

Dynamics of Income Inequality in India

Insights from World Top Incomes Database

AMIT BASOLE

This article analyses the evolution of income inequality in India in the period 1922-99 using the World Top Incomes Database. Inequality decreased steadily in the planning period, driven by a fall in real incomes at the top of the distribution. This decline reversed itself in the early 1980s. The 1990s saw an increasing divergence between the rich (top 1%) and the rest of the country.

Amit Basole (amit.basole@umb.edu) is at the Department of Economics, University of Massachusetts, Boston, the US.

Thomas Piketty's (2014) bestseller, *Capital in the Twenty-First Century*, has made the dynamics of income and wealth inequality a widely debated topic. Piketty provides a wealth of evidence (no pun intended) from developed countries to document that the capital-income ratio, the share of income going to the top 1%, and, in the case of the United States (US), the proportion of wealth owned by the top 1% have risen to pre-first world war levels after a period of relatively low inequality from the end of the second world war to the 1980s.

Piketty and his colleagues have also constructed the World Top Incomes Database (WTID) (Alvaredo et al 2014) for a larger set of 29 countries using tax returns data. The database has been used to study the dynamics of inequality

in several different countries (Atkinson and Piketty 2010).

The series for India was earlier constructed by Abhijit Banerjee and Thomas Piketty using tax returns published in the All-India Income-Tax Statistics (AIITS) series for the years 1922 to 1998 (and extrapolated to 1999). Unfortunately, the Government of India stopped publishing detailed tax return data after 1999, so the series stops there. While tax-based data suffer from several limitations for an economy like India's, which has a preponderance of informal (and hence officially untaxed) economic activity, has high tax evasion and possesses a narrow direct tax base, the WTID is an important complement to the National Sample Survey (NSS) data (that typically underestimates inequality). It clearly illustrates the massive shift in Indian political economy in the 1980s, as seen through the lens of income inequality at the top of the distribution.

Banerjee and Piketty (2005) present income shares of the top 1, 0.5, 0.1 and 0.01% of the income distribution in India from 1922 to 1999, and compare the trends to those found in the US, United Kingdom and France. Consistent with global trends,

they find that inequality declined from the 1950s to 1980, and increased thereafter. In this short note, I use the same data to take their analysis forward. While top income shares measure relative inequality, changes in absolute inequality are also an important part of the story. I chart and discuss these trends. I also calculate decadal growth rates in real income at the top of the distribution to highlight the stark difference in political economy pre- and post-1980. Finally, while Banerjee and Piketty briefly allude to the changes in Indian political economy that may explain the observed income trends, I provide some more institutional details to place the observed dynamics in the context of the transition from the planning to the neo-liberal period.

The Indian economy has experienced vast changes since 1999 (the last year for which data is available), but despite the lack of recent information the following points emerge clearly. The planning period (1950s to 1970s) was associated with a marked decrease in inequality that had prevailed during the colonial period. In particular, the rich (top 1%), the super-rich (top 0.1%), and the ultra-rich (top 0.01%) suffered significant declines in real incomes, even as average income rose slowly. The situation changed dramatically in the early 1980s, which marks the turning point for the dynamics of income inequality across the world. While average income grew faster than it had in the planning period, inequality increased rapidly, driven by a huge increase in top incomes, particularly incomes at the very top (0.01%). The data lend support to the view that the structural transformation of the Indian economy from a “socialistic” to a pro-business path was well-underway before the 1991 reforms. Further, the “new economy” of the 1980s and 1990s, even as it delivered faster growth on average, ensured rates of growth and levels of top incomes that were in stark contrast to the turbulent 1970s and had never been seen in India.

Data

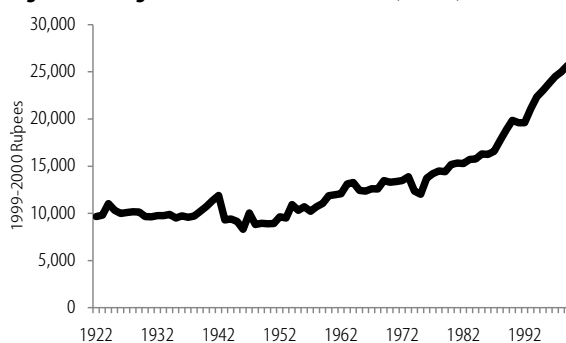
For a detailed description of the Indian database, how it was constructed, and what its limitations are, the reader is

referred to Banerjee and Piketty (2005). As stated earlier the AITS series published every year by the Indian Income Tax department constitutes the primary data source. The authors assumed that there were 400 million “tax units”¹ (roughly individuals in the labour force) in India in 1999. Of these only 4% (16 million) had taxed incomes.² The top 1% of the income distribution thus refers to 4 million individuals, the top 0.1% to 4,00,000 and the top 0.01% to 40,000 individuals. In addition to the average incomes in the top 1%, 0.1%, and 0.01% of the distribution, the database also provides the average income per tax unit as well as income thresholds for being in the top 1, 0.1, and 0.01%, for reference purposes. For example, in 1999, to belong to the top 0.01% the threshold is Rs 14 lakh per annum (\$160,000 at PPP). The average income in that category was Rs 40 lakh (\$470,000 at PPP). Interestingly, the threshold income for being included in the top 1% of the distribution, in 1999 was only Rs 87,632 per year or Rs 7,303 per month (in 1999 rupees). This number, which may appear low to some, is indicative of the low overall levels of income in this period, but may also result from the exclusion of untaxed incomes in the database.

Inequality in the 20th Century

Figure 1 plots the average annual real income per tax unit (in 1999-2000 rupees). As expected, roughly three distinct periods can be observed: stagnation

Figure 1: Average Income Per Tax Unit in India (1922-99)

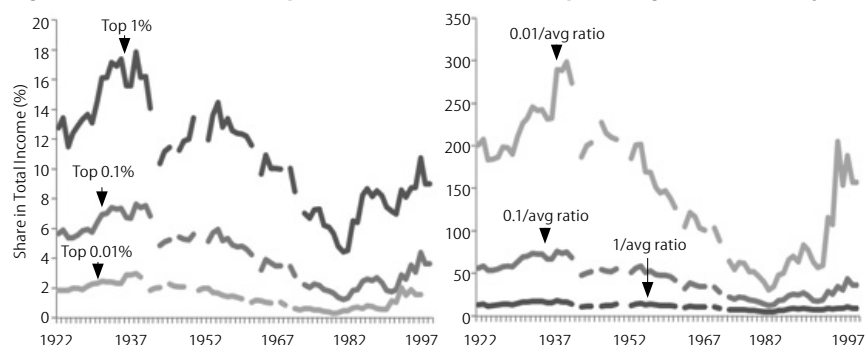


Source: WTID.

for most of the pre-Independence period, a comparatively slow rate of growth from the 1950s through the 1970s and relatively more rapid growth in the 1980s and 1990s. An “average Indian”, in 1999 was expected to earn Rs 25,000 per year, up from Rs 10,000 around Independence (in 1999 rupees).

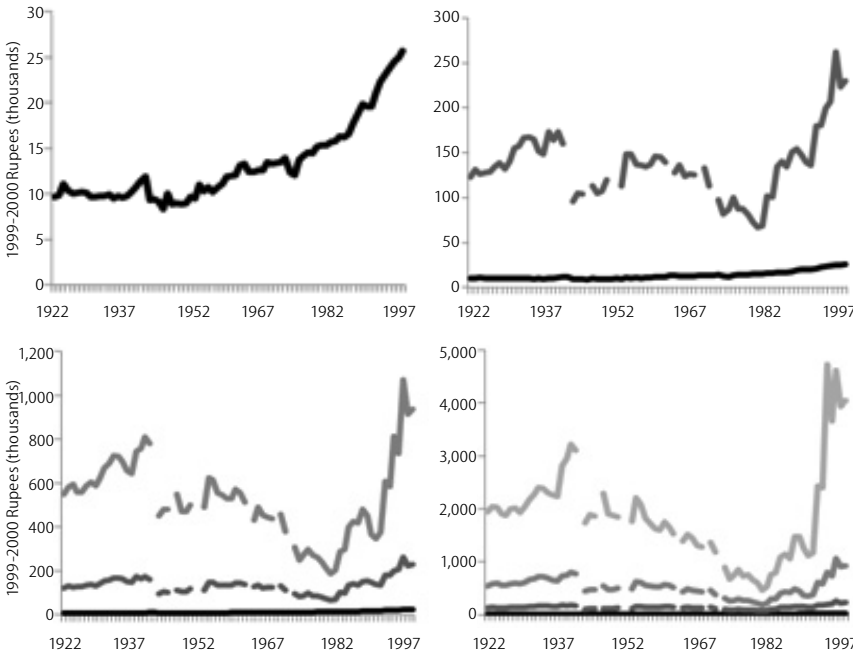
Since the database only carries information on top incomes and the national average, the only measures of inequality that can be constructed are income shares (share in national income of the top centile) and ratios (ratio of top incomes to the average). After peaking in the 1930s, the share in national income of the top 1%, 0.1%, and 0.01% steadily declined following the second world war and decolonisation (Figure 2, left). Throughout the planning period, when India followed the “socialistic path” of development, inequality decreased continuously. The share of the top 1% fell to its lowest point (4.4%) in 1981 before starting to rise in the 1980s and accelerating in the 1990s. Banerjee and Piketty (2005) note that the reversal in decline in inequality starts 10 years before the 1991 economic reforms and attribute it to the pro-business policies brought in

Figure 2: Income Shares of the Top 1%, 0.1%, and 0.01% (left) and Top to Average Income Ratios (right)



Source: Author's calculations based on WTID.

Figure 3: Top Incomes Compared to Average. Average (top left), **Top 1% Added** (top right), **Top 0.1% Added** (bottom left), and **Top 0.01% Added** (bottom right)



Source: WTID.

by the Indira Gandhi and Rajiv Gandhi governments of that period. This view is consistent with other recent scholarship that has put forward the view that the neo-liberal period in India starts in the mid-1980s, several years before the 1991 reforms (Kohli 2012). I discuss this further in the next section.

Figure 2 (left) also suggests that there has been a divergence *within* the top 1%, with the very top (0.01%) pulling away from the rest of the 1%. This becomes clear in the right panel of Figure 2 that plots the same data in a different form, as the ratio of top incomes to the national average. Consistent with the behaviour of the income distribution in other countries (Atkinson and Piketty 2010), inequality increases sharply at the top of the distribution. The 1% to average ratio in 1999 was 9:1, but the 0.1% to average ratio was 36:1 and the 0.01% to average ratio was 157:1. Note that the 0.01% to average ratio, which had reached a historic high of 300:1 in the pre-Independence period had decreased significantly to 45:1 by 1979 before climbing again to 200:1 in 1995. Thus a mere 15 years of a changed political economy were enough to restore a substantial portion of the inequality of the pre-Independence period.

The measures presented in Figure 2 show that inequality was on the rise throughout the 1980s and 1990s, though not reaching colonial levels. However, these relative inequality measures only give us part of the picture. Subramanian and Jayaraj (2013) and Ravallion (2014) have recently argued in favour of measuring absolute inequality in addition to relative inequality in order to gain a

more complete picture. A simple measure of absolute inequality is the real rupee difference (as opposed to the ratio) between the average income and the income of the top 1, 0.1, and 0.01%. To appreciate the difference between relative and absolute measures, note that if two incomes of say Rs 1,000 and Rs 10,000 increase, in real terms, to Rs 2,000 and Rs 20,000, respectively, the relative inequality, as measured by shares/ratios or the Gini coefficient, is unchanged but the absolute inequality has doubled from Rs 9,000 to Rs 18,000. This is clearly an important change in this hypothetical economy and there is evidence to suggest that people are sensitive to this aspect of inequality (Ravallion 2014).

Figure 3 shows real incomes for all three categories over the data period. For reference purposes the national average (Figure 1) is reproduced at the top left. The subsequent charts add the real annual incomes of the rich (top 1%, top right), the super-rich (top 0.1%, bottom left), and the ultra-rich (top 0.01%, bottom right). Note that even though the average income rises in real terms throughout (albeit at different rates in different periods, as we saw earlier), real incomes actually *fell* for the rich, very rich, and super-rich during the 1960s and 1970s. Thus for the average to rise

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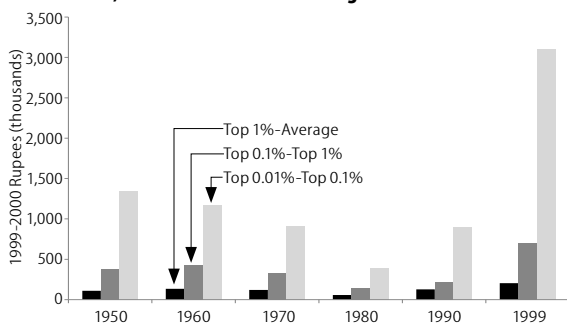
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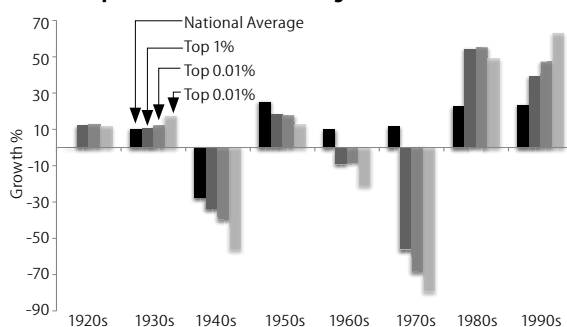
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Figure 4: Absolute Inequality between the Top 0.01% and 0.1%, the 0.1% and 1%, and 1% and National Average



Source: Author's calculations based on WTID.

Figure 5: Decadal Growth in Real Incomes for the Top 1, 0.1, and 0.01% Compared to the National Average



Source: Author's calculations based on WTID.

during this period, incomes in the middle and at the bottom had to have increased to compensate for this decline at the top. After reaching their nadir in the late 1970s, top incomes rose, first slowly in the 1980s and then rapidly in the 1990s. During the 1980s and 1990s, all the losses experienced in the earlier decades were more than recovered and we see that absolute inequality increased in India to unprecedented levels (Figure 4). We also see that the 1990s are characterised by a pulling away of the 0.01% from the rest of the 1%. The real rupee difference in annual income between the top 0.1% and the 0.01% was Rs 8,96,810 per year in 1990 but had ballooned to Rs 30,99,421 per year in 1999, a three-fold increase.

As can be surmised from the data presented here, the planning period was not a good era for the growth of top incomes in the Indian economy. In particular the 1960s and 1970s were decades during which average income grew at decadal growth rate of around 10-12%, but incomes of the rich, very rich, and super rich fell sharply (Figure 5). The decadal growth rates for the three were -56%, -68%, and -79%, respectively.

But the situation dramatically reversed itself by the end of the 1980s. The same growth rates in the very next decade were 54%, 55%, and 49%! In comparison, the national average grew by 23% in the 1980s as opposed to 12% in the 1970s. Another strong decade of top income growth in the 1990s more than restored the real incomes of the rich that had taken a hit in the turbulent 1970s.

Institutional Context

The structural transformation that the Indian economy underwent in the 1980s is clearly reflected in the data presented here. In conclusion I offer a few comments on the nature of this transformation. A particularly striking aspect of the data is the sharp decline in real income at the top in the 1960s and 1970s. A detailed discussion of the causes is outside the scope of this article but the prolonged industrial stagnation of the 1960s and 1970s (Raj 1976; Nayyar 1978) is likely to have contributed to this phenomenon. But several years before the economic reforms of 1991, incomes had recovered substantially. Allowing for artefacts such as the improved ability of the state to tax incomes and increased incentives to pay tax due to reduced rates (which would also result in a rise in top incomes in the data), Banerjee and Piketty (2005) suggest that changing social norms, a booming economy, international trade and globalisation can explain the rise. Indeed, the WTID data fit very well with the emerging view that a pro-business policy climate was the hallmark of the post-Emergency Indira Gandhi government as well as the Rajiv Gandhi government and that the Indian political economy had shifted unmistakably from the Nehruvian statist model to a pro-big business regime several years before the reforms of 1991 (Frankel 2005; Kohli 2012). The result was a reversal of

the industrial stagnation and the industrial growth rate increased from 3.8% a year in the period 1965-79 to 6.5% a year during 1980-90 (Kohli 2012: 99). As the emphasis shifted from redistributive justice to increasing productivity as well as private investment via relaxing of licensing requirements, taming labour, and host of other by-now familiar neoliberal policies, faster growth was indeed achieved, but the gains went disproportionately to the top.

Conclusions

The WTID data clearly reveal the nature of growth experienced by the Indian economy since the 1980s. While average incomes grew faster than they ever did before, most of the gains went to the very top and inequality exploded. In absolute terms, inequality at the end of the 1990s was far higher than it had been even in the colonial period.

NOTES

- 1 In the WTID "tax units" are individuals. Data are obtained from individual income tax returns filed by individuals and by "Hindu undivided families" (less than 5% of the total in the 1990s). The theoretical number of tax units is 40% of the total population of India (Banerjee and Piketty 2005, Table 1A.1, col (2)). This is close to India's labour force.
- 2 The proportion of taxable individuals has increased in India from around 0.5%-1% (from 1920s to the 1980s) up to 4% at the end of the 1990s.

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