Asia’s Wealth Gap

Asia’s developed and emerging economies are both facing a common challenge following decades of rapid growth: how to address growing inequalities in wealth and income that are creating increasing social tensions and, in some instances, have the potential to threaten social stability.

While the problems require different solutions from one country to the next, all of Asia must address the need for inclusive growth, if the region is to keep itself on a path that is sustainable in the future.
Growth? Yes, but India Must Do More for Those Left Behind

By Rajat Kathuria

India is a widely diverse country of more than 1.2 billion people and is likely to be the fastest-growing major economy in the world this year. The International Monetary Fund (IMF) projects annual growth of 7.5 percent in 2016 and 2017 on the back of continued labor market and infrastructure reforms. Although the country is confronted by numerous challenges, the optimism is rooted in the economy’s past performance and impending reforms. India experienced the most sustained periods of rapid growth in its economic history during the 2000s — an average of close to 9 percent a year between 2003 and 2011. This growth contributed to an unprecedented fall in poverty. The proportion of the population in poverty fell from 37.2 percent in 2004-05 to 21.9 percent in 2011-12, pulling 137.4 million people out of poverty. While structural and institutional reforms also support optimism, notes of caution are appropriate, not to deflate the optimism but to reflect the practicality of contemporary developments.

MEASURING INEQUALITY
There is a widespread perception in India, backed by empirical evidence, that the benefits of faster growth in gross domestic product (GDP) are being undermined by a pro-rich bias. Harmful spillovers from the current growth model — severe local air pollution and the damage it causes to health — also affect the poor disproportionately. Thus, even as India grapples with how to achieve rapid and sustainable economic growth, it must ensure that growth is more inclusive. The share of national consumption expenditures accounted for by the top 10 percent of income earners has increased in the post-reform period along with a corresponding fall in the share of the bottom 20 percent (see Table 1). Further, the Gini coefficient of consumption expenditure, based on estimates using data from the National Sample Survey (NSS), shows an increase in consumption inequality from 0.30 in 1993-94 to 0.359 in 2011-12. It is important to flag here that while inequality in India is generally measured by consumption expenditure, the standard for other countries is income inequality. Empirically, consumption inequality measures are lower than similar measures of inequality based on income. This is partly due to the fact that consumption expenditure as measured by the NSS in India tends to underestimate income and consumption. In addition, inequality of opportunities such as access to education and ownership, which is much more skewed than the distribution of household assets, especially land income and nutrition tend to be persistent, requiring special government support to mitigate them. All the above statistics point to rising inequality. The question that needs to be asked is, if economic growth helps alleviate poverty, how much should one worry about inequality? There are at least two good reasons for concern. First, while growth helps reduce poverty, it may not be fast enough to address inequality, because rapid growth alone won’t solve the problem, writes Rajat Kathuria.

<table>
<thead>
<tr>
<th>Year</th>
<th>Bottom 20%</th>
<th>Bottom 40%</th>
<th>Top 20%</th>
<th>Top 10%</th>
<th>Urban top 10%/Rural bottom 10%</th>
<th>Urban top 10%/Urban bottom 10%</th>
<th>Urban top 10%/Rural bottom 40%</th>
<th>Gini of consumption expenditure (0 to 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>8.50</td>
<td>20.30</td>
<td>43.90</td>
<td>29.20</td>
<td>12.74</td>
<td>9.14</td>
<td>9.40</td>
<td>34.70</td>
</tr>
<tr>
<td>2009-10</td>
<td>8.20</td>
<td>19.90</td>
<td>44.80</td>
<td>30.10</td>
<td>13.86</td>
<td>10.11</td>
<td>10.11</td>
<td>35.80</td>
</tr>
<tr>
<td>2011-12</td>
<td>8.10</td>
<td>19.60</td>
<td>44.70</td>
<td>29.90</td>
<td>13.98</td>
<td>10.06</td>
<td>10.16</td>
<td>35.90</td>
</tr>
</tbody>
</table>

1 Estimates based on the Tendulkar poverty line.
2 The India Human Development Survey is a privately collected household survey by the National Council of Applied Economic Research and the University of Maryland.
enough. The average annual decline in the poverty rate of 2.18 percent between 2004 and 2012, a period when growth averaged over 8 percent a year, is reflective of this. And second, growth that increases the incomes of the well-to-do disproportionately may be a bad thing in itself. Indeed, inequality — particularly the disparity between the incomes of the very rich and the very poor — is considered one of the major failings of capitalism and markets. In India, the share of wages in the net value added by industries has shown a decline in the 30 years since 1983, while the share of profits has climbed (See Figure 1). The cause does not seem to lie in the failure of markets to reward labor adequately, however, but in labor market rigidities that drive a wedge between GDP and employment growth.

NEEDED: MORE JOBS
Further, results from the ICE 360° Survey (2014) reveal that almost 63 percent of the top 10 percent of rich Indians reside in urban India, whereas 85 percent of the bottom segment of households resides in rural India, reinforcing urban-rural inequality. Over half of Indian households depend on agriculture as their principal means of livelihood, while the agricultural sector contributes just over 15 percent of GDP. Rural youth unwilling to work in the places of their birth are increasingly seeking non-farm employment elsewhere. In addition, India’s population bulge has not coincided with a manufacturing boom, as it did in China. The growing calls for “reservation” — the Indian term for affirmative action programs — in education and government jobs by the relatively wealthy in the states of India-Gujarat and Haryana, reflects the failure of the current growth model to absorb a million young Indians joining the labor force every month. Affirmative action in another state, Tamil Nadu, which earmarks 69 percent of public sector jobs and slots in colleges for deprived castes (that figure is 50 percent in other Indian states), is founded on the hope that it will right the wrongs of decades of discrimination. In practice, it is a reflection of inadequate job creation leading to social movements that demand favorable treatment, with the attendant social and economic consequences, including eroding confidence in institutions.

The disconnect between growth and job creation is largely because India’s structural transformation has not conformed to custom. India bypassed the stage of labor-intensive growth driven by manufacturing in favor of services-led growth. While the services sector contributed enormously to growth in the last decade, its share in employment, at 25 percent, is less than half its share of GDP. From the perspective of inclusion, therefore, the shortcomings of India’s growth composition have resulted in relatively fewer opportunities for productive employment for India’s poor. The country thus needs to boost manufacturing growth to absorb more workers to realize the principal intent underlying the “Make in India” initiative. Several recognized impediments to doing business — infrastructure and regulatory bottlenecks, land acquisition and environmental clearances — need to be addressed along with easing labor regulations to make manufacturing a major source of jobs in India. The increasing numbers of contract and informal workers are an unintended consequence of labor regulations that seek to protect workers, but end up harming them. Two out of every three workers in the private, organized sector in 2011-12 were informal workers with no social security. Along with the growing capital intensity of manufacturing, it comes as no surprise that India’s recent growth has been described as “jobless.”

There is empirical evidence to suggest that Indian states with more flexible labor regulations witnessed stronger growth in manufacturing employment than states with more inflexible regulations (Besley and Burgess, 2004; Gupta et al, 2009). However, it would be grossly inaccurate to put the entire onus for the lack of job growth on labor regulations. Along with other reform measures cited above, however, labor law flexibility could become the force multiplier necessary to take advantage of the space being vacated by Chinese firms due to rising costs. Much of the action to improve the business environment under competitive federalism needs to be taken at the state level and already is in Rajasthan, Madhya Pradesh and Haryana, which have embraced labor market reform. How labor markets function is fundamentally determined by individual states, which in turn influence economic growth and inequality nationally. In particular, participation in non-farm regular employment will help to reduce income disparities.

HELPING GOVERNMENT
An attendant benefit of rapid economic growth is that it generates resources for the government to spend on its priorities. It is, however, worth emphasizing that GDP is not an end in itself, but a means to improving the quality of people’s lives. In India, given limited social safety nets, well-designed fiscal policies are vital to address inequality; at the same time, the IMF has shown that this can be done without restraining the wealth-creating potential of economic growth.

Allocations for social infrastructure — health, education, nutrition and so on — have gone up in India in the recent past, but remain well below the levels in China, for example. World Bank estimates suggest that while China spent 3.1 percent of its GDP on public health expenditures in 2014, India was far lower at 1.4 percent. If India is to reap the benefits of its demographic bulge in the years ahead, it must increase investment in social infrastructure to achieve the desired educational and health outcomes. Poorly targeted policies and leakages ensure that only about 15 percent of expenditures reached the intended beneficiaries in the late 1980s; recently, there is evidence that this may have increased to roughly 50 percent. Thus, India confronts two distinct yet related challenges. First, to increase public social spending, and second, to better target the spending. Technology now offers hope. In the mid-2000s, India embarked on an ambitious program to ensure universal coverage of all households by financial institutions, the Prime Minister’s Jan

FIGURE 1 SHARE OF PROFITS AND NET VALUE ADDED IN INDIAN INDUSTRY
Source: Annual Survey of Industries, various years

![Figure 1: Share of Profits and Net Value Added in Indian Industry](image-url)
Dhan Yojana, (Prime Minister’s People’s Money Scheme, or PMJDY). One year after the launch, more than 210 million bank accounts have been opened, utilizing a network of more than 100,000 business correspondents (BCs). Permitting BCs to substitute for physical bank branches is an important regulatory change. The erstwhile model of bank-led financial inclusion has rightly yielded to a new approach that involves multiple entities including last mile intermediaries like BCs, specialized payments banks, Micro Finance Institutions (MFI) and Small Finance Banks (SFb).

The PMJDY forms the core of the government’s financial inclusion agenda. With a bank account, every household could potentially gain access to banking and credit facilities and participate in the formal financial system. A biometric identity system called e-Aadhaar, after the 12-digit unique identity number issued by the government for all residents in India, is envisaged as the sole Know Your Customer (KYC) proof, in addition to serving as the backbone for Direct Benefit Transfers (DBT) linked to bank accounts — this can make income transfers predictable and targeted. Add so-called mobile money to this blend — there are over 600 million unique mobile users in India — and there is an opportunity to resolve the last-mile problem that has been the Achilles heel of formal financial institutions in India for decades. The so-called JAM Number Trinity — Jan Dhan Yojana, Aadhaar and Mobile — might well be transformative, because it will allow expansion and better targeting of social welfare schemes.

There is already evidence that payments under the rural employment program, the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), through Aadhaar-linked bank accounts have increased efficiency and reduced leakages. The challenge and promise of this program is that it helps provide rural asset creation such as roads, micro-irrigation and water management systems, that, while boosting rural incomes, will also help lessen income inequality.

**UNPRECEDENTED TIME**

India stands at the cusp of a huge new opportunity. Unlike many countries that are struggling with aging populations and rising dependency ratios, India has a potential demographic dividend. Over 60 percent of the population is within the working age of 15-59 years. One segment of the economy, startups, is witnessing extraordinary dynamism. As of January 2016, there were 19,400 technology-enabled startups in India, of which 5,000 were seeded in 2015 alone. As of December 2015, eight Indian startups had graduated to the so-called Unicorn Club (valuations greater than US$1 billion). This represents the dynamic role that liberated markets can play in driving innovation and growth. However, it is important to note that such skill-biased technological changes are likely to benefit the skilled disproportionately, fueling increasing wage inequality.

Building long-run fiscal capacity is going to be vital for India to meet its development challenges, including financial inclusion. Growth has helped shore up total tax revenues. Tax collections have increased at a compounded annual growth rate (CAGR) of 13.85 percent over the period 1990-2014, while GDP grew at a CAGR of 6.6 percent over the same period. Yet, there is the definable impression that India undertaxes and under-spends, especially on social infrastructure. The number of reported taxpayers is low, at about 4 percent of the total population, compared to almost 45 percent in the US and the UK. India’s total tax-to-GDP ratio has remained at 9-13 percent, considerably lower than China’s 20 percent and South Korea’s 27 percent. It is imperative therefore that India redouble efforts to widen and deepen its tax base. On this front, there are reasons for incipient cheer. India has joined the global effort at forums such as the G20 to jointly resolve issues around tax avoidance and tax evasion. Closer to home, the government is investing in several initiatives to improve systems, simplify procedures and alter the unhelpful perceptions of tax administration.

At the threshold of take-off, India stands to benefit immensely from an efficient and non-adversarial tax regime for at least two reasons. First, to strengthen and legitimize the sovereign function of government, and second, to bolster revenue collections that enable government to intervene to achieve more equity in the distribution of income. That, along with several complementary measures cited above to support more inclusive growth, will alone free the government of the rather unusual pressure created by relatively affluent groups seeking protection in public sector jobs. For everyone’s sake, growing distribution concerns are best nipped in the bud.

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