



Rising Income Inequality amid Declining Poverty: The Experience of China and India*

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Abstract: The unprecedented decline in poverty rates in China, and to a lesser extent, in India, has been accompanied by a sharp increase in income inequality, including new forms of impoverishment and destitution. What explains this paradoxical outcome where high GDP growth that has helped reduce absolute poverty has also resulted in widening income inequalities? What are the potential socioeconomic and political implications? And, how best to mitigate and reverse this growing socioeconomic polarization and promote more inclusive and balanced economic growth? This paper addresses these interrelated questions.

Keywords: Income Inequality, Inclusive Growth, Poverty Rates, China and India, Globalization

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Between 1990 and 2010 the Asian region saw its average per capita GDP (in 2005 PPP terms) increase from \$1,633 to \$5,133 with declines in the proportion of people living on less than \$1.25 a day falling from an estimated 54 percent to below 22 percent. Overall, by the end of 2010, some 715 million people had been lifted out of poverty (ADB 2012). Leading the charge have been the two Asian giants: the People's Republic of China (PRC) and the Republic of India. Home to some 2.5 billion people or two-fifths of humanity, these two countries are among the world's fastest growing economies.¹ In both countries high and sustained economic growth has translated into significant increases in per capita GDP. For India, in 1978 its per capita GDP (in PPP terms) was \$1,255. It increased to \$2,732 in 2003, \$3,452 in 2005 and \$3,900 in 2012. In China, GDP per capita (PPP) growth skyrocketed from \$1,071 in 1978, to \$4,726 in 2003, \$6,757 in 2005 and \$8,500 in 2012.² Table 1 shows recent nominal GDP per capita growth in the two countries, Table 2 confirms that these sustained and high rates of growth have translated into a sharp reduction in poverty and overall improvements in living

¹ Over the past three decades the Chinese economy has grown at an unprecedented rate of just over 10 percent, while the Indian economy grew at an average annual rate of around 6.4 percent. However, during 2002-2011, India's average growth rate was an impressive 7.7 percent. Arguably, in the post-global financial crisis era, such sustained and high growth rates will be hard to maintain. Although growth in both countries remains robust when compared to the OECD average, it is nevertheless slowing down. In 2013, China saw 7.8 percent growth, while India slipped to under 5 percent—in sharp contrast to the 1.7 percent for the United States, 2 percent for Japan, and -0.6 percent for the Eurozone (IMF 2013).

² Gross Domestic Product (GDP) represents the size of a country's economy. Purchasing Power Parity (PPP) GDP is gross domestic product converted to US dollars using purchasing power parity rates. PPP is more useful when comparing broad differences in the living standards between countries because it factors in the relative cost of living and the inflation rates, rather than relying exclusively on exchange rates (World Bank 2012).

standards.

Table 1.
Nominal GDP per capita (in current \$US)

Country	2008	2009	2010	2011	2012
China	3,414	3,749	4,448	5,442	6,188
India	3,414	1,147	1,419	1,534	1,489

Note. Data retrieved from World Bank (2013).

Table 2.
Number of People Living on Less Than \$1.25 per Day (at 2005 PPP prices)

% of Population 2010		Number (Millions)		
1990	2008	1990	2008	
China	60	13	683	173
India	47	33	433	395
Rest of Asia	58	31	427	287

Note. Data from The World Bank, cited in Balakrishnan, Steinberg and Syed (2013: 4).

For example, the Indian Planning Commission notes that in 1981 an estimated 60 percent of India's population lived on less than \$1.25 a day. By 2008, this poverty rate had dropped to about 33 percent. The proportion of Indians living in "extreme poverty" (on \$1 a day or less) has fallen from 40 percent in 1990 to about 25 percent in 2007 even though the overall population has increased.³

³ The Planning Commission traditionally estimated "poverty levels" on the basis of consumer expenditure surveys conducted by the National Sample Survey Office (NSSO). Nevertheless, the measurement of India's poverty levels is not without controversy. For example, in the mid-1990s, India's official poverty estimates were based on the methodology developed by the 1993 Lakdawala Committee which defined the poverty line as a daily per capita caloric intake of 2,400 calories for rural areas and 2,100 calories for

Nevertheless, India's record in reducing poverty pales in comparison with that achieved by China—where the rate of poverty reduction has been unprecedented. This is largely because China's much longer period of sharp increases in average income has translated into concomitant poverty reduction and improvements in living standards. For example, on the eve of the reforms in 1978, the incidence of poverty in China was among the highest in the world. As a recent IMF study notes, in 1981 an estimated 84 percent of the Chinese population lived on

urban areas. However, the Tendulkar Committee appointed by the Planning Commission in 2005 revised the Lakdawala "poverty line," making adjustments for the difference in prices due to inflation—both spatially (across regions) and temporally (across time). Under the new estimates the poverty headcount ratio for rural areas increased from 28 percent to about 42 percent—or an increase of 105 million people in absolute terms.

Table 3.

India's Poverty Rates (%)

	Lakdawala Committee			Tendulkar Committee		
	Rural	Urban	Combined	Rural	Urban	Combined
1993-94	37.3	32.4	36	50.1	31.8	45.3
May-04	28.3	25.7	27.5	41.8	25.7	37.2

Note. Data from Government of India (2013).

Table 4 shows national poverty levels based on the Tendulkar Committee methodology.

Table 4.

All-India poverty estimates: Percent below Poverty Line

Year	Rural	Urban	Total
1993 – 94	50.1	31.8	45.3
2004 – 05	41.8	25.7	37.2
2009 – 10	33.8	20.9	29.8
2011 – 12	25.7	13.7	21.9

Note. Data from Government of India (2009; 2013). In 2012, the Planning Commission constituted a new expert panel to measure poverty levels. The panel, headed by C. Rangarajan, is expected to submit its report by mid-2014.

less than \$1.25 a day; however, by 2008, China's poverty rate had declined to around 13 percent—far below the developing country average (Balakrishnan, Steinberg and Syed 2013: 6). This means that across China there were over 500 million fewer people living in extreme poverty in 2008 than 20 years previously.⁴

The experiences of China and India confirm that the most powerful force for the reduction of poverty and improvements in living standards is a relatively long period of sustained economic growth. China successfully reduced absolute poverty via its turbo-charged economic growth and resultant massive job creation. While in India, high growth rates since 2000 coupled with state-sponsored welfare transfers and trickle-down policies have played a larger role.

Nevertheless, these achievements in poverty alleviation and improvements in living standards also mask an alarming trend. On the one hand, sustained increases in aggregate GDP growth and poverty alleviation policies have sharply reduced absolute poverty and brought

⁴ Like India, there is also debate in China regarding the extent of poverty reduction. Until recently, China's official poverty line was derived from levels of food grain consumption that did not always reflect changes in consumption patterns nor was it adjusted to inflation. In 2011, the central government adjusted the country's rural poverty line from 1,274 yuan per year in 2010 to 2,300 yuan (an increase of over 80 percent). When adjusted by PPP of 2005, the new poverty line is equivalent to approximately US\$1.80 per day—far above the US\$1.25 used by the World Bank for international poverty comparisons. Specifically, the World Bank has set \$1.25 a day of consumption (rather than income) as the poverty rate. This rate is based on averaging the “poverty lines” in the world's 15 poorest countries. On the basis of this, the World Bank concludes that if in 1981 roughly 52 percent of the global population lived in “absolute poverty” (meaning less than \$1.25 a day), in 2012, the percentage had dropped to 20 percent. As a comparison, in the United States, the “poverty line” is set at around \$11,500 per year for a one-person household. This translates to just over \$30 a day.

greater affluence to all socioeconomic groups. However, on the other hand, economic inequalities—and in particular—the income gap, continue to worsen. This inequality includes growing disparities in access to basic social services such as education and healthcare (Chen and Ravallion 2010; Li, Sato and Sicular 2013; Ravallion 2013).

This paradoxical trend, where countries are becoming less poor but also more unequal, is also apparent in a growing number of other economies, including several OECD countries, and the United States in particular (OECD 2011). Research by Thomas Piketty (2014) has underscored this widespread trend of a disproportionate share of the national income going to a relatively small percentage of the populace. Again, to reiterate, this does not mean that livelihoods have not improved. Rather, even as incomes and purchasing power of a broad cross-section of the populace have increased, the beneficiaries of growth have been the disproportionately already well-off (especially those at the high-end of the income scale), including the well-connected. By capturing a disproportionately large share of the overall income gains, these groups have seen an astronomical expansion of their income and wealth.

Perhaps, nowhere is this more the case than in contemporary China. Indeed, Naughton (2007: 218) notes that “in the course of two decades China has gone from being one of the most egalitarian societies about as equal as Japan, to being more unequal than the United States....There may be no other case where a society’s income distribution has deteriorated so much, so fast.” The extensive national and micro-level data gathered by the China Household Income Project (CHIP)⁵ (published in Li, Sato and Sicular 2013) unambiguously underscore these trends. During the period 2002–2007 the CHIP data shows sustained growth in per capita household income of the poorer deciles or the bottom 20 percent. That is, incomes increased by some 50 percent for

⁵ An international collaborative survey project started in the late 1980s to track changes in incomes, poverty levels and inequality.

the poorest decile and by about 60 percent for the second-poorest decile. However, the incomes of richer deciles grew at an even faster rate. Specifically, the richest two deciles of the income distribution saw their incomes almost double. As a consequence, the income gap between the richest and poorest deciles widened from 19:1 to 25:1. Yet, it is reasonable to note that the level of income inequality in China is probably understated. Official figures try to downplay the problem of growing inequality. Until recently, the Chinese government simply refused to release official figures on inequality as the reality is so sharply at odds with the ruling Communist Party's austere egalitarian ideology. But more importantly, China's wealthy have every reason to hide or not disclose their wealth—in particular, if it is “earned” through kickbacks and other illicit means. Reporting on an independent survey conducted by Peking University, Wong (2013) noted that “in 2012, the households in the top 5 percent income bracket earned 23 percent of China's total household income. The households in the lowest 5 percent accounted for just 0.1 percent of total income.” The Asian Development Bank has lucidly captured this trend by noting that the “rising inequality in developing Asia is closely associated with very rapid increases in the very top income groups.... That is, the rich are getting richer much faster” (ADB 2012: 15).

In fact, the Gini coefficient, a common measure of income inequality based on per capita consumption expenditure,⁶ vividly

⁶ Specifically, the Gini coefficient uses an algorithm to produce a numerical rating to show how far a society is from perfect income equality denoted by a Gini of 0. A higher Gini coefficient means greater income inequality. A Gini coefficient of 1 means maximum or “extreme” inequality. Thus, in the Gini index, 0 is perfect equality, while 1 can mean one individual capturing all the income. A more practical way to understand the Gini index is to see it as corresponding to the share of total income that would be needed for redistribution in order to achieve perfect income equality. For example, a Gini index of 0.60 means that 60 percent of the income would need to be redistributed to achieve complete income equality.

highlights this trend in both China and India—albeit, China has experienced a much steeper rise in income inequality based on household income per capita than India.⁷ Citing official estimates, Balakrishnan and his co-authors (2013: 6) note that “China’s Gini increased from 37 percent in the mid-1990s to 49 percent in 2008. It has since ticked down to 47.4 in 2012 but remains higher than that in the United States and close to levels in parts of Africa and Latin America.” Nevertheless, it is important to reiterate that inequality in China is not due to stagnant or declining incomes among poorer households, but the result of substantial gains in incomes made by the top decile of income earners. As the Li, Sato and Sicular (2013) study points out, China’s high and growing inequality has not meant a deterioration of living standards for poorer groups. To the contrary, during the years 2002 to 2007 (the period for which CHIP data is available) growth in the per capita household income of poorer deciles was quite significant—increasing by about 50 percent for the poorest decile, and by nearly 60 percent for the second-poorest decile. Indeed, it is the sustained rise in the incomes of poorer households which contributed to the sharp reduction in poverty rates.

As Balakrishnan and his co-authors (2013: 6) note, “India has also witnessed a rise in inequality, though much less pronounced than in China, with its Gini ticking up from 33 percent in 1993 to 37 percent in 2010.” However, given India’s rigid and entrenched system of socioeconomic stratification, the authors appropriately caution that there are “other important dimensions of inequality in India that are not evident in conventional inequality indices based on consumption or

⁷ In the Asian region, the Asian Development Bank reports that “Inequality widened in 11 of the 28 economies with comparable data, including the three most populous countries and drivers of the region’s rapid growth—the PRC, India, and Indonesia. From the early 1990s to the late 2000s, the Gini coefficient—a common measure of inequality—worsened from 32 to 43 in the PRC, from 33 to 37 in India, and from 29 to 39 in Indonesia. Treating developing Asia as a single unit, its Gini coefficient went from 39 to 46 in that period” (ADB 2012: xviii).

income.” Moreover, as Bardhan (2009) points out:

there are reasons to believe that the NSS data [official data collected by the Indian government] under-represent the rich, and in any case while for other developing countries the Gini coefficient often refers to income distribution, India’s refers to distribution of consumption expenditure (as NSS does not collect income data), which is usually less than that of income (partly because the rich tend to save more than the poor).

As Jean Dreze and Nobel laureate Amartya Sen (2011) recently noted: “[India’s] growth record is very impressive...but there has also been a failure to ensure that rapid growth translates into better living conditions for the Indian people.”⁸

The widening disparities have served to further exacerbate the divide between the so-called “haves” and “have-nots” (or pejoratively the “winners” and “losers”) with potentially corrosive political and socioeconomic implications. What explains this paradox of growing income inequalities amid robust economic expansion and rising prosperity in these two Asian giants—one which prides itself on being the world’s quintessential representative democracy defined by the separation of powers and popular consent, and the other, an exemplar of a new and dynamic model of authoritarian capitalist economic development? Indeed, the “Beijing consensus” exemplifying the virtues of state-controlled capitalism is now seen as an alternative to the widely discredited free-wheeling market-capitalism championed by the “Washington consensus.” As Bremmer (2010) notes, replicating “state capitalism with Chinese characteristics” is in vogue in many world capitals. Finally, what needs to be done to ameliorate and reverse this problem—in other words, what can be done to make economic growth

⁸ Similarly, Kaushik Basu (2008: 36), a former senior adviser to the Indian government warned that “the bulk of India’s aggregate growth is occurring through a disproportionate rise in the incomes at the upper end of the income ladder.”

more inclusive? The following sections address these interrelated issues.

Why Inequality amid Growth?

A vast corpus of research has long claimed that economic growth and inequality follow an inverted U-pattern—with inequality rising sharply in the early stages of development, but gradually declining as the economy matures. Therefore, it is not unusual for inequalities—and in particular, the income-gap—to widen as countries undergo rapid industrialization and urbanization. For example, in the early 1950s, Nobel laureate Arthur Lewis argued that the process of economic development is never uniform, but painstakingly uneven with different sectors of the economy and different regions growing faster than others. Hence, rising inequality is endemic to the process of economic growth and development. Similarly, Simon Kuznets (1955) argued that although underdeveloped countries tend to have relatively equal income distributions in their “initial” stage of development, it becomes more unequal once these economies began to modernize. Hence, Kuznets would be hardly surprised by the fact that as China makes the transition from a centrally planned economy to a market-based one, inequality would widen even with sustained growth in per capita incomes. Nevertheless, striking a more optimistic note, Kuznets did claim that inequality would eventually decline once an economy matures. That is, inequality in income tends to decline once an economy attains a certain level of average income.

Although the current patterns of income inequality in China and India seems consistent with the Kuznets hypothesis (at least as reflected in the increases in the Gini coefficient) it remains to be seen if such a growth–inequality trade-off exists and that income inequalities in these countries will gradually flatten out.⁹ Of course, Kuznets did suggest that

⁹ Ravallion (2011) has noted that the existence of a trade-off between growth and inequality is far from obvious with regard to China. First, the more rapid periods of economic growth in China did not translate into more rapid

governments could always step in to mitigate income inequalities by creating social safety nets. However, evidence shows that although there have been several government initiatives in both China and India to mitigate and eventually reverse the problem of rising inequality, their records have been mixed, if not dismal. Clearly, having the right kind of public intervention is essential.

According to the Asian Development Bank, the face of poverty in Asia is mainly rural because of the failure of many countries, including India and China, to generate sustained growth in their agricultural sectors. The ABD (2012) report *Framework of Inclusive Growth Indicators 2012* documents that the ratio of rural poverty to urban poverty has worsened in 18 of Asia's economies between 1990 and 2010. The imbalance is particularly stark in China where the rural-urban income gap accounts for close to half of total inequality.

In fact, the report notes that since 1998 the rural-urban income gap in China has reached a ratio of over 3:1, symptomatic of the country's dual economic structure comprising of an urban sector based on modern industries, manufacturing and services and a rural sector that remains far less productive. Similarly, according to the CHIP study (Li et al. 2013), per capita incomes for urban households were, on average, more than three times higher than those for rural households by 2002. The study finds that China's urban-rural income ratio (the average income per capita of urban households divided by the average income per capita of rural households) has remained high for some two decades. It is also worsening, with its contribution to overall inequality increasing from 45 percent in 2002 to 51 percent in 2007 (also see Knight and Song 1999). This widening divergence is largely due to a marked slowdown in growth in the agricultural sector and dissipation of the "one-time" gains from

increases in inequality, while periods of falling inequality (1981-1985 and 1995-1998) came with the highest average growth in average household income. And, second, provinces that experienced more rapid rural income growth did not see a concomitant sharp rise in income inequality.

efficiency-enhancing reforms such rural de-collectivization and the introduction of the incentive-based “household responsibility system.” Invariably, slower growth in the countryside has translated into slower growth in rural job creation and incomes, including further widening of the rural–urban income gap. However, as the CHIP study makes clear, the rural–urban income gap in China is not due to stagnation in rural incomes, **but the** result of higher growth in urban incomes. During the period 2002–2007, rural incomes grew at a remarkable average annual rate of over 7 percent; however, the growth in urban incomes was much greater at 11 percent (in constant prices).

This is partly because the rural–urban divide is embedded in China’s urban–rural household registration system, called *hukou*. This system has exacerbated inequalities as it provides highly disproportionate benefits in matters regarding employment, residence, education, health care and other social services to urban *hukou* holders. This system places constraints on geographic mobility by denying rural migrants access to services in urban centers. In addition, the Chinese fiscal system has also served to unintentionally increase regional income inequality. Differentiating between what he calls “revenue and spending decentralizations,” Song’s (2013: 294) exhaustive “econometric analysis shows that the increase in revenue share of local governments from mid-1980s to 1994 indeed increased regional inequality, while the revenue re-centralization in 1994 only had a modest effect on reducing regional inequality.”

In his book *Capitalism with Chinese Characteristics*, Yasheng Huang (2008) blames China’s state-backed crony capitalism for creating macroeconomic distortions and exacerbating inequalities. Specifically, Huang divides China’s economic reform trajectory into two distinct periods. In the first phase, the market-based economic reforms introduced in the 1980s helped unleash pent-up entrepreneurial activity in the countryside and in the process helped to improve incomes and living standards of millions of Chinese peasants. However, a regressive step was taken in the 1990s during the Jiang Zeming period. During this

second phase statist policies deliberately favoring large urban-based state-owned enterprises (including their foreign and domestic subsidiaries) at the expense of the smaller (but more nimble) rural private and collective enterprises served to stifle individual incentive and suffocate private enterprise. Huang persuasively shows that the policies introduced during the second phase disproportionately benefited urban residents, while the rural population was adversely impacted. The latter not only experienced a decline in their incomes, but also their standard of living and access to education, health and other social services. Cumulatively, greater statist control and regulation exacerbated inequalities, especially the rural-urban divide, and created more opportunities for rent-seeking, cronyism and corruption.

In the case of India, the agricultural sector makes up less than 15 percent of GDP yet employs more than one-half of the total workforce. This means that the relative income per person engaged in agriculture is only about one-sixth of those engaged in non-agricultural activities. Available data from the “National Sample Survey on Consumption Expenditure” shows that inequality has not risen in the rural areas, but has in urban areas. The Gini coefficient in rural areas was 0.28 in 1973–1974 and 0.29 in 2009–2010, while in the urban areas the Gini coefficient increased from 0.30 in 1973–1974 to 0.38 in 2009–2010. This underscores that although growth has been very much concentrated in India’s urban areas, inequality in rural areas has also been mitigated by the government’s various rural development and anti-poverty programs. Specifically, government transfer initiatives to agriculture, including the “Minimum Support Prices” for agricultural crops, subsidies for power and agricultural inputs, greater availability of institutional credit, and anti-poverty programs such as the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), the *Swarna Jayanti Shahari Rozgar Yojana* and the National Rural Livelihood Mission have helped to keep poverty and inequality in check. These subsidies and support have come at a huge fiscal and economic cost, with the subsidies alone estimated to consume anywhere between 2.7 to 3.0 percent of the

country's GDP, with only a modest impact on poverty reduction.¹⁰ Therefore, as a large body of research has compellingly shown, the root cause of the dramatic increase in income inequality in both China and India has been largely due to the sharp rise in rural–urban income gap—which is closely correlated with rising inter-provincial or regional inequalities (Bajpai, Chowfla and Jayanthi 2013; Datt and Ravallion 2002; Wan 2007). Although it is inevitable for continental size countries such as China and India to have large spatial or geographical differences in income and wealth levels, the troubling development in both countries has been an accentuation of regional imbalances with greater regional economic divergence and polarization rather than convergence. In China, the gap between the richer coastal provinces (which have led the country's export-driven economic expansion) and the interior, and in India between the wealthiest states such as Gujarat and the poorest such as Bihar and Uttar Pradesh, have significantly widened.¹¹

Although China and India are portrayed as veritable poster-children for globalization, the reality is far more complicated. On one hand, both countries' continental size, huge markets, rich resource base and human capital gives them a comparative advantage in this age of globalization. China and India's ability to expeditiously utilize these initial endowments and navigate their way to prosperity in an increasingly enmeshed, integrated and interconnected world accounts much for their economic renaissance. On the other, the celebrated universalizing impulse of globalization and its inexorable ability to "lift all boats" is also an exaggeration (Hung and Kucinskas 2011). Rather, the contradictions inherent in such an encompassing process as globalization have produced its own asymmetries and unintended outcomes.

¹⁰ The MGNREGA, for example, is designed to provide rural households with at least 100 days (out of a year) of guaranteed wage employment.

¹¹ According to the ADB (2012), regional disparities have sharply increased in India, with the ratio of per capita GDP of the richest state (Punjab) to that of the poorest state (Bihar), rising from 2.9 in 1980 to 4.1 in 2010.

For example, the World Bank's senior economist Branko Milanovic (2011), basing his findings on cross-country comparisons using data from the Bank's household surveys covering some 120 countries from 1988 to 2008, concludes that the real beneficiaries of globalization have been the world's richest one percent and the emerging "global middle class" estimated to number some 400 million people in countries like China, India, Indonesia and Brazil. Specifically, the top one percent saw their real incomes increase by more than 60 percent during the 20-year period. In absolute terms this translated to about \$23,000 per capita per year, compared with some \$400 for those around the median. That is, the inflation-adjusted real income of the global middle class rose 80 percent between 1988 and 2008. By contrast, the real incomes for the bottom and the second-lowest deciles only saw a modest increase, while the incomes of world's poorest 5 percent remained stagnant. Milanovic concludes that, overall, the lower-middle class in rich countries and the world's poor "at the very bottom of the income ladder," have lost out. To add further complexity, Jaumotte, Lall and Papageorgiou's (2013: 274) exhaustive study based on newly compiled panel data for 51 countries over a 23-year period from 1981 to 2003, finds that:

increasing trade and financial globalization have had separately identifiable and opposite effects on income distribution. Trade liberalization and export growth are found to be associated with lower income inequality, while increased financial openness is associated with higher inequality. However, their combined contribution to rising inequality has been much lower than that of technological change, both at a global level and especially markedly in developing countries.

In both China and India, at different times, the power and sway of globalization has ebbed and flowed, sometimes rather unpredictably, making the claim of the seamless link between globalization and each country's miraculous economic transformation far more ambiguous, complex and multifaceted.

More specifically, as noted earlier, even as India's overall poverty

levels have declined, the absolute numbers are still unacceptably high. Not only significant numbers of Indians continue to live in abject poverty, an equally large number are negatively affected because of the inadequacy or absence of essential public goods and services such as access to education, health care, housing, clean drinking water and jobs. Why has India been far less successful in reducing poverty than China? Put another way, why have voters (the vast majority who are poor) in the world's largest democracy failed to get their elected officials to deliver basic social services and put in place more effective redistributive measures? In part, this discrepancy is the result of the fiercely divisive (and increasingly partisan and acrimonious) tenor of Indian politics. Despite the fact that both the central and state governments have increased expenditure for social services, including for programs explicitly aimed at poverty alleviation, most tend to be short-term populist palliative measures designed to get incumbents re-elected, while others languish due to gridlock, rent-seeking and ineffective implementation.¹² More perniciously, as Kohli (2012: 2) has persuasively argued, the Indian state since the 1980s has been "pro-business" rather than "pro-market." Because business enjoys "disproportionate control over economic resources," it "enables businessmen to 'buy' politicians," and shape policy. Kohli notes that "the narrow nature of the ruling alliance in India that, in its newfound relationship with business, has prioritized economic growth above all other social and political considerations."

However, India's inability to reduce poverty to the levels achieved by China has little to do with any supposed superiority of non-democratic over democratic rule. Rather, it is the singular failure to fully utilize the opportunities provided by economic globalization to develop India's

¹² For example, while India's educational system provides access to millions of children (75 percent of all children attend government schools), the lack of proper facilities and high rates of teacher absenteeism (India has the second-highest rate of teacher absenteeism in the world) has failed to adequately capitalize on India's "demographic dividend."

manufacturing sector that is the main reason. Manufacturing jobs have historically served as a ladder out of poverty for many countries. Unlike China's large labor-intensive manufacturing sector which has absorbed millions of workers, India's narrow dependence on just a few sectors such as services (banking, real estate, finance), and "information technology" (which means everything from computer programming, software development and production, communication networks, call centers and outsourcing services) rely on a relatively small number of highly educated and skilled workers. Unlike China's broad based integration into the global economy, India's narrow and highly specialized comparative advantage in the skill-intensive services and technology sector rewards the "skill premium"—or individuals with advanced technical skills and education. This explains the significant earnings differentials among individuals and widening income inequality in India. An apt description of India's experience is Jaumotte, Lall and Papageorgiou's (2013: 302) observation that:

Both financial globalization and technological progress tend to increase the relative demand for skills and education. While incomes have increased across all segments of the population in virtually all countries in the sample, incomes of those who already have higher levels of education and skills have risen disproportionately more.

Compounding these problems, India's poor infrastructure notorious for its delays and bottlenecks, coupled with equally pernicious bureaucratic and regulatory red tape, have served to greatly limit the expansion of the industrial and manufacturing sector. This has resulted in India experiencing "jobless growth."

Reversing the Rise in Inequality

As is well documented, over the past several decades the United States has become a more unequal society in terms of income and wealth distribution. Although average incomes have grown since the 1970s, this

expansion has hardly been uniform. The incomes of the already high-earners, in particular, the top 1 percent, have grown much faster than average (Hacker and Pierson 2010; Piketty 2014; Stiglitz 2012). According to Piketty and Saez (2003; 2011), in the United States, the share of income, excluding capital gains, earned by the top 1 percent of earners jumped from 7.7 percent in 1973 to 17.4 percent in 2010. However, the income earned by the top 0.01 percent (whose annual income is in excess of \$5.9 million), saw their share of total income rise from 0.5 percent in 1973 to 3.3 percent in 2010. Such glaring wealth disparity triggered widespread public furor at a time of high unemployment and economic hardships following the financial crisis in the United States. This backlash included the “Occupy movement” and demands that policymakers use the government’s powers (punitively if need be) to redistribute wealth through tax and transfer. This led US President Obama to declare that inequality is “the defining challenge of our age” and that now is the time to “spread the wealth around.”

But, how can governments best utilize their prerogatives to mitigate rising inequalities? The answer is more complex than it seems. Is it morally just to punish high earners such as a Bill Gates, Steve Jobs or Mark Zuckerberg—individuals whose high incomes and wealth is derived from their unique innovative abilities and entrepreneurial talents and who have provided valued goods and services, including creating good paying jobs in the United States and elsewhere? After all, is it not prudent to reward such creativity if for no other reason than to provide incentives to future innovators? And, what is so wrong with the premise that one’s income should be proportional to effort and talent—an idea that is at the very foundation of liberal democracy? Second, given that the structural changes in the global economy sees technological change disproportionately reward skilled workers in advanced economies (meaning the better educated) at the expense of the unskilled and poorly educated (Goldin and Katz 2008), is it not more prudent (and just) for authorities to invest in improving skills instead of punishing the skilled and better educated? And third, who could possibly object to the

celebrated “Pareto criterion”—that is, if some people become better off without making anyone worse off, what is the problem?

Certainly, it is difficult to justify punitive and confiscatory tax for wealth redistribution if the income is earned from free and open market competition rather than accumulated via predatory rent-seeking or crony capitalism. Nevertheless, there are compelling moral and practical, if not utilitarian, reasons for public authorities to meaningfully respond to the problem of rising inequality. First, it is hard to justify on moral and ethical grounds the currently high and growing levels of disparities in income and wealth given the crushing societal hardship and need—especially, in the aftermath of the global financial crisis. Second, what about Arthur Okun’s (1975) famous caution that a “tradeoff” exists between efficiency and equality and that the pursuit of economic equality through non-market mechanisms can reduce efficiency and even exacerbate inequality? This is because a more equitable distribution of incomes not only reduces incentives to work and invest, but also because state intervention to redistribute wealth (via punitive taxation, welfare payments, increased entitlement spending or arbitrarily imposed minimum wages), tend to be ineffective and damaging to growth. To Okun (1975: 15), governmental efforts are as effective as a “leaky bucket” because much of the funds meant to uplift the poor “will simply disappear in transit, so the poor will not receive all the money that is taken from the rich.” The whole exercise is a net lose–lose—creating disincentives to work for both donors (i.e. taxpayers) and beneficiaries—the large and costly bureaucratic and administrative apparatus to support it, notwithstanding. No doubt, inequality is inherent in a market economy, and, indeed, some level of inequality is essential to the effective functioning of a market economy. However, how much is not clear.

Indeed, even if Okun’s claim has validity vis-à-vis advanced welfare states, it is not necessarily applicable to societies marked with high and widening levels of income and wealth inequalities, and lacking commensurate safety nets. Moreover, economic theory (in particular, the

Kaldor-Hicks criterion) has long suggested that a high-level of inequality is inefficient as it stifles growth over time, shrinks the size of the overall economic pie, and leads to a decline in the standard of living. This is because high-levels of inequality foster even more inequality. In a recent IMF report, Ostry, Berg and Tsangarides (2014: 4) argue that countries with pronounced levels of income inequality tend to experience slower economic growth. Moreover, contrary to conventional thinking, a more balanced and fair income distribution does not have a negative effect on overall economic growth. The authors claim that more equitable income distribution may actually help economies to grow faster. In part, this is because excessive inequality is likely to undercut growth, for example by undermining access to health and education, causing investment-reducing political and economic instability, and thwarting the social consensus required to adjust in the face of major shocks. Thus, some form of redistribution is an imperative.

Third, as Roemer (1998) has pointed out, there is more to the idea of “equality of opportunity” than first meets the eye. That is, “fairness” is not only about ensuring that all individuals enjoy the same “outcomes” regardless of their ability or effort, but also, to the extent possible, ensure each person has the same chances or “opportunities.” As Roemer notes, outcomes (for example, one’s income) can be determined both by individual “effort,” as well as factors beyond one’s control or the so-called “circumstance variable.” Thus, to Roemer, a level playing field is when opportunities are equalized to the best extent that is possible. Only under such circumstances can differences in individual outcomes be deemed fair and acceptable.

Clearly, in neither China nor India does such a “level playing field” or equality of opportunity exist. To the contrary, in both countries the playing field is increasingly tilted in favor of those blessed with initial advantageous circumstances (such as income, wealth, education), and with connections. Under these circumstances economic growth (regardless of how high) will not always be sufficient to lift all boats. It also means that concentrating exclusively on only aggregate economic

performance, without due consideration to how to facilitate a more balanced and equitable income and wealth distribution, is problematic. Given this, what can China and India (and other countries), do to make economic growth more inclusive?

Ideally, the goal of public policy should be to create a level-playing field where everyone has an equal opportunity (including those at the very top) to become better off. Yet, neither the Chinese nor the Indian political systems (for different reasons) have the institutional and administrative capacity, nor arguably the demonstrated genuine commitment, to play such a role. Instead, both have opted for “second-best” solutions which ostensibly rely on various types of state intervention to mitigate inequalities.

To this effect Beijing has unveiled a series of policies and programs to reduce socioeconomic disparities—or in the official (and altruistic) sounding jargon, to “harmonize” economic development. These include a commitment to the gradual dismantling of the institutional foundations of the rural–urban divide—the *hukou* system (Lardy 2012), and expanding the scope and coverage of various social insurance programs.

For example, the state’s flagship program the “Minimum Livelihood Guarantee Scheme,” popularly known as *Dibao*, has been the main response to the growing income divide in urban China. Introduced in 1993, the *Dibao* is designed to provide assistance to urban workers laid-off following the closure or downsizing of state-owned enterprises. *Dibao* is a classic “cash-transfer program,” and had been extended to much of the country by 2007. The amount of assistance or “benefit” one receives under the program equals the household’s size multiplied by the gap between per capita household income and a locally determined minimum living standard. Financing is provided by both the central government and the municipalities. Despite its broad coverage, the *Diabo* still excludes a majority of poor households, as rural migrants are explicitly excluded because of their non-urban *hukou*.

To assist rural residents, agricultural taxes were eliminated nationwide in 2006. In 2008, the Rural Cooperative Medical Insurance

was fully restored, and in 2009, a rural pensions program was introduced. Perhaps, most significantly, in 2008, Beijing introduced the Labor Contract Law which requires employers not only to sign legal labor contracts with migrant workers, but also provide these workers with basic social insurance coverage. Of course, until the *hukou* is fully eliminated (thereby allowing rural labor and households to move freely between the countryside and cities), the most important source of China's growing inequality will not be resolved. Until then, the state's redistributive programs are essential to mitigating the problem of growing income inequality.

More broadly, in the wake of the global financial crisis, China can no longer depend on export-led growth to create jobs. That is, China can no longer rely solely on high-growth rates to ensure incomes continue to rise for millions of its workers. How Beijing navigates through this period of slow (and uncertain) growth, in particular how it negotiates the problem of growing inequality, will remain huge challenges.

India, too, has a long and troubled history of direct intervention by both the central and state governments aimed ostensibly at *garibi hatao* or "eradicating poverty and inequality." A variety of rural "uplift programs" ranging from food subsidy schemes and guaranteed work targeting the rural poor to farm-input subsidies such as fertilizers, pesticides, irrigation (via loan waivers and subsidizing energy and water costs) and subsidized credit to farmers, have been provided over the years. However, the actual outcome of these programs has been mixed. Although there is acknowledgement that these interventions have helped at least to some extent to alleviate poverty and deprivation, there is also recognition that a huge gulf exists between intentions and outcomes. The problem not only has to do with ineffective implementation and failure to properly target the needy, but also due to pervasive corruption in both the state and society, and the fraught calculations of democratic politics where the exigencies of the electoral cycle makes ad hoc populist programs attractive. The Indian government's recently announced massive "food security program" is a case in point. Facing increasingly

frustrated voters angry at fast rising food prices and growing shortages of basic essentials, the incumbent government announced what seems to be a politically expedient (but economically imprudent) program to distribute an estimated 62 million metric tons of rice and wheat to the “poor.” Costing the exchequer an estimated \$20 billion every year at a time when the government’s fiscal deficit is already at an unsustainable 9 percent of GDP, the program inevitably has triggered inflationary pressures—with huge adverse consequences for the very groups the program is designed to help. The irony is that India already has a massive food distribution system, which has proved to be hugely wasteful and inefficient, losing over 70 percent of its value before it reaches the intended beneficiaries. Even relatively successful programs have limits. For example, while the MGNREGA (see above) has helped to provide employment and income for the rural poor during lean times, the preponderance of evidence suggests it is hardly a long-term solution to rural poverty and inequality.

Arguably, China and India can learn some valuable lessons on reducing inequality from their fellow giant: Brazil. Until recently, Brazil had the unflattering distinction of being the most stratified and unequal country in the world. However, since 2000, Brazil has made a significant dent in poverty and inequality, with the Gini coefficient falling sharply from a high of about 0.63 in 1990 to around 0.54 in 2009 (Barros, De Carvalho, Franco and Mendonça 2010; Ferreira, Leite and Ravallion 2010). In January 2012, the Gini had dropped to 0.52. If current trends continue, the Gini is projected to fall below the 0.5 line some time in 2014 or 2015 at the latest. Brazil’s remarkable achievement underscores that there is nothing inevitable about economic growth resulting in increased income inequality.

Brazil’s success in reducing income inequality is due to a combination of factors. First, effectively reining-in the pervasive problem of hyperinflation has meant that incomes are no longer being rapidly eroded through an informal inflation tax. The second major factor is the unwavering commitment of the Lula’s administration, which took

office in 2003, to redistributive justice to ameliorate Brazil's long and deep-rooted economic and social inequities.

Targeted programs, namely the minimum wage policy under the *Benefício de Prestação Continuada* (BPC) and the *Bolsa Família* family grant program, has allowed for a simultaneous reduction in poverty levels and income inequalities. Like China's *Diabo*, the *Bolsa Família* is also a classic "conditional cash transfer" program. However, the difference is that the *Bolsa Família* not only provides extensive coverage, it is also better managed and implemented. The *Bolsa Família* provides regular payments to poor families either in the form of modest cash transfers on the condition they meet certain requirements such as having mothers participate in educational programs or making sure that children attend school, get vaccinated, and receive regular medical check-ups. The program is well targeted. There are regular follow-ups with each family's eligibility reassessed every two years through careful monitoring, including personal visits by social workers. A fortuitous outcome of such diligence is that it has enabled the program to establish an exhaustive register of Brazil's poor families called *Cadastro Único*. Under the Lula Administration, *Bolsa Família's* coverage grew from some 4.9 million families in 2002 to over 12 million families (or 97.3 percent of the target population) by 2009. Although Brazil has been able to pay for the program because of windfall revenues from commodity exports, it is important to note that *Bolsa Família* is not only inexpensive (costing just 0.4 percent of GDP), it is already shown to have a positive impact on educational outcomes.¹³ That is, by providing access to basic education (such as literacy and numeracy skills), *Bolsa Família* provides opportunities to the current generation to escape grinding poverty, with clear long-term socioeconomic benefits (Lopez-Calva and Rocha 2012).

¹³ *Bolsa Família* is not the only such cash transfer program. Mexico's *Oportunidades* covers about a quarter of the population and provides a 20 percent increment over pre-transfer income on average at a cost of 0.5 percent of GNP in 2006 (Fiszbein et al. 2009).

The experience of *Bolsa Familia* underscores that well-targeted and implemented programs can help to both significantly alleviate immediate short-term inequality and poverty, as well as break the cycle of intergenerational poverty. In fact, well-targeted social safety nets and transfer programs can actually contribute to growth itself, thereby reducing the overall cost of social safety nets and transfers over time. This is because beneficiaries of such programs not only use transfers to finance their immediate consumption needs, the cash also provides them with much needed (and hard to get) credit. This in turn allows poor households to overcome credit constraints and gives them some capital to invest. Gertler, Martinez, and Rubio-Codina (2012) show that many poor rural Mexican households invested part of their cash transfers they received from the *Oportunidades* program in productive assets. And some, after an 18 month period of diligent saving and investment were able to increase their agricultural income by almost 10 percent.

Conclusion

The experience of Brazil underscores that targeted redistributive measures and the provision of a viable social safety net can go a long way to alleviate human suffering and income inequalities. Of course, continued spending on such programs requires sustained economic growth. For both China and India, promoting economic growth with redistribution will be essential to further improve the living standards of their citizens. The corrosive effects of rising socioeconomic disparities amid plenty is well known—triggering revolutionary upheavals throughout history, most recently the Arab Spring (Wilkinson and Pickett 2009). Widening inequality, and in particular, the popular and largely accurate perception that corruption and connections is what enabled the nouveau riche in both countries to amass their fortunes, not to mention the hedonistic and vicarious lifestyle of the rich, lies at the heart of the growing resentment, civil unrest and popular mobilization in both countries (Schortgen and Sharma 2012). Both the Indian and Chinese

governments recognize the imperative to reduce inequalities and promote more inclusive growth. India has its massive food subsidy program and other short-term populist programs to buy voters and time. China's State Council (or cabinet) endorsed an ambitious program put together by three key ministries,¹⁴ unambiguously titled "On Deepening the Reform of the System of Income Distribution" to reduce income inequalities. Most importantly, the new program plans to simultaneously crack-down on corruption and reduce income inequality. Of course, its effectiveness remains to be seen.

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¹⁴ The National Development and Reform Commission, the Ministry of Finance, and the Ministry of Human Resources and Social Security.

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