Income Inequality: A Defining Challenge of Our Times

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1. Introduction

- Widening income inequality is the defining challenge of our time. In advanced economies, the gap between the rich and poor is at its highest level in decades.
- Economic inequality – the skewed distribution of income and wealth – has reached extreme levels and continues to rise. Seven out of 10 people on the planet now live in a country where economic inequality is worse today than it was 30 years ago.
- Measures of inequality based on Gini coefficients of gross and net incomes have increased substantially since 1990 in most of the developed world.
- Inequality of wealth is even more extreme than the inequality of income. The number of dollar millionaires – known as High Net worth Individuals – rose from 10 million in 2009 to 13.7 million in 2013. Since the financial crisis, the ranks of the world’s billionaires have more than doubled. The billionaire boom is not just a rich country story: the number of India’s billionaires increased from just two in the 1990s to 65 in early 2014.
- Equality, like fairness, is an important value in most societies. Irrespective of ideology, culture, and religion, people care about inequality. Inequality can be a signal of lack of income mobility and opportunity—a reflection of persistent disadvantage for particular segments of the society.
- Policy makers needs to focus on the causes and consequences of the rising income inequality to avoid the conflicts and social upheavals.

2. Causes of Income Inequality

- **Market Deregulation and Liberalization:**
  - With regulation, capitalism can be a very successful force for equality and prosperity. But unregulated market forces and unmindful liberalization drives the concentration of wealth and fuels the extreme inequality.
  - Changes in existing markets in the last few decades to make them more unregulated led to wealth concentration. Liberalization extended market mechanisms to ever more areas of human activity, leading to disparities of wealth in increasing areas of human life.
  - In recent decades economic thinking has been dominated by a ‘market fundamentalist’ approach which insists on sustained economic growth coming from leaving markets to their own devices. A belief in this approach has significantly driven the rapid rise in income and wealth inequality since 1980.
  - Liberalization of the agricultural sector, including the removal of subsidized inputs, like credit and fertilizer, has impacted all poor farmers.
  - Easing of labor market regulations is associated with higher market inequality and income share of the top 10 percent rich population.

- **Technological Change:** New information technology has led to improvements in productivity and well-being, but has also played a central role in driving up the skill premium, resulting in increased labor income inequality.

- **Trade globalization:** Trade has been an engine for growth in many countries by promoting competitiveness and enhancing efficiency. Nonetheless, high trade and financial flows between countries, partly enabled by technological advances, are commonly cited as driving income inequality.

- **Capture of Power and Politics by the Elites:** A major driver of rapidly rising economic inequality is the excessive influence over politics, policy, institutions and the public debate, which elites are able to employ to ensure outcomes that reflect their narrow interests rather than the interests of society at large.

**Gini Coefficient:** Inequality of income, wealth and other assets, such as land, have been historically measured by the Gini coefficient, named after the Italian statistician Corrado Gini. This is a measure of inequality where a rating of 0 represents total equality, with everyone taking an equal share, and a rating of 1 (or sometimes 100) would mean that one person has everything.
3. Consequences of the Inequality

- **Outcomes and opportunities**: High and sustained levels of inequality, especially inequality of opportunity can entail large social costs. Entrenched inequality of outcomes can significantly undermine individuals’ educational and occupational choices.

- **Effect on Growth**: Income distribution matters for growth, studies conducted by IMF on income distribution shows strong relationship between growth and income distribution. Higher inequality lowers growth by depriving the ability of lower-income households to stay healthy and accumulate physical and human capital. For instance, it can lead to underinvestment in education as poor children end up in lower-quality schools and are less able to go on to college. As a result, labor productivity could be lower than it would have been in a more equitable world.

- **Inequality dampens investment**, and hence growth, by fueling economic, financial, and political instability. A growing body of evidence suggests that rising influence of the rich and stagnant incomes of the poor and middle class have a causal effect on crises, and thus directly hurt short- and long-term growth. Economists opine a prolonged period of higher inequality in advanced economies was associated with the global financial crisis of 2008.

- **Conflicts**: Extreme inequality may damage trust and social cohesion and thus is also associated with conflicts, which discourage investment. Conflicts are particularly prevalent in the management of common resources where, for example, inequality makes resolving disputes more difficult. The Arab Spring of 2011 and subsequent political conflicts in the Middle-East, rise in extremist forces in the world is attributed to rising disparity between nations and within particular nations.

4. Indian Scenario

Analysis of India’s Performance on some of the indicators of Equality:

- India has fared dismally in a two-year study on income inequality conducted by the World Economic Forum (WEF). The report, titled Inclusive Growth and Development Report 2015, ranked India 37th out of 38 lower-middle-income countries in fiscal transfers. Another area to prioritize improvement for India is “Asset building and entrepreneurship”, in particular the sub-pillar “Small business ownership”, where it ranks at the bottom (38th) among its peers.

- Educational enrollment rates are relatively low across all levels, and quality varies greatly, leading to notable differences in educational performance among students from different socio-economic backgrounds.

- While unemployment is not as high as in some other countries, the labor force participation rate is low, the informal economy is large, and many workers are in vulnerable employment situations with little room for social mobility.

- India under-exploits the use of fiscal transfers. Its income tax is regressive and social spending remains low, which limits accessibility of healthcare and other basic services. Sanitation continues to be a problem across the board.

- India performed well in terms of access to finance for business development and real economy investment, yet new business creation continues to be held back by the large administrative burden of starting and running companies, corruption, and underdeveloped infrastructure.

Steps taken by the Government of India:

- **Jan Dhan Yojana**: The IMF paper on income inequality notes that governments in emerging market economies need to push such efforts at inclusion to make a dent in inequality. Country experiences suggest that policies such as granting exemptions from onerous documentation requirements, requiring banks to offer basic accounts, and allowing correspondent banking are useful in fostering inclusion.

- **Jan Dhan Yojana** seeks to bring banking services to the poor, including landless labourers, and offer them easy credit. However, the IMF warns against offering too much credit “without sufficient regard for financial stability”.

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• **Labour Reforms**: States like Rajasthan and Maharashtra have begun to loosen rules for hiring of labour. Cross-country evidence shows easing of market regulations and technological progress reduce the chances of the less-educated labour force rising in life. Labour market policies should attempt to avoid both excessive regulation and extreme disregard for labor conditions.

• **Tax Reforms**: The IMF paper is clear that tax rates need to be far more progressive across most of the world. It uses data from non-official sources to show that the income share of the middle 20% in BRICS countries has shrunk even more than for developed countries in the period 1990-2009. “The redistributive role of fiscal policy could be reinforced by greater reliance on wealth and property taxes, more progressive income taxation, removing opportunities for tax avoidance and evasion, better targeting of social benefits while also minimizing efficiency costs, in terms of incentives to work and save.”

• Budget 2015-16 has announced a timeline to ease corporate tax rates to 25% in the next four years, but plans to erase most tax exemptions.

• **Skill Development**: Improving education quality, eliminating financial barriers to higher education, and providing support for apprenticeship programmes are all key to boosting skill levels in both tradable and non-tradable sectors. These policies can also help improve income prospects of future generations as educated individuals are better able to cope with technological and other changes.

5. **Way Forward to a just world**

• **Make governments work for citizens and tackle extreme inequality**: Working in the public interest and tackling extreme inequality should be the guiding principle behind all global agreements and national policies and strategies. Effective and inclusive governance is crucial to ensuring that governments and institutions represent citizens rather than organized business interests. This means curbing the easy access that corporate power, commercial interests and wealthy individuals have to political decision making processes.

• **Close international tax loopholes and fill holes in tax governance**: Today’s economic system is set up to aids tax dodging by MNCs and wealthy individuals. Tax havens are destroying the social contract by allowing those most able to contribute to society opt out of paying their fair share. Until the rules around the world are changed, this will continue to drain public budgets and undermine the ability of governments to tackle inequality. However, any process for reform must deliver for the poorest countries. A multilateral institutional framework will be needed to oversee the global governance of international tax matters.

• **Achieve universal free public services for all by 2020**: The high cost of healthcare and medicines drives a hundred million people into poverty every year. When user fees are charged for schooling, some children can access high-quality private education, but the majority makes do with poor-quality state education, creating a two-tiered system. Privatization further entrenches the disparities between the poorest and the richest, and undermines the ability of the state to provide for all.

• **Implement a universal social Protection floor**: Social protection is central not only to reducing economic inequality, but also as a way to make society more caring and egalitarian, and to address horizontal inequalities. For the very poorest and most vulnerable there must be a universal and permanent safety net that is there for them in the worst times.