

Inequality and Equity
during
Rapid Growth Process

by

Suresh D. Tendulkar

Basic proposition

Rapid economic growth does not necessarily widen income inequalities but even when it does, rising inequalities, more often than not, are likely to be accompanied by advancement of distributional equity in the society.

Production and distribution are inextricably linked in a mutually interactive and continuing chain of production and distribution during the process of economic change. For discussion, Kuznets considered two links separately, namely, (a) economic growth as a causal factor and its consequences for income inequalities; and (b) income inequalities as a causal factor and its consequences for economic growth

Growth-inequality Link

At the aggregate macro-level, inter-sectoral (A,I,S) shifts in the composition of GDP and workforce widen inter-sectoral disparities in productivity per worker. These translate into widening of relative income inequalities basically because slower-growing rural (mostly agricultural) incomes are usually less unequally distributed than their faster-growing urban (non-agricultural) counterparts.

(a) Growth-Inequality Link (contd)

At a disaggregated micro-level, economic growth brings about shifts in the location of individual economic agents along real income scale termed income mobility by Kuznets. Incidence of income mobility is governed by that of productivity-enhancing technological changes, required mix of skills and occupations in faster-growing sunrise industries and geographical distribution of available skill-cum-educational mix of labour supply.

(a) Growth-Inequality Link (contd)

Mismatch between location-specific labour supply and demand from faster-growing industries results in obsolescence, unemployment and rising earning disparities so that income mobility can be in *both* upward or downward direction. Opportunities for upward income mobility are expected to far outweigh those for downward or unchanged income position during the rapid growth process.

Mechanisms underlying income mobility :

- (i) adoption of upgraded technology**
- (ii) acquisition of new skills in greater demand than than existing one**
- (iii) exogenous outward shift in demand for existing occupation of skill**
- (iv) rural to urban locational shifts**

Determinants of income mobility : individual specific attitudes and motivational factors and barriers to mobility of two broad varieties: economic barriers (inadequate access to input, output, factor, credit markets or education/training or transport and communication facilities) and/or social barriers (attitudes and discrimination practices) barriers to mobility

Two Important Propositions on income mobility offered by Kuznets

One, the higher the rate of economic growth, the greater is its impact on weakening the barriers to income mobility.

Two, in the presence of income mobility, identity of those at different income positions along the real income scale undergoes rapid changes during the dynamic growth process so that there is “little meaning to the question whether poor are getting poorer and rich getting richer”.
(Kuznets).

(b) Consequences of Income Inequality for economic growth:

Scitovsky (1964,1986) argued that economic incentive-generating inequalities was a price society paid for having economic growth and economic growth was necessary for raising the living standards of rising population.

A.P.Lerner(1961) classified inequalities as functional (i.e. those that are instrumental in promotion economic development) and dysfunctional (those arising from deliberate creation of shortages of any kind) inequalities.

Functional Inequalities

- Rewards for (i) greater labour input;**
(ii) acquisition of skills and educational endowments in short supply;
(iii) natural abilities;
(iv) experience;
(v) forgoing current consumption enabling greater investment;
(vi) undertaking risky uncertain productive investment.

Inequalities in dynamic growth process

- **In dynamic growth process, both functional and dysfunctional inequalities get inextricably mixed in a priori unpredictable fashion depending on the behaviour shaped by perceived returns at the margin. Hence, economic inequalities need to be dealt with *as and when they arise* through non-distortionary and non-intrusive instruments. Note that observed outcome of rapid growth necessarily implies functional inequalities dominating over dysfunctional ones.**

Scitovsky on Equity

Scitovsky suggests three criteria for ascertaining social acceptability of inequalities :

(i) those correlated with merit or peoples' contributions to society – broadly incentive-based functional inequalities;

(ii) those that arise in an environment of broad-based equality of opportunity; and

(iii) those that go with improvement of well-being of those at bottom of social ladder.

Scitovsky on Equity (contd.)

Given (i) and (ii) and focusing on (iii) he links advances in equity to increased availability and affordability (a function of income *and* price) of what are commonly deemed to be basic necessities of life that satisfy urgent and essential needs. This de-links one-to-one correspondence between degree of inequity and inequality.

Scitovsky on Equity (contd.)

Equity is made a function of not just (i) Lorenz curve of income; but also (ii) mean income level or average living standard underlying Lorenz curve; and (iii) relative price of necessities.

Major implication : equity advancement can take place by reduction in relative price of necessities without changing Lorenz curve and mean income.

Equity enhancement thus can take place through a variety of channels: (i) income re-distribution; (ii) raising mean income through economic growth; (iii) increasing affordability of necessities through supply enhancement, real resource cost-reducing technological change or subsidized supply.

Social tolerance of growing inequalities

Drawing on sociological, anthropological, social psychological besides economic studies, Hirschman(1973) suggested rising social tolerance of growing inequalities arising from favourable signaling effect of upwardly mobile on those left behind in an environment of a growing economy. It is based not on altruism but on expectational calculus of perceiving advancement of some as signaling future income-earning opportunities for those left behind.

Hirschman quotes:

“To the extent such (societal) tolerance (based on expectational calculus) comes into being, it accommodates, as it were, rising inequalities in an almost providential fashion.....It is, therefore, conceivable that some *uneven distribution of new incomes may be preferred to an egalitarian distribution by all members of the society.* In this eventuality, the increase in income inequality would not only be politically tolerable; it would in fact be *desirable* from the point of view of social welfare. [emphases added]

Social Consequences of Economic Inequalities

Available analytical as well as empirical studies indicate ambiguous relationship in terms of *direction of causation* as well as *social outcomes* between economic inequality and political conflict (Lichbach(1989)). Not surprising because social conflicts can be caused by factors other than economic inequalities as much as economic inequalities caused by factors other than economic growth.

Indian Study

Applying the stochastic dominance criteria for binary comparisons of the entire size distributions, it was shown that a doubling of per capita GDP growth in India in the 1980s was associated with uniformly better equity-enhancing outcomes in comparison with those during the slower growth in the 1970s.

(Tendulkar and Jain, 1995)

Conclusions

Growth-promoting impulses and policies aimed at opening up the economy, intensifying competition and facilitating access to technology should not be curbed because of prior apprehensions about their adverse distributional consequences which may turn out to be wrong *ex post* in *a priori* diagnosis as well as incidence.

The conclusion does not deny that government policy needs to be sensitive to alleviating the adverse distributional consequences, but only *as and when they arise, and should be dealt with in a non-distortionary fashion and using non-intrusive methods.*

Notice that income mobility effects, incentive effects and signaling effects are distinct from each other and may operate independently and reinforce each other during the rapid growth process so as to advance equity unambiguously.