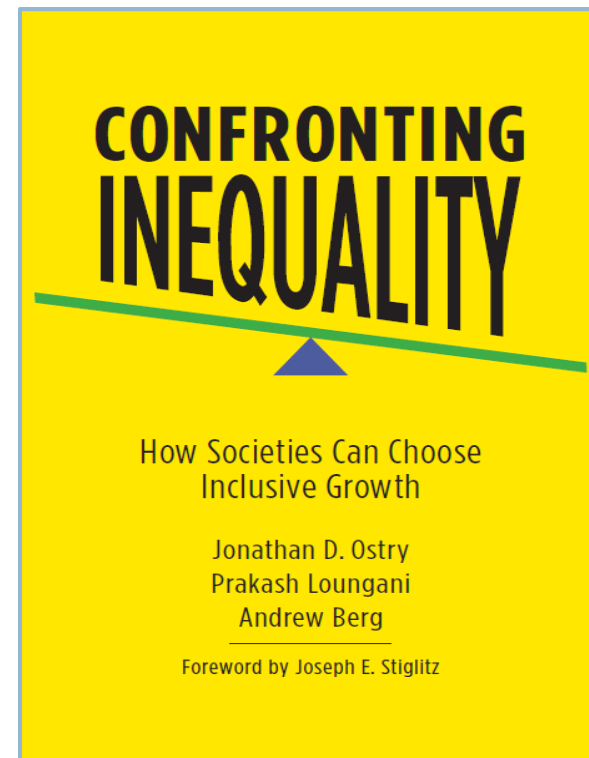
*Yes*

# Sources for presentation

**2020 paper**  
**(with Sriram Balasubramanian**  
**and Rishabh Kumar**

- **Forthcoming IMF**  
**Working Paper,**
  - ▣ **Inequality in India**

**2019 book (with Jonathan Ostry**  
**and Andrew Berg)**





# Should we worry about inequality?

## Some perspectives

# Summary

- Range of views
  - Bhalla: go for growth
  - Mitra: go for poverty reduction
  - Montek: inclusive growth
    - My book champions inclusive growth
      - Evidence that attention to inequality needed to sustain growth
    - Covid-19 has led to change in rhetoric (not yet in action) in the West

# Trickle-down Economics

Promoting  
Growth



```
graph TD; A[Promoting Growth] --> B[Reducing Poverty]; A --> C[Confronting Inequality];
```

The diagram illustrates the concept of Trickle-down Economics. It features a light blue background with three white boxes. The top box, labeled 'Promoting Growth', has a red border. Below it, there are two boxes: 'Reducing Poverty' on the left with a blue border, and 'Confronting Inequality' on the right with a green border. A large grey arrow points from the right towards the 'Promoting Growth' box. Another large grey arrow points from the 'Promoting Growth' box down towards the 'Reducing Poverty' box. A small grey arrow points from the 'Promoting Growth' box down towards the 'Confronting Inequality' box.

Reducing  
Poverty

Confronting  
Inequality

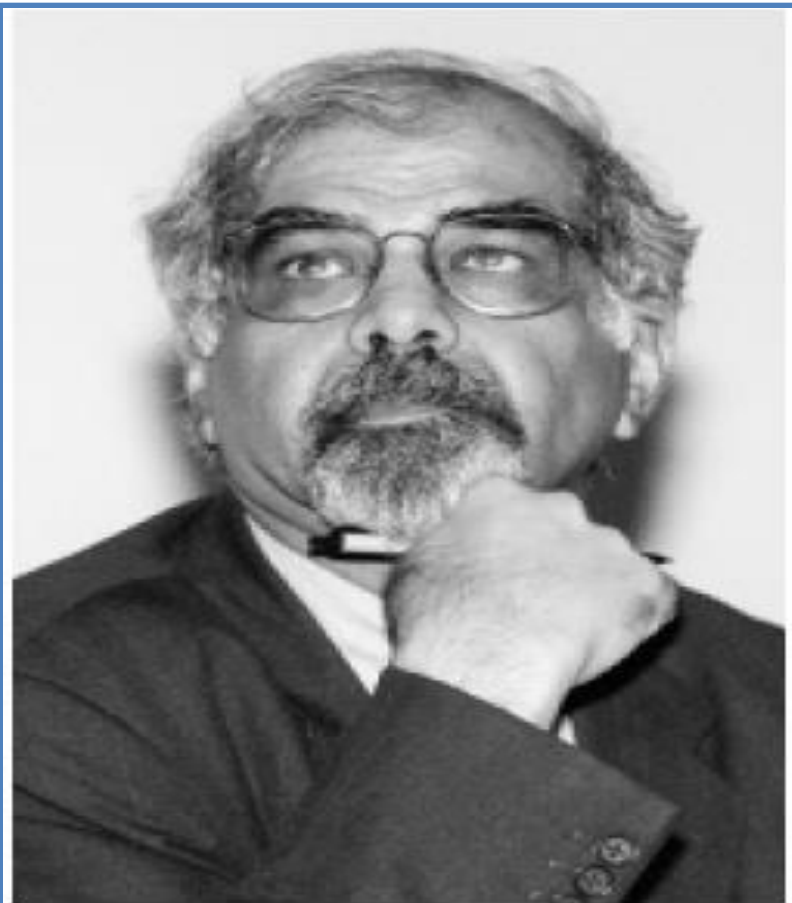
*Interview with Surjit Bhalla*

## **Growth, poverty, inequality—getting the facts right**

**LOUNGANI:** Your book suggests that we should be concerned about growth, poverty, and inequality in that order. Why?

**BHALLA:** Without growth, we will not get anywhere with the other two. We certainly cannot reduce poverty, in an absolute sense, without growth. And you might reduce inequality without growth, but simply by cutting the pie into thinner and thinner slices.

**BHALLA:** If I'm right, growth is sufficient, period. If the Bank is right, there is a big mystery about why growth has not translated into much poverty reduction. This, in turn, justifies the entire cottage industry of getting pro-poor growth, improving the quality of growth, developing a holistic approach, and so on.



*Bhalla:* "If I'm right, growth is sufficient, period."

# Trickle-up Economics?

Give up Growth  
"Fetish"

Reduce  
Poverty

Confront  
Inequality

—



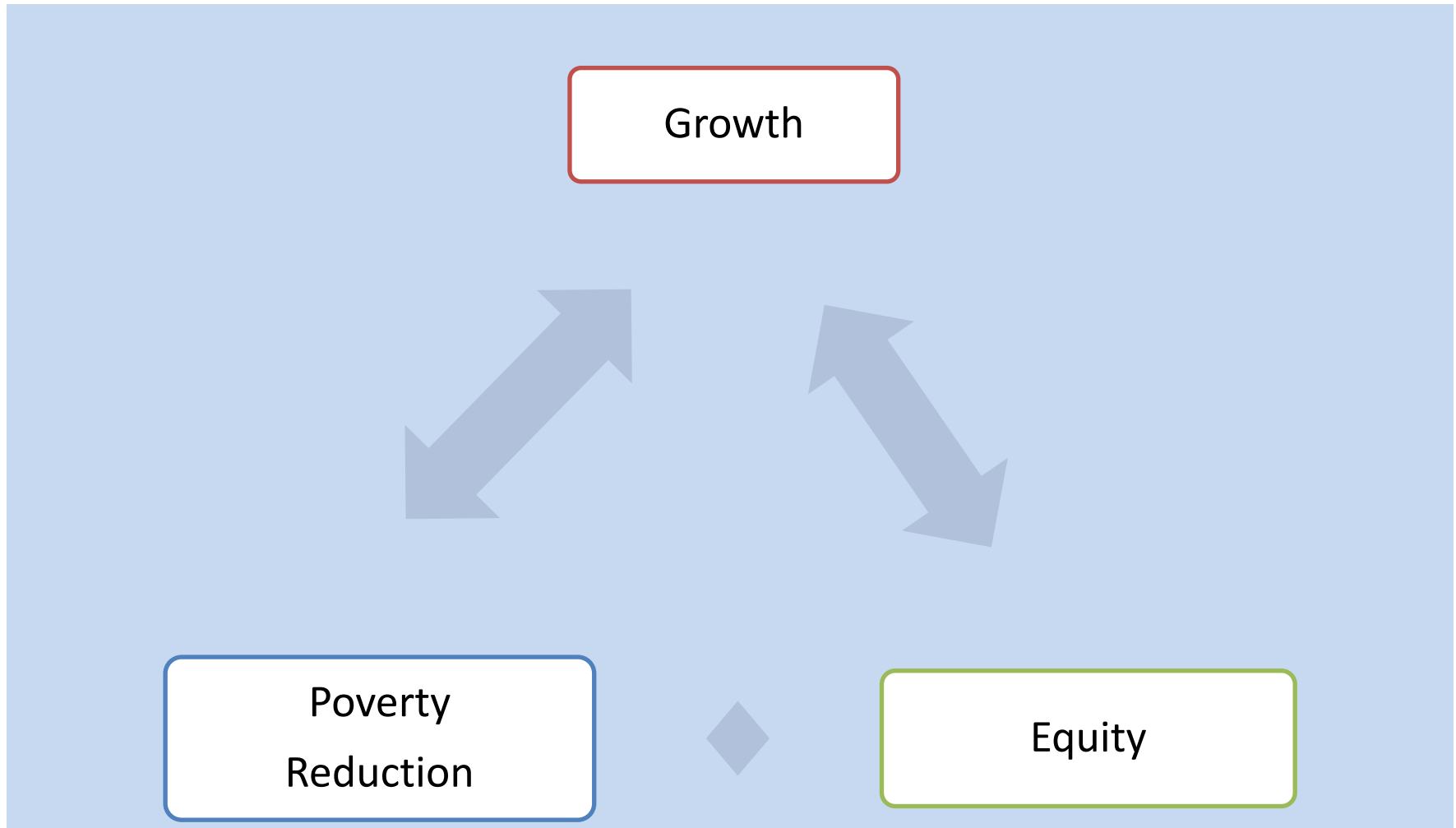
“One of the finest minds of our times, Ashok Mitra, was anguished by poverty and inequality”

In India for the first several decades the principal failure was that we never got to the growth target. Underlying growth targeting was a belief that if the growth takes place then there be more goods that will be distributed and everybody's income will go up. Somewhere around the 1970's Ashok Mitra wrote a piece in the *Economic and Political Weekly*, arguing to get rid of these growth fetishes and go for what really matters, which is poverty reduction. Maybe we could achieve poverty reduction without worrying about growth.

“To sum up, there is not enough growth, and whatever growth does take place is unjustly distributed. The consequence is a rising turbulence at different points of the polity. A certain disenchantment is in the air, a disenchantment which feeds upon itself.”

(Ashok Mitra, EPW, 1975)

# THREE GOALS: Inclusive Growth



# What's Inclusive Growth?

## **Inclusive Growth: What does it mean?**

***Montek Singh Ahluwalia***  
***Deputy Chairman of Planning Commission of India***

Earlier it was thought that with growth everybody will benefit. It was believed by many that if we achieve, say, 8 per cent growth everyone's income would grow by 8 per cent. But it was realised quite early that this is not the way the system works. It is possible to have a growth rate which is high, but it is also possible that the same is not broadly spread raising concerns and doubts over the growth process.

I would say that a growth process that doesn't reduce poverty is really not worth it unless poverty is down to under 10 per cent. But the growth process I would say certainly should not be increasing inequality too much. What is important is not so much equality, but "social mobility" because the concept of equality itself can be,

# CONFRONTING INEQUALITY

How Societies Can Choose  
Inclusive Growth

Jonathan D. Ostry  
Prakash Loungani  
Andrew Berg

Foreword by Joseph E. Stiglitz

<https://www.amazon.in/Confronting-Inequality-Societies-Choose-Inclusive/dp/0231174691>

“This book shows that, far from being either necessary or good for growth, inequality leads to weaker economic performance. These conclusions come from careful research conducted over several years.”

► From the foreword by Joseph Stiglitz, Nobel Laureate in Economics

“Ostry, Loungani, and Berg have done some of the best empirical research on globalization, inequality, and economic growth. *Confronting Inequality* should be on the shelf of everyone who wants to understand the future of our economies.”

► Dani Rodrik, Harvard University

Coming from the top IMF economists, this new approach may herald a major change in global policies such that attention is paid to both growth and equality.”

► Branko Milanović, The Graduate Center, CUNY

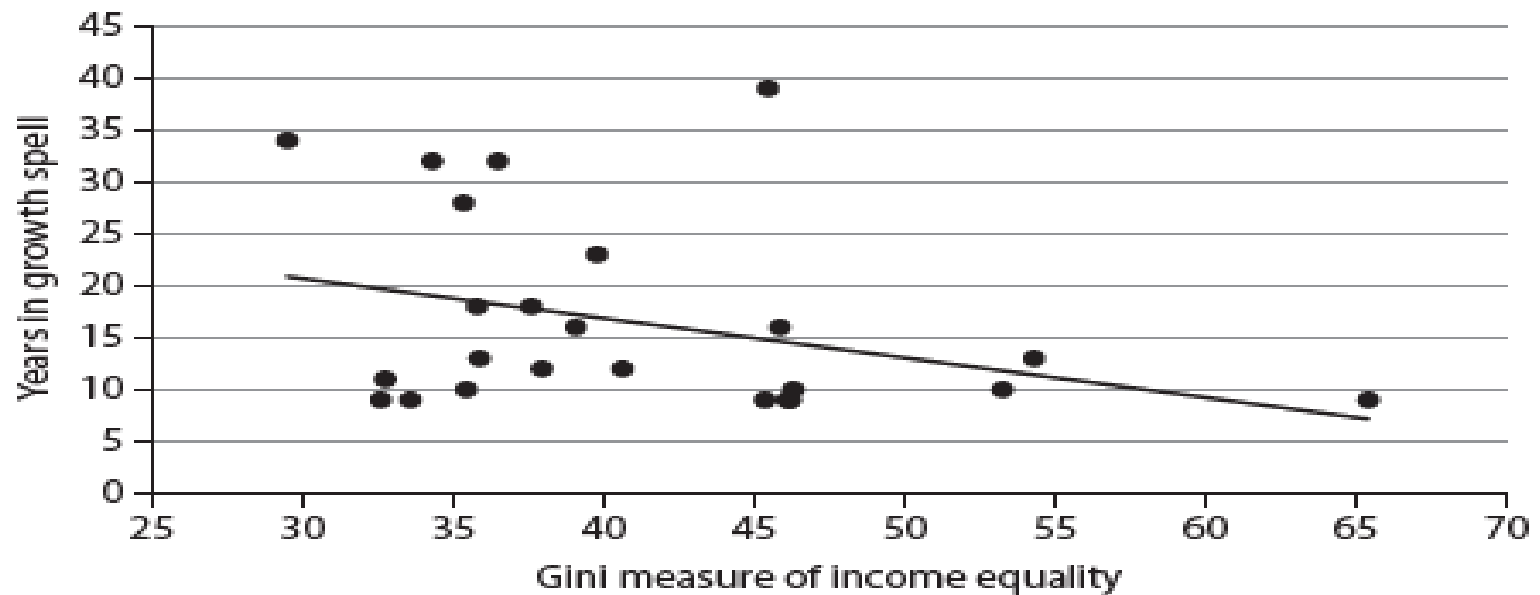
“The IMF has been an unlikely accompaniment to the chorus of voices speaking out against increasing inequality, influenced primarily by the work of these authors. Backed by sensible empirical work, their arguments deserve to be read and discussed widely.”

► Raghuram G. Rajan, University of Chicago Booth School of Business

## Inequality leads to fragile growth

**FIGURE 3.3: Duration of Growth Spells and Inequality**

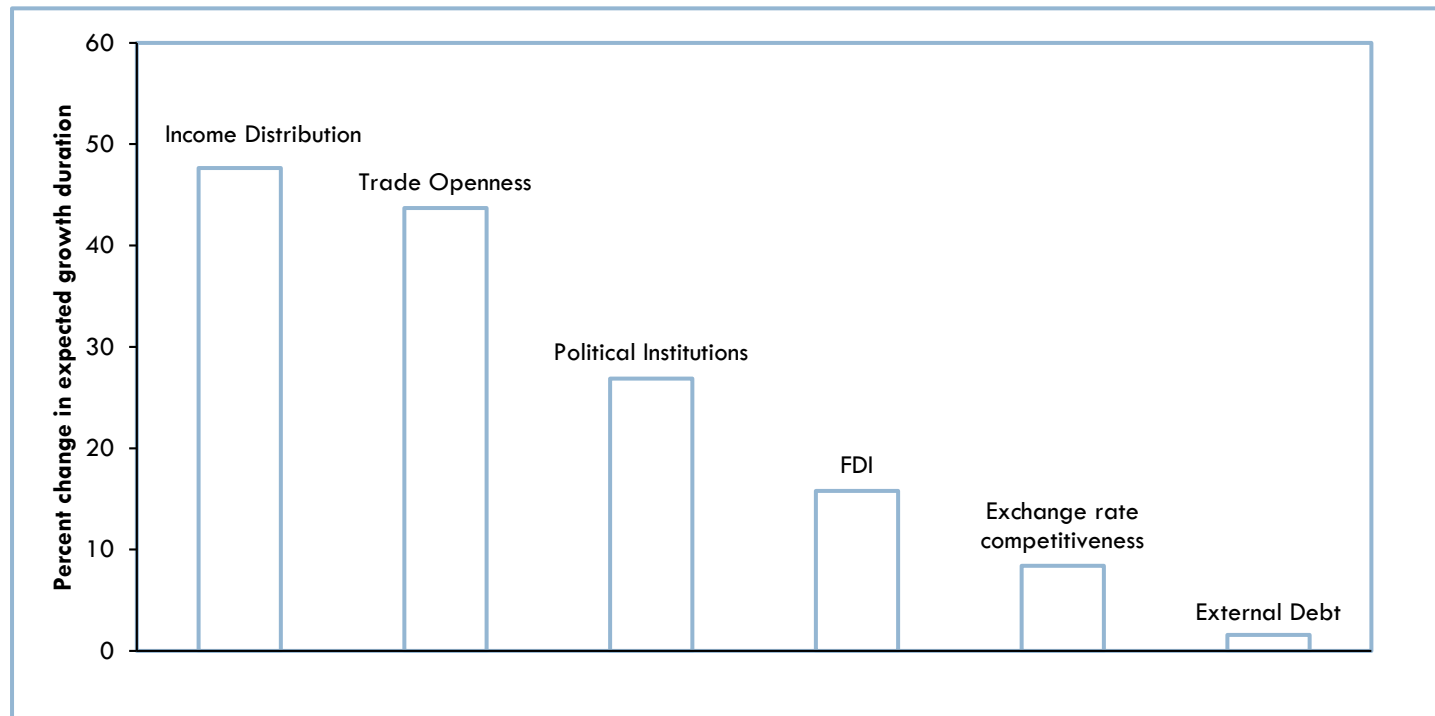
More inequality is associated with less sustained growth.



Relationship across countries between income inequality and duration of growth spell.  
Ostry and Berg (*IMF Economic Review* 2011); updated in Ostry, Loungani and Berg (2019, chapter 3)

# A more equal income distribution sustains growth

## The impact of different factors on growth spell duration



A more equal distribution increases the duration of growth spells even after controlling for the other factors shown. Berg, Ostry, Zettelmeyer (*Journal of Development Economics*, 2012); see also Ostry, Loungani and Berg (2019, chapter 3)

# World Bank on inclusive growth

Elena Ianchovichina & Susanna Lundstrom (“What is Inclusive Growth?”, World Bank, 2009)

- Inclusive growth = ‘growth that is broadly shared’
  - *“it should be broad-based across sectors and inclusive of the large part of the country’s labor force”*
- “inclusiveness – a concept that encompasses equity, equality of opportunity, and protection in market and employment transitions – is an essential ingredient of any successful growth strategy” (Growth Commission)
- In long-run, “productive employment rather than direct income redistribution as a means of increasing incomes for excluded groups”

# Inclusive growth and the IMF

We want growth, but we also want to make sure:

- that people have [jobs](#)—this is the basis for people to feel included in society and to have a sense of dignity;
- that women and men have equal opportunities to participate in the economy—hence our focus on [gender](#);
- that the poor and the middle class share in the prosperity of a country—hence the work on [inequality](#) and shared prosperity;
- that, as happens, for instance when countries discover natural resources, wealth is not captured by a few—this is why we worry about corruption and [governance](#);
- that there is [financial inclusion](#)—which makes a difference in investment, food security and health outcomes; and
- that growth is shared just not among this generation but with future generations—hence our work on building resilience to [climate change](#) and [natural disasters](#).



## A remarkable editorial in the *Financial Times* ...

### **“Virus lays bare the frailty of the social contract” (April 3, 2020)**

- recent developments “shine a glaring light on **existing inequalities**”
- “Radical reforms — **reversing the prevailing policy direction of the last four decades** — will need to be put on the table.”
- **“Redistribution will again be on the agenda**; the privileges of the elderly and wealthy in question.”
- Policies until recently considered eccentric, such as **basic income and wealth taxes**, will have to be in the mix.”

## ... a remarkable change from the *Financial Times* in 2017

### Financial Times editorial, 2017

- “sorry spectacle befell the IMF” when it concluded that some economic policies have not delivered growth but raised inequality
- “In seeking to be trendy, the IMF instead looks as out of date as a middle-aged man wearing a baseball cap backwards.”
- “The IMF should stick to its knitting and tackle the decline in productivity”



## Billionaires grow a conscience ...

- “This is our chance to **do the right thing**,” by reducing income disparities, Mark Cuban, billionaire, sports & entertainment
- **Inequality is “a national emergency.”** “If you don’t have a situation where people have opportunity ... you’re threatening the existence of the system,” Ray Dalio, hedge-fund billionaire
- The pandemic is “a wake-up call ... for business and government to think, act and invest for **the common good**”.

Jamie Dimon, CEO, J.P. Morgan

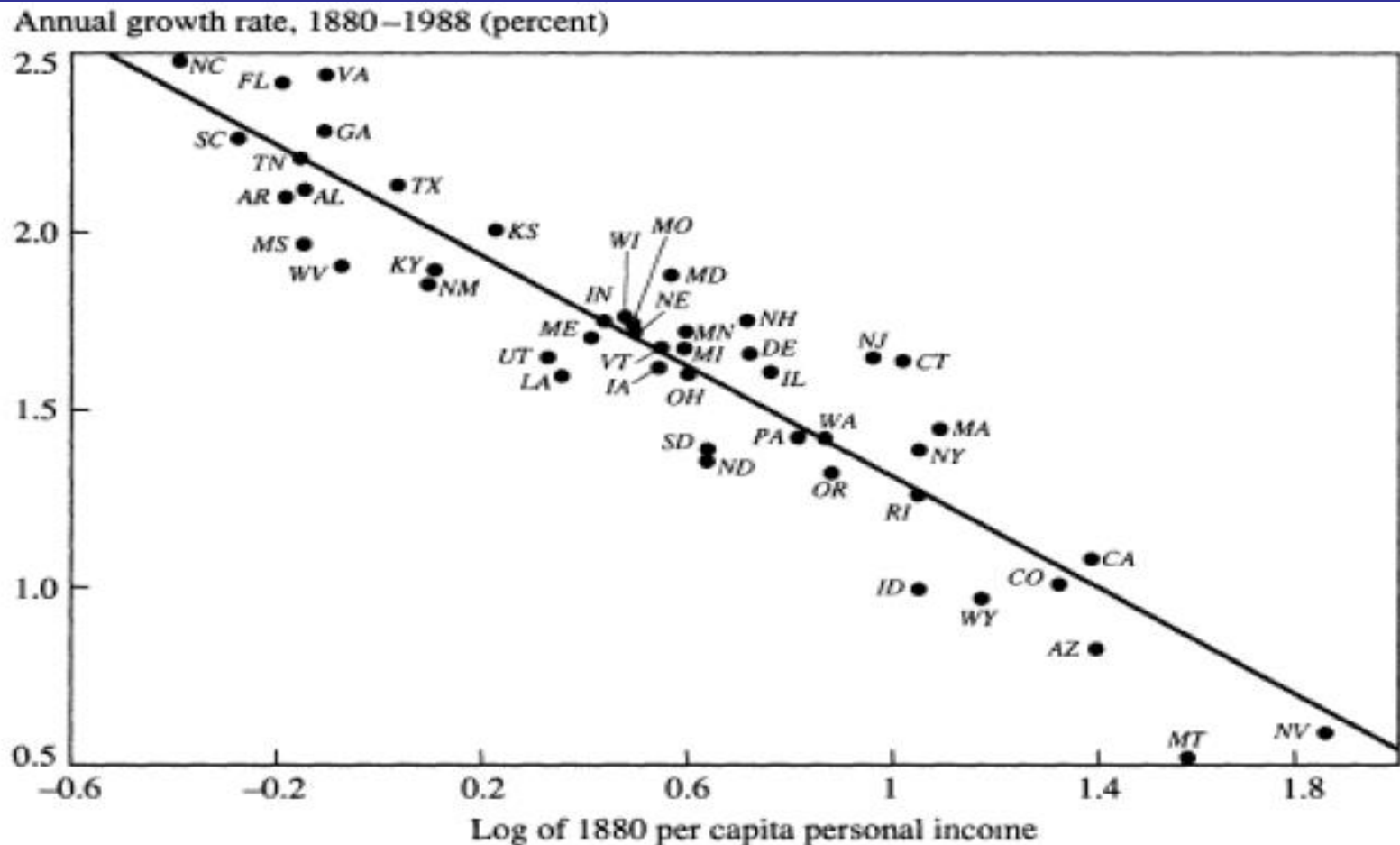


## Characteristics of inequality in India

## Locational variation in living standards in India is very large

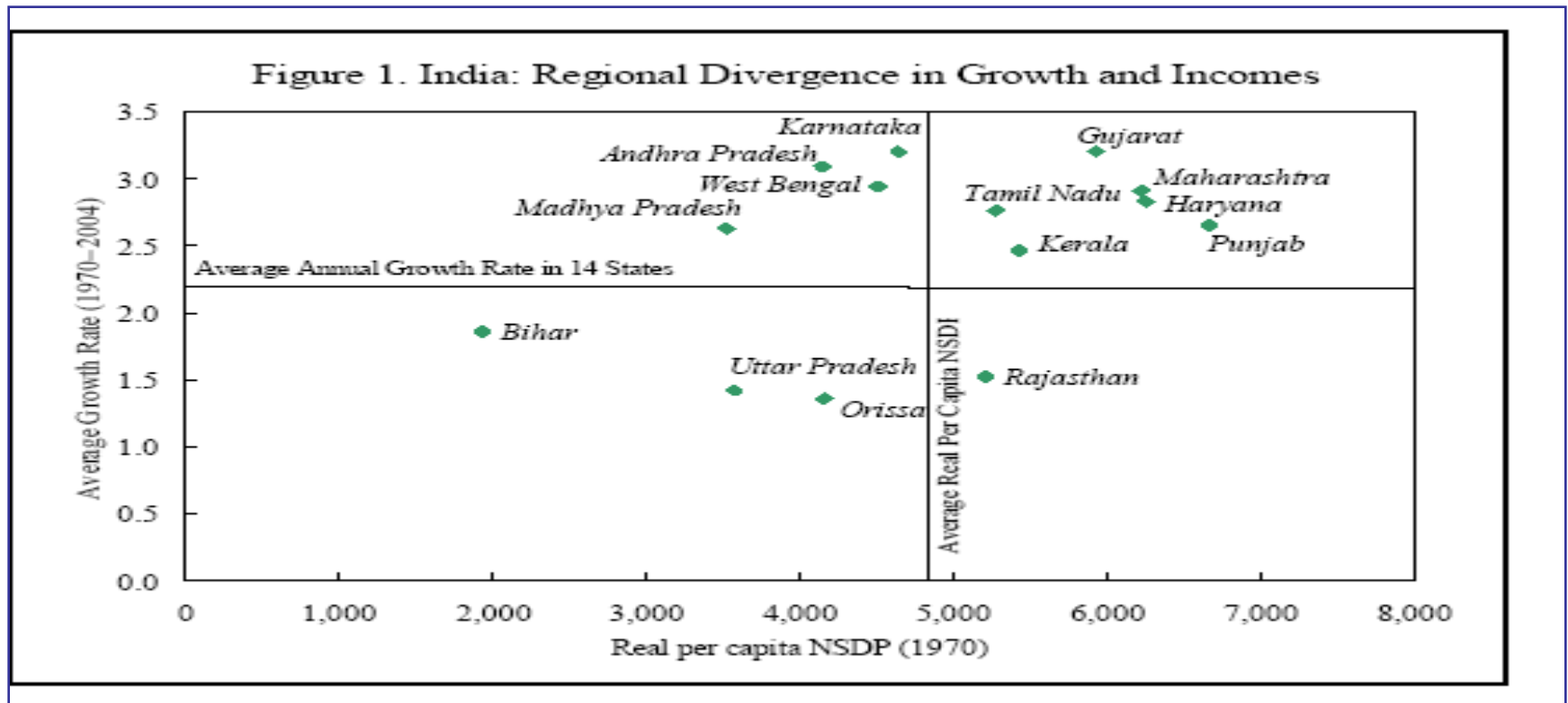
- In 2011-12: per capita income in Bihar around 13% of same for Delhi
- This within-country variation in India is similar in the gaps between countries (e.g. US vs. India)

# Convergence in personal income across U.S. states



Sources: Bureau of Economic Analysis (1984), Easterlin (1960a, 1960b), and *Survey of Current Business*, various issues. The postal abbreviation for each state is used to plot the figure. Oklahoma, Alaska, and Hawaii are excluded from the analysis.

# Lack of convergence in Indian states, 1970 to 2004



## Don't worry, it's a “race to the top”?

Rodrik and Subramanian

<http://www.imf.org/external/pubs/ft/wp/2004/wp04118.pdf>

It should be noted that the disparity between states is both a cause for concern but also the consequence of a very powerful positive dynamic in India: namely, the competition among states to improve institutions and policies—a kind of “race to the top”—as a means of attracting increased amounts of foreign and domestic capital. For these reasons, it is possible that the divergence is self-limiting—states left behind will be under pressure to follow the demonstration effect of the more successful states or else face the consequences.<sup>5</sup> In an internal market such as India's with free movement of capital and labor, these consequences could be severe. Admittedly, India has not witnessed, yet, the movement of labor commensurate with the growing divergence (Cashin and Sahay, 1996), but capital flows are proving to be more sensitive to state-level policies, and over time inter-state labor flows could also accelerate.

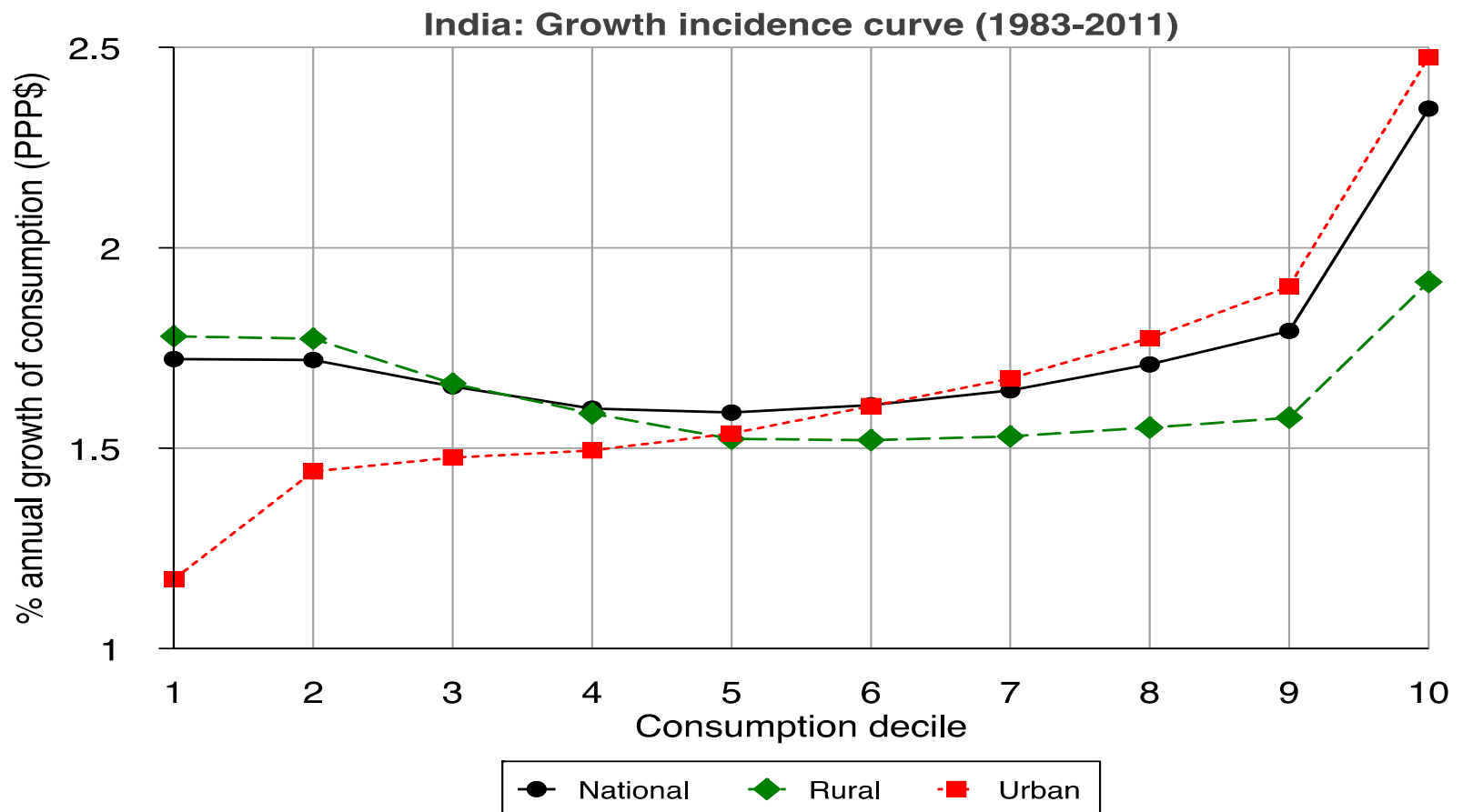


## What we study

- How much inequality in India is determined by a person's location (state; urban vs. rural sector)?
- We use India's NSSO consumption surveys
  - our data ends in 2011/12  
(well-known controversy about redacted survey for 2017/18)

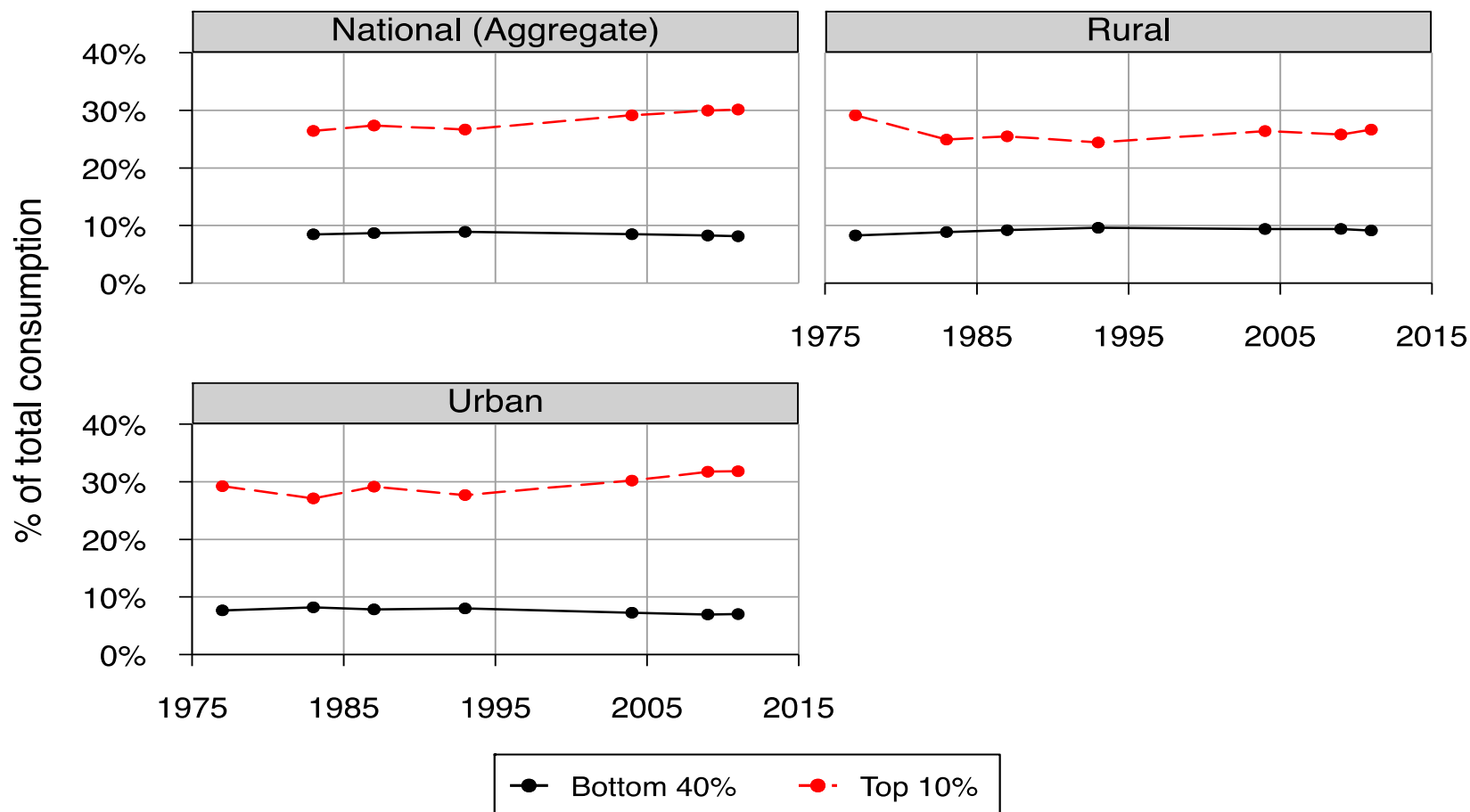
# Growth Incidence Curves

GIC curve measures growth in each decile over period  $(t, t+n)$  on an annual basis



# Consumption Shares of Top vs. Bottom Deciles

India: top and bottom consumption shares



Graphs by Coverage

# Applying Milanovic model to India

- Milanovic used pooled global household surveys and found:
  - per capita income of country
  - inequality in country

...can alone explain **>50%** of a person's consumption
- **“Citizenship premium”** – no need to work hard, just be lucky enough to be born in a rich country
- Is there a similar **location premium** within India?
  - Should one expend effort to improving incomes *when moving from poor to rich state is easier?*

# Estimation

- $C_{ij} = b_0 + b_1 \text{SGDPpc}_j + b_2 \text{Gini}_j + u_{ij}$
  - Where C is the (log) consumption of an individual i in state j
  - SGDPpc is the (log) per capita income in state j
  - Gini is the gini index for state j
- Both covariates cannot be altered by one's own individual effort  
i.e one person cannot change the inequality and average income of the region they live in. Individual circumstances (caste, gender etc) and luck are captured by the error term u.

# First model: state level only

Model 1	Original equation	State dummies
	Log of consumption	Log of consumption
	b	b
Log of state GDP per capita	0.5***	
State Gini (0-100)	-.00	
Constant	3.8***	10.5***
State dummy	No	Yes
<b>R<sup>2</sup></b>	<b>.18</b>	<b>.25</b>
N	3189	3189

## Second model: we split each state into rural and urban

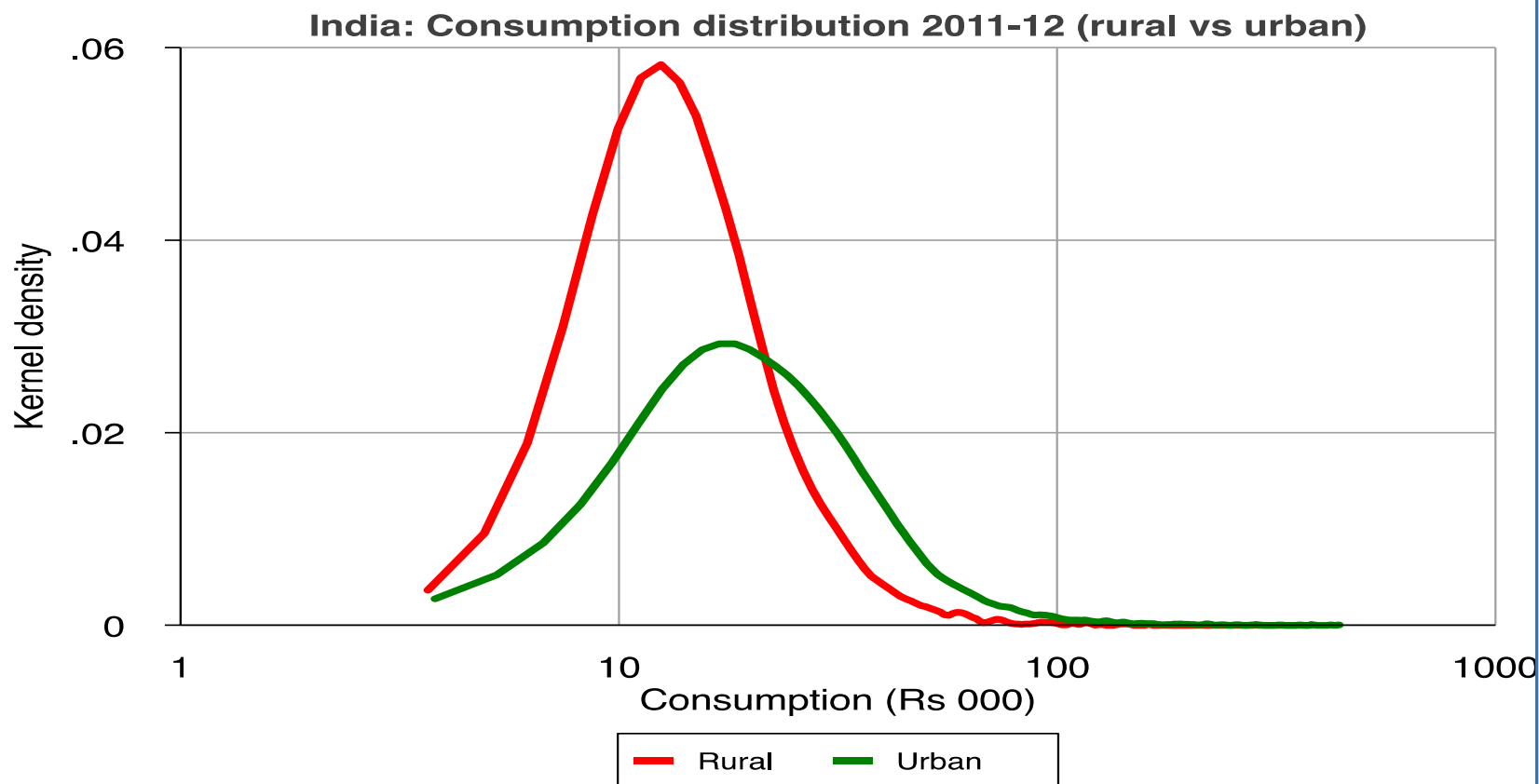
	Original equation	State-sector dummies
Model 2	Log of consumption	Log of consumption
	b	b
Log of state GDP per capita	0.4***	
State-Sector Gini (0-100)	.02***	
Constant	4.7***	10.3***
State-Sector dummy	No	Yes
<b>R<sup>2</sup></b>	<b>.18</b>	<b>.31</b>
N	6114	6114

# Key Findings

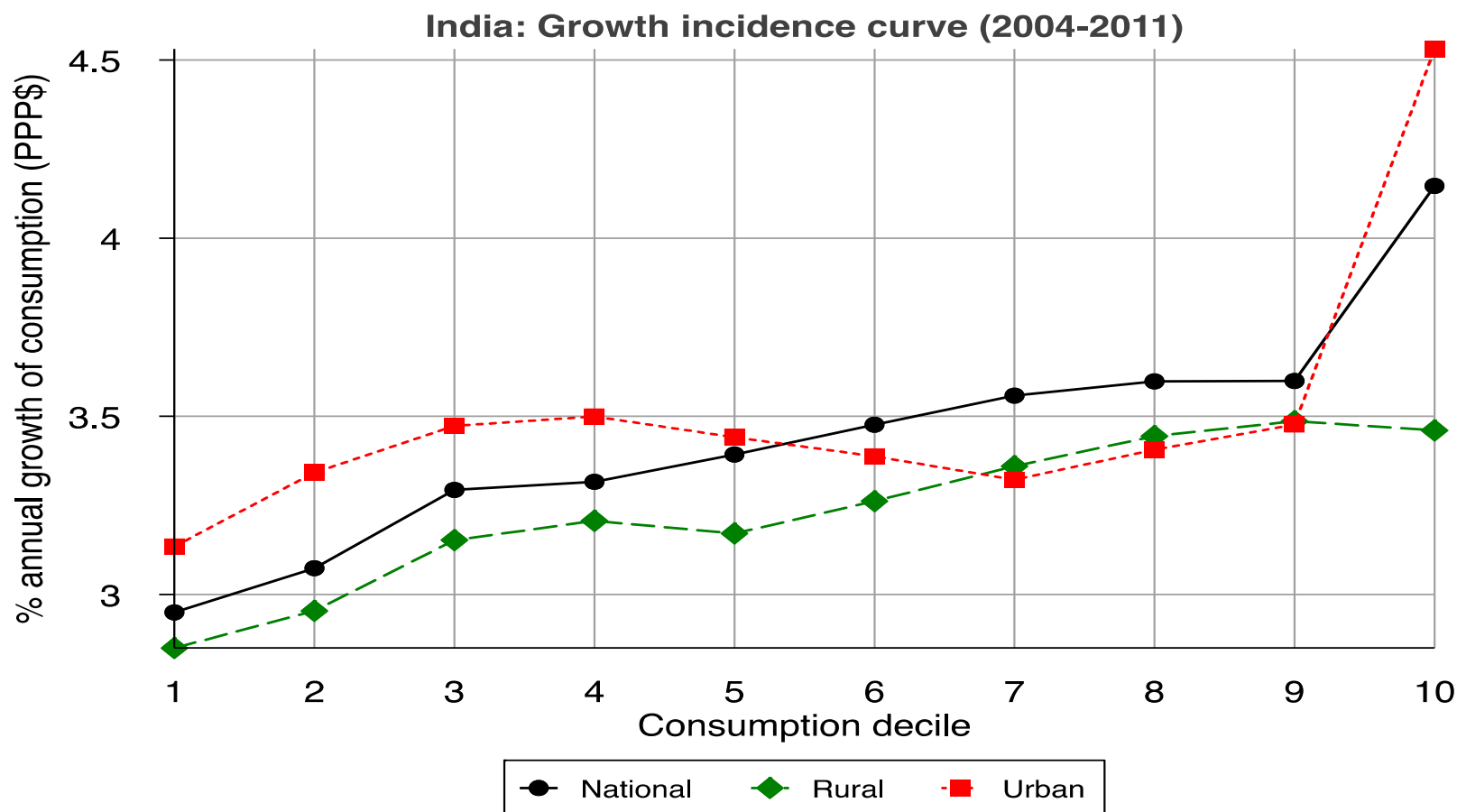
- Location alone explains almost  $1/3^{\text{rd}}$  of the variation in living standards (measured by consumption in India)
  - There is a **location premium (or penalty)**
- Income elasticity of consumption is positive.
  - an individual can improve living standards by moving to a richer state
- With rural and urban split: significant and positive elasticity for inequality
  - an individual can improve living standards by moving to more unequal region.



# Understanding our findings: rural and urban consumption distribution



# Understanding our findings: urban lower-income class vs. rural lower-income class

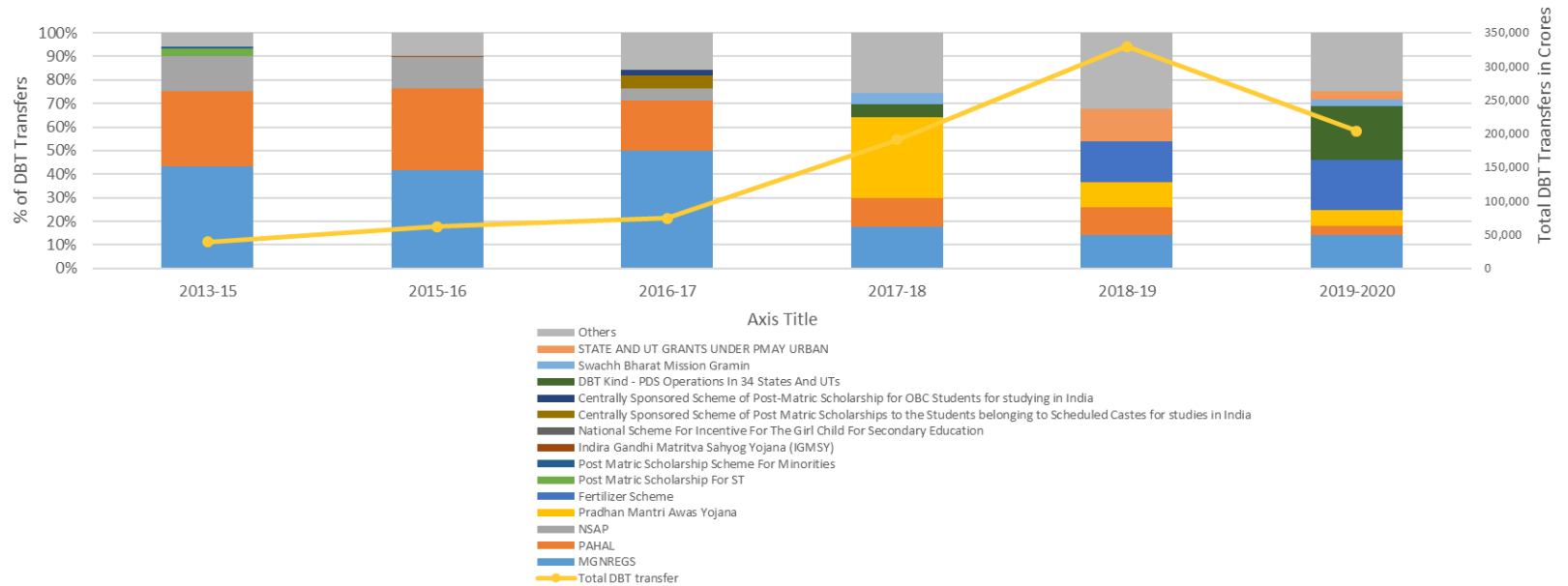


# Developments since Covid-19

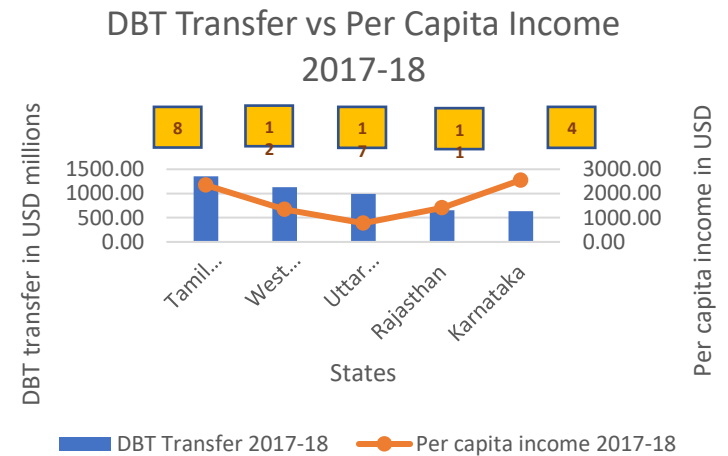
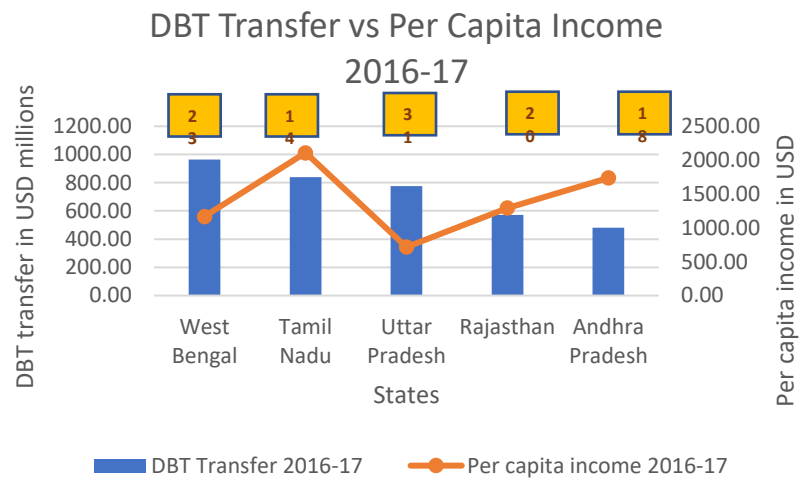
- Shut down urban economy -> forced a return to rural India where distribution of living standards is less favorable
- This explains immediate resumption of migration to urban India after the end of lockdown
- Can DBT-type help?

## DBT by Schemes

### DBT Transfer by Scheme 2013-2019/20

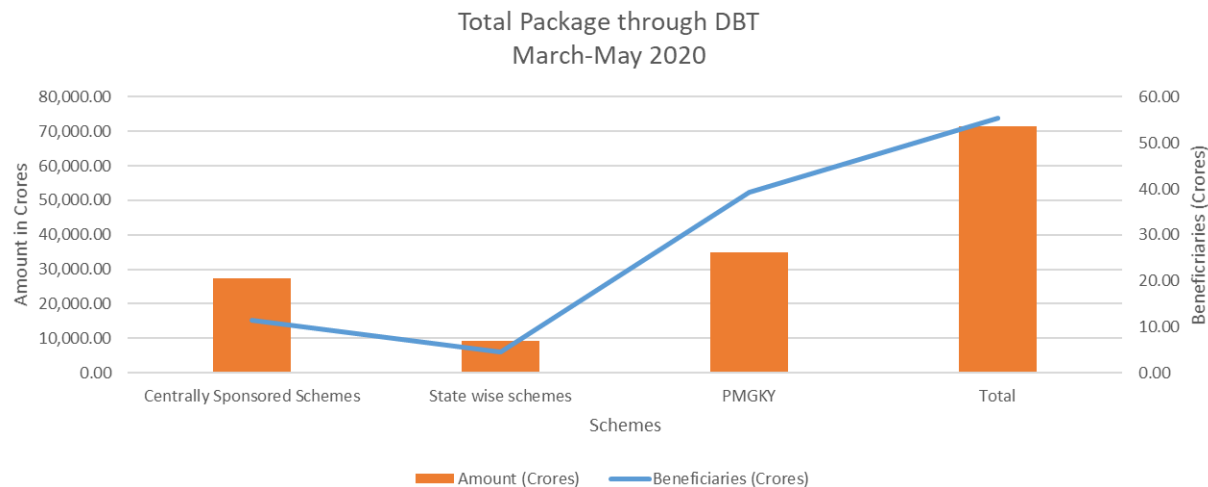


# DBT by States



Source: DBT Mission and authors analysis

# Covid Impact on India—DBT Support



# Conclusions

- In a country where specific circumstances like caste, inheritance and gender are vital, we found that almost 25-30% of variation in living standards is due to location specific circumstances alone.
- Individuals may not be able to change specific circumstances, but can change location
  - this explains the vitality of migration (9mn flow, 139 mn stock)
- Individuals would be willing to trade class for location
  - i.e. drop down from rural middle to urban poor to improve consumption.

# THANKS!

<https://www.amazon.in/Confronting-Inequality-Societies-Choose-Inclusive/dp/0231174691>

