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Income inequalities: the rationale of demarcation amid growth and development

Bharat Gahlot[a] and Akanksha Dubey[b]

[a/b]Assistant Professor, JP School of Business, 369, Krishna Nagar, Roorkee Road, Meerut 250105, India.

ABSTRACT:

In this paper we provide an analytical view of the effect of income inequality over economic development even in the charisma of continuous economic growth. In the beginning a detailed discussion has been done regarding the differences between economic growth and development.

Ours is a developing economy with a continuous rise in GDP. However due to unequal distribution of income, the economy has not been able to witness economic development on an overall basis. An introduction is given regarding the HDI, the ultimate measure of economic development. This paper also proves the fact that economic development is possible only if there is equality in the distribution of income.

In our study we have included a number of facts and figures to conclude that income equality is a precondition for economic development. At the end, few suggestions are given as to how we can overcome this problem and promote economic development.

Key Words: Economic Growth; Economic Development; Poverty; Income Inequalities; HDI

INTRODUCTION

India is a developing economy with a continuous rise in GDP and Per Capita income. With the policy change initiated in 1991 and the advent of three fold policies viz. Liberalisation, Privatization and Globalization, the Indian economy and GDP has continuously been on the rise. The Economy saw a Growth rate of 8.5 percent during 2010-11. In the beginning of 1990's the growth rate was a mere 1.4 percent which rose to 8 percent in the mid 90's. From 2000 until 2011, India's average quarterly GDP Growth was 7. 45 percent reaching an historical high of 11.80 percent in December of 2003.

It is suspected that because of the specific localization of the nascent economic growth, the benefits have been realized by a relative minority, while hundreds of millions continue to live in abject poverty. This could result in further significant increases in income inequality; a situation that may have significant repercussions.

However, income equality is important because of the implications for social and political development. It is widely understood that income equality can provide stability for a nation, which can only help in fostering long-term economic growth. More directly, income equality enables many more individuals to participate more fully in the economy. This is due to income equality providing opportunities for employment, product consumption, access to borrowing, and the ability to invest and save.

Therefore, it is necessary to understand the income distribution effects in India. By comparing India's economic growth and income equality, we can determine whether the recent economic prosperity has been realized by many or relatively few individuals and whether this economic growth has led to economic development.

1. OBJECTIVE

The objective of the study is to point out the reason underlying the differentiation between economic growth and development i.e. income inequalities. The study starts with an understanding of the meaning of Economic Growth and Development and the differences between these two and then moves on to explain the effect of income inequality on the economic development of the country. The aim of the paper is to study the underlying reason for the demarcation between growth and development. Under normal circumstances any rise in the GDP of a country, which means a rise in the economic growth and per capita income should result in economic development. However the current Human Development Index Report released by UN shows that despite economic growth the country is not witnessing economic development and the basic reason which lies below it is the unequal distribution of income.

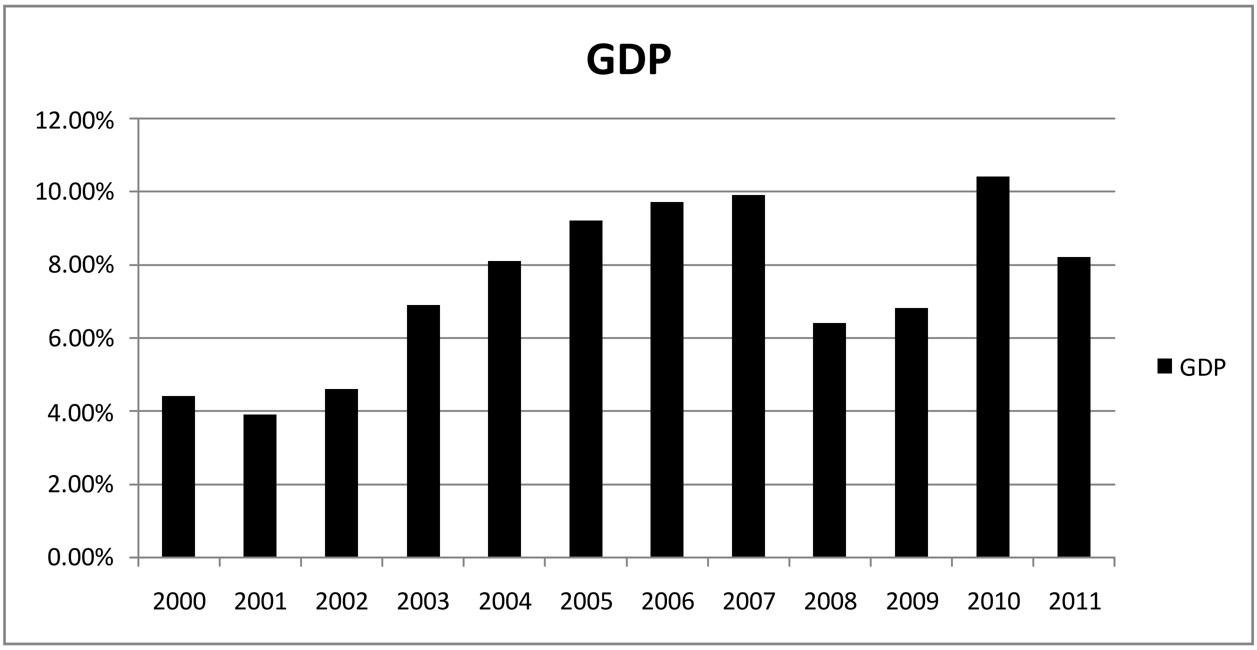
2. REVIEW OF LITERATURE

Recent literature has contrasted Human Development, described as the ultimate goal of the development process, with economic growth, described as an imperfect substitute for more general welfare, or as a means toward enhanced human development. Keith Gehring (2006) and Kishore G. Kulkarni (2006) in their paper Economic Growth and Income Inequality in India have mentioned that the implications for income equality are indeed significant in maintaining stability in such a large and diverse nation like India. Pranab K. Bardhan (2005) has also highlighted the point that the poverty reduction effect of a given growth rate, of course, depends on the income or wealth inequality. It is only with equal distribution of income and wealth that a country can move toward economic development. Gustav Ranis (2004) in his own words has stated that an increase in Growth rate will increase the range of choices and capabilities enjoyed by households with a rise in per capita income but this is possible only with an equal distribution of income that, economic growth will enhance human development.

3. MEANING: ECONOMIC GROWTH & DEVELOPMENT

Economic Growth is an increase in the total value of goods and services produced by a nation However, such an increase should not be one time but must continue over a long period. It does not necessarily mean an increase in the volume of all goods and services. It is an overall increase in Total Physical Production. Economic growth can be measured in nominal terms, which include inflation, or in real terms, which are adjusted for inflation. For comparing one country's economic growth to another, GDP or GNP per capita should be used as these take into account population differences between countries.

Economic Growth is a narrower concept than economic development. It is an increase in a country's real level of national output which can be caused by an increase in the quality of resources (by education etc.), increase in the quantity of resources & improvements in technology or in another way an increase in the value of goods and services produced by every sector of the economy. Economic Growth can be measured by an increase in a country's GDP (Gross Domestic Product).



Note: the graph shows the rise in GDP over the years(1991-2011)

Economic development is a normative concept i.e. it applies in the context of people's sense of morality (right and wrong, good and bad). The definition of economic development given by Michael Todaro is an increase in living standards, improvement in self-esteem needs and freedom from oppression as well as a greater choice. The most accurate method of measuring development is the Human

Development Index which takes into account the income, literacy rates & life expectancy which affect productivity and could lead to Economic Growth. It also leads to the creation of more opportunities in the sectors of education, healthcare, employment and the conservation of the environment. It implies an increase in the per capita income of every citizen.

Economic Growth does not take into account the size of the informal economy. The informal economy is also known as the black economy which is unrecorded economic activity. Development alleviates people from low standards of living into proper employment with suitable shelter. Economic Growth does not take into account the depletion of natural resources which might lead to pollution, congestion & disease. Development however is concerned with sustainability which means meeting the needs of the present without compromising future needs. These environmental effects are becoming more of a problem for Governments now that the pressure has increased on them due to Global warming. Economic growth is a necessary but not sufficient condition of economic development.

4. ECONOMIC GROWTH VS. ECONOMIC DEVELOPMENT

Basis of Difference	Economic Development	Economic Growth
Concept	Normative concept	Narrower concept than economic development
Scope	Concerned with structural changes in the economy	Growth is concerned with increases in the economy's output
Growth	Development relates to growth of human capital indexes, a decrease in inequality figures, and structural changes that improve the general population's quality of life	Growth relates to a gradual increase in one of the components of Gross Domestic Product: consumption, government spending, investment, net exports
Implication	It implies changes in income, saving and investment along with progressive changes in socio-economic structure of country(institutional and technological changes)	It refers to an increase in the real output of goods and services in the country like increase the income in savings, in investment etc.
Measurement	Qualitative.HDI (Human Development Index), gender- related index (GDI), Human poverty index (HPI), infant mortality, literacy rate etc.	Quantitative. Increase in real GDP. Shown by PPF.
Effect	Brings qualitative and quantitative changes in the economy	Brings quantitative changes in the economy

5. ECONOMIC GROWTH AND INCOME EQUALITY

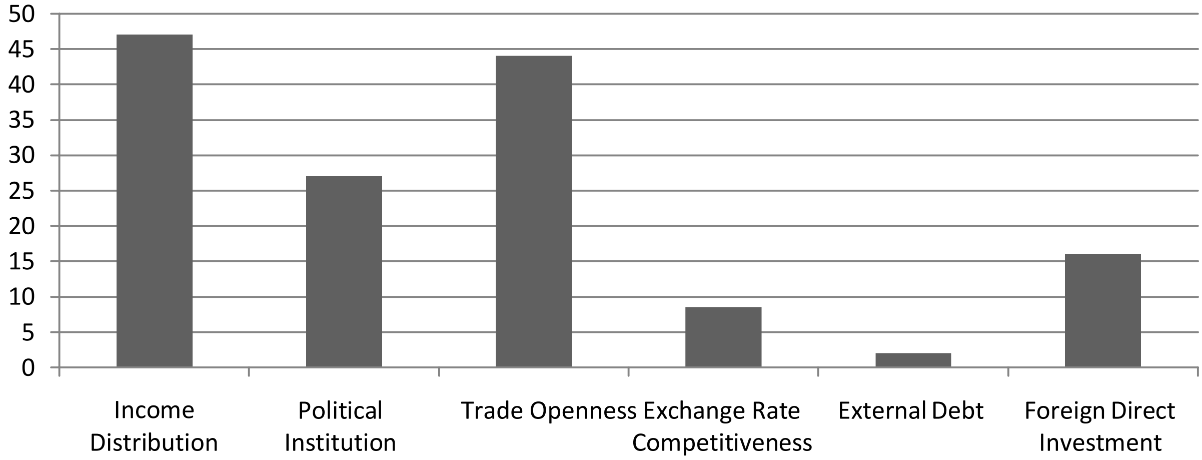
Economic growth, as we have already seen, refers to ―the steady process by which the productive capacity of the economy is increased over time to bring about rising levels of national output and income‖. Economic growth is generally gauged by level of GDP which represents the total output or production of an economy. Equal distribution of this income is a precondition for economic development. Income equality is the equal distribution of total income amongst the representative Population.

"Countries where income was more equally distributed tended to have longer growth spells," says economist Andrew Berg, whose study appears in the current issue of *Finance & Development*, the quarterly magazine of the International Monetary Fund. Comparing six major economic variables across the world's economies, Berg found that equality of incomes was the most important factor in preventing a major downturn.

Growth Spells

Factors have differing impacts on how long growth periods last. Income Distribution appears quite important, whereas other factors are less so.

(Change in expected growth duration, percent)



Source: *Finance & Development*, the quarterly magazine of the International Monetary Fund.

6. POVERTY AND INCOME INEQUITY

Poverty remains an enormous problem worldwide, despite major reductions over the past 50 years. Within the developing countries, about one third of the population lives on less than US$1 a day. The World Bank defines poverty as an income of less than US$1 per day, using purchasing power parity-in other words, exchange rates adjusted to the local currency. By this measure, although the percentage of the world‘s population living in poverty declined slightly between 1987 and 1993 from 30.1 percent to 29.4 percent), the absolute number of people living in poverty increased from 1.2 billion to 1.3 billion people.

Similarly, the estimates for India also indicate a continuing decline in poverty with the increasing inequalities in income. The revised estimates suggest that the percentage of people living **below $1.25 a day in 2005** which, based on India‘s PPP rate, works out to **Rs 21.6 a day in urban areas and Rs 14.3 in rural areas in 2005** decreased from 60% in 1981 to 42% in 2005. Even at **a dollar a day** i.e. **Rs 17.2 in urban areas and Rs 11.4 in rural areas in 2005** poverty declined from 42% to 24% over the same period.

Both the dollar a day and $1.25 measures indicate that India has made steady progress against poverty since the 1980s, with the poverty rate declining at a little under one percentage point per year. This means that the number of very poor people who li ved below a dollar a day in 2005 has come down from 296 million in 1981 to 267 million in 2005.

However, the number of poor people living under $1.25 a day has increased from 421 million in 1981 to 456 million in 2005. This indicates that there are a large number of people living just above this line of deprivation (a dollar a day) and their numbers are not falling. To achieve a higher rate of poverty reduction, India will need to address the inequalities in opportunities that impede poor people from participating in the growth process.

India has grabbed seven billionaires in the Forbes top 100 rich list 2011 which puts India in the league of the countries with the most riches. Unfortunately at the same time, nearly 28% of the total population of India, accounting for nearly 300 million people is under below poverty line. With increasing population in India, the inequality in India has also grown and the gap between the rich and poor has widened over the past decades

Inequality in earnings has doubled in India over the last two decades, making it the worst performer on this count of all emerging economies. The top 10% of wage earners now make 12 times more than the bottom 10%, up from a ratio of six in the 1990s.

Moreover, wages are not smoothly spread out even through the middle of the distribution. The top 10% of earners make almost five times more than the median 10%, but this median 10% makes just 0.4 times more than the bottom 10%. "The main driver has been an increase in wage inequality between regular wage earners-contractual employees hired over a period of time," says the Organisation for Economic Cooperation and Development (OECD) in a new report on inequality in the developed world and emerging economies. "By contrast, inequality in the casual wage sector-workers employed on a day-to-day basis-has remained more stable," the report said.

Wage inequality has driven more general income inequality in the country. India has got more unequal over the last two decades-India's Gini coefficient, the official measure of income inequality, has gone from 0.32 to 0.38, with 0 being the ideal score. In the early 1990s, income inequality in India was close to that of developed countries; however, its performance on inequality has diverged greatly since then.

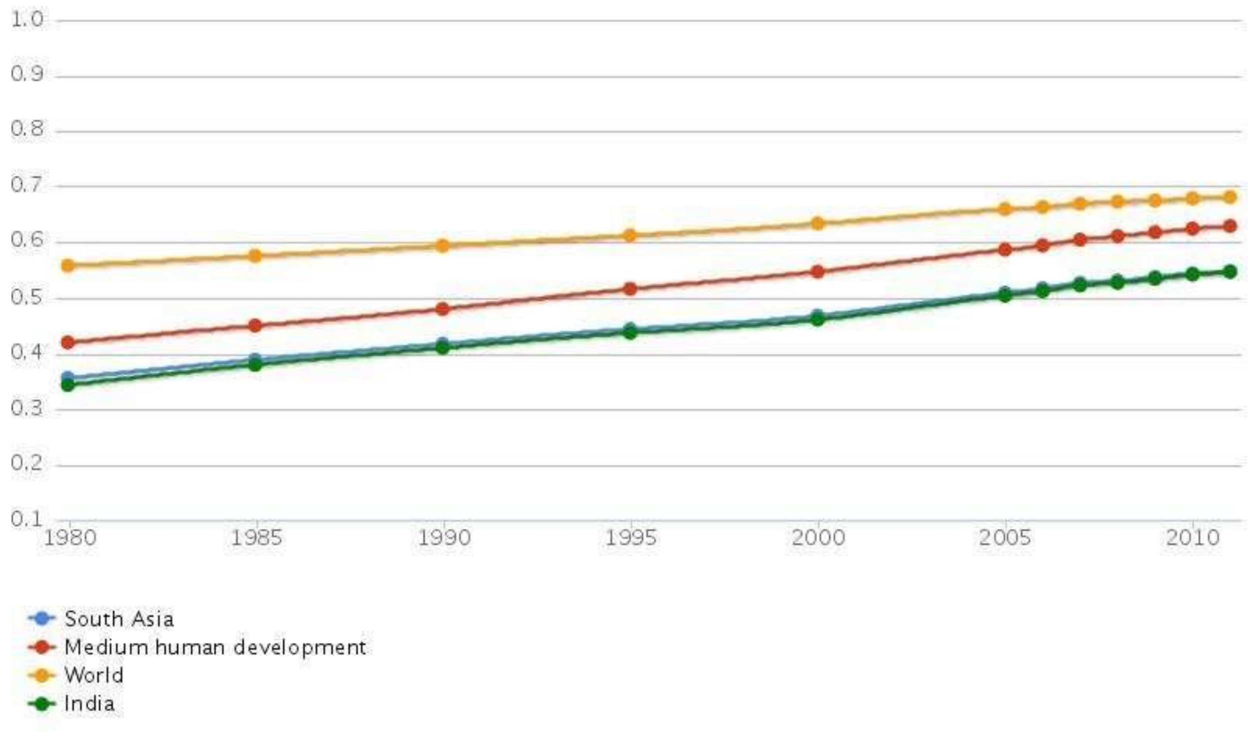
There is evidence of growing concentration of wealth among the elite. The consumption of the top 20% of households grew at almost 3% per year in the 2000s as compared to 2% in the 1990s, while the growth in consumption of the bottom 20% of households remained unchanged at 1% per year.

It has been analyzed that particularly there exists high urban advantage in human development in the six metropolitan areas—Mumbai, New Delhi, Bangalore, Kolkata, Chennai, and Hyderabad—compared with two- and three-tier cities. Similarly, the rural disadvantage is particularly sharp in the least developed villages. Indians in metropolitan areas seem to live in a totally different universe from their brothers and sisters in the least developed villages.

7. INDICATOR OF ECONOMIC DEVELOPMENT: HUMAN DEVELOPMENT INDEX

The first major attempt to translate the capabilities approach into a tractable ranking of nations came in the 1990 UNDP Human Development Report. The HDR‘s objective was to ―capture better the complexity of human life‖ by providing a quantitative approach to combining various socio-economic indicators into a measure of human development (UNDP 1990).

The Human Development Index (HDI) is a summary measure of human development. It measures the average achievements in a country in three basic dimensions of human development: a long and healthy life (health), access to knowledge (education) and a decent standard of living (income). The present ranking of India as per HDI report 2011 is 134, as it stands in lower segment of medium human development nations.



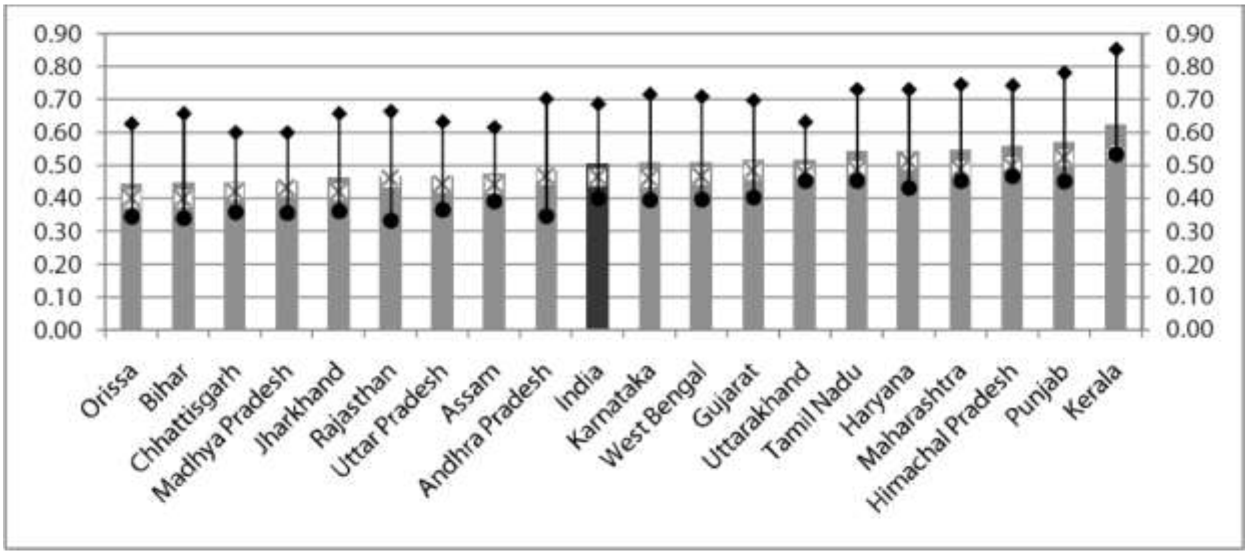
Source: UNDP – Human Development Index for Asia 1980 -2012

However Economic growth (growth in income) is an important factor in reducing poverty and generating the resources necessary for human development and environmental protection. There is a strong correlation between gross domestic product (GDP) per capita and indicators of development such as life expectancy, infant mortality, adult literacy, political and civil rights, and some indicators of environmental quality. But, economic growth alone does not guarantee human development. Well-functioning civil institutions, secure individual and property rights, and broad-based health and educational services are also vital to raising overall living standards. Despite its shortcomings, though, GDP remains a useful proxy measure of human well-being.

8. INCOME GROWTH AND ITS IMPACT ON HUMAN DEVELOPMENT

Income growth clearly strikes one as the main contributor to directly increasing the capabilities of individuals and consequently the human development of a nation since it encapsulates the economy's command over resources (Sen, 2000). For example, while the citizens of the Indian state of Kerala have life expectancies, better health and literacy rates comparable to those of many developed countries, the fact that they cannot enjoy many of the benefits of citizens of such countries (such as better housing, transportation, or entertainment) demonstrates the importance of GDP as an instrument for achieving a wide range of capabilities. On the other hand, GDP also has a strong effect on literacy and health outcomes, both through private expenditures and government programs. Thus, insofar as higher incomes facilitate the achievement of other crucial human development objectives, it also has an indirect effect on human development.

Income growth: GDP by states HDI and its dimensions



Notes: *Vertical bars (Light colour for states and Dark for India in middle) indicate the HDI; dark black circles (inside the bars) indicate the education dimension index; cross within white squares, the income dimension index; and dark black diamonds (outside the bars), the health dimension index; and the states are arranged in ascending order of their HDIs.*

The Human Development Index (HDI) achievements of states in India both at the aggregate and disaggregate levels are shown in Figure . India has a HDI value (using international goalposts) of 0.504.The HDI is the highest for Kerala (0.625) followed by Punjab (0.569) and the lowest for Orissa (0.442), Bihar (0.447) and Chhattisgarh (0.449). As the graph reveals, while the HDI scores across states show little variation and range between 0.442 (Orissa) and 0.625 (Kerala), the variation in the sub-indices for education and health show a greater degree of variation. The income index shows the least degree of variation.

However the impact of economic growth on a nation's human development level depends upon the distribution of income, both at a micro level within a household as well as at a macro level across households. Since poorer households spend a higher proportion of their income on goods which directly promote better health and education, economic growth whose benefits are directed more towards the poor will have a greater impact on human development, via increased food expenditure as well as on education. As GNP rises, the resulting income inequality may be negatively impacting overall life expectancy. As fewer people earn more the GNP rises, but the large majority that gets relatively poorer are worse off. The correlation between GNP growth and income inequality seems to support one final reason to believe income inequality negatively impacts health.

9. THE ROAD AHEAD IN REDUCING INCOME INEQUALITY: CHALLENGES AND OPPORTUNITIES

India needs to look at the holistic view of the inequality existing across the states. Special assistance and focus is required on the eastern states on their poverty reduction and skills development. India needs to develop an integrated mechanism where eastern states can be benefited from the greater economic development of the western states by sharing different economic activities. The current need is to balance economic growth with social development and more emphasis should be given on the wider reach of government schemes and equitable distribution of resources.

The challenges to India‘s sustained economic growth are considerable. Poor infrastructure, stagnate reform, and underperforming industrial sectors will continue to cost India considerably.

The challenges for India are significant, but the opportunities are promising. To sustain long term growth, Indian firms will need to move into currently untapped markets by leveraging more collaborative partnerships. This will on one hand help companies to expand, while on the other the people in these backward areas will have access to such companies and may get employment.

However, the strength of this effect depends entirely on the effectiveness of expenditure targeting and delivery. The government must identify priority sectors such as primary education and health that have the highest potential for HD improvement. Government expenditures for HD should be distributed predominantly to low income groups and areas since it is here that the highest marginal impact will be had.

Social entrepreneurship which focuses on developing innovative solutions to solve the social problems with sustained revenue growth can be the possible solution. The companies need to create shared value for all stakeholders rather than just investing in corporate social responsibility programmes which can help them to increase their future income and wealth.

India needs targeted government investments to meet the fixed costs of HD improvements that will lead to later economic growth. These fixed cost investments may include schools, hospitals, and the necessary governance improvements to effectively implement investment projects.India desperately needs to improve its infrastructure to support continued growth. Improvements in highways, airports, and utilities are all desperately needed; all of which could generate numerous jobs in other sectors.

10. CONCLUSION

The study clearly points out the differences between economic growth and development. Economic growth is a narrower term as it relates only to the rise in the GDP of an economy. However the term economic development means an improvement in the standard of living of the people of an economy. The recent economic growth in India has been quite impressive. However the growth has been inhibited with unequal distribution of income, education and health. Even though education and health inequality was at a higher rate, the income inequality poses a much bigger threat for human development because without income no person can have access to better health facilities nor can have proper education.

The study points out that there exists inequality in the distribution of income even amongst states. Some of the states witness high economic growth while others are discarded. GDP has been continuously on the rise but there exist no signals of human development. The HDI of the country is far below in the lower segment of MHD countries. This shows that even after the rise in income human development is very low. Inequality is the basic reason for this undeveloped growth. The study clearly affirms that the stat es having higher rates of GDP are also having higher HDI. There exists concentration of wealth amongst only a few, either we talk in stipulations to states or in relation to individuals. The reason responsible for the low level of economic development is inequality in the distribution of income.

A correlation between growth and inequality does not by itself disprove the need for economic growth. Growth may well be a necessary condition for reducing poverty, and in India it has indeed brought millions out of poverty. But surely, bringing people out of absolute poverty cannot be the ultimate goal and the only barometer of development.

These varied outlooks to human development show that income equality is the single formula for sustainable progress. Impressive long-term gains can be achieved only with consistent economic growth and income equality. The need of the hour is to balance economic growth with social development by equitable distribution of resources. What India must strive for is to improve the quality of life of people – which means providing better health, education, and other services to the poor and the rich. In this objective, income inequality matters in very tangible ways, and insofar as economic growth increases inequality it may make many worse off. Entrepreneurs and the government both share an equal responsibility of improving this situation by creating employment opportunities and provision of resources to the needful so that every person of the country can reap the benefits of economic growth.

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