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"Fighting Inequality" by S L Rao

The article by Rajesh Shukla on "India's Growth-Inequality Predicament" (FE Nov 23 2013) makes the policy argument that both growth and poverty reduction are necessary in a country with many very poor people. Social welfare schemes that are in the nature of charity for physical well-being must accompany others that build skills. This enables the poor to seize the opportunities offered by a growing economy. Such charity welfare programmes must be within the country's means. They should not lead as they have done in India, to large government deficits. Persistent large government deficits have had negative consequences, one being persistent inflation. Persistent inflation hurts the poor and can make charity for physical well-being less effective. That is why growth is important. It enables increasing tax revenues which can fund such programmes. It is not the "trickle-down" effects of growth, (a presumptuous phrase) that reduces poverty. When growth pulls up the well-to-do, it does so, to a much smaller Rupee income extent, the badly-off as well. The poor earn better because of growth, not from a "trickle" from the tables of the well-to-do.

Is economic inequality at all avoidable? Most people do not want to be equal; they want to be better than their friends and neighbours. Political parties and governments must not attack income inequalities. Inequalities in wealth are a different matter, since a concentration of wealth in a few hands might lead to political power as well. In a democracy, policies to ameliorate the effects of social inequalities must be followed. Urban migration seems to lead to diminishing social inequality. Merit and hard work are the differentiator, not caste, community, etc.

However, a more basic issue must be addressed. Should governments tackle poverty or income or wealth inequality? During India's socialist era of a "command and controls economy", all three were the objectives of state policy. Government policies did not reduce poverty. To control income and wealth inequalities, penal rates of income taxation, high import duties, high wealth and inheritance taxes, and other indirect taxes, were expected to limit the consumption of goods and services considered as "luxuries".

For example, polyester fabrics were for many years considered as luxuries and the fiber for its manufacture was subject to heavy duties. Even the chemicals to make polyester fibers were heavily taxed. In the event, even the poor were willing to pay the high prices for polyester fabrics because they could do with fewer garments and yet look decently dressed in uncrushed garments every day, unlike the case with cotton fabrics. High income taxes, inheritance and wealth taxes became disincentives to capital accumulation and investment. The ambitious entrepreneur found ways to hide such incomes and wealth when they occurred. The means were illegal, generating "black" money and investments, as well as underground outflows of funds to foreign countries.

Another consequence of the state's attempt to curb inequalities in income and wealth was that the state entered all types of manufacturing and service industries. State ownership, control and management, were considered fair and equitable, as against private. Some hold to this myth even today. People from the private sector are rarely considered for high government positions. Government ownership continues in a variety of sectors. In every case, whether owned by the central or a state government, such enterprises are inefficient, have low productivity and restrict the economy.

Take the example of the national ownership of coal. No political party questions its usefulness. As the demand for energy grew in our growing economy, so did the demand for coal, the principal resource in our possession that could be used to generate electricity. Coal India is generally recognized as the most corrupt of organizations. The coal mafia steals a great deal of coal from the mines or in transit, with collusion from company officials. State owned coal mines have inefficient mining practices and use outdated technologies. Their productivity is low and their costs high. They are unable to deliver their commitments and the country imports increasing quantities of coal, causing adverse effects on the balance of payments. But the fetish for equality and the faith in government ownership to deliver it, retains the status quo. Instead, private ownership and independent regulation might give us more coal, cheaply, and help the economy.

Government enterprises do not have profit as their main objective, as much as to make that product or service available. The result, until private enterprise was allowed in most fields, was a thriving black markets as well as smuggling from other countries. When private investment was permitted in some fields in the 1960s to 1980s, it was with designated capacities, technology determined by a bureaucrat, numbers to be employed laid down, and in many cases the sale prices also laid down. Heavy estate duties at death, and high wealth tax on assets when alive, along with the high income tax rates, were intended to make people more equal in income and wealth. But inequalities remained. Indians became the largest holders of wealth in foreign banks overseas.

Thus, policies aimed at income equality have never worked. Even wealth equality was never achieved. After the economy was opened from 1991, both have shot up. The first priority of governments must be to eliminate poverty. This may be accompanied by growing income and wealth inequalities. If the state invests heavily in education and skills free or at low cost for the poor, we have a greater chance over time of reducing income inequality. We should never try to eliminate it. As far as wealth inequality is concerned, the state can deal with it in

due course as have other nations. Political equality must be ensured through freedom to vote, limiting election expenses, and severe penalties for violations. Social inequality does need reservations, but they must be accompanied by high quality education and skills development. But we should not discount the importance of economic growth for reducing poverty. India has barely begun this journey. (988)