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Growth, Inequality and Structural Adjustment: An Empirical Interpretation of the S-Curve for the Indian Economy

Narain Sinha

18.1 Introduction

Most developing countries have witnessed a higher rate of growth in the modern industrial sector than for GDP. This highlights the fact that effect of growth in one sector is crucial to growth in another. The, sectoral composition of economic growth changes with time and thus influences economic inequality. A change in overall level of economic development, according to the Kuznets’ Hypothesis of Economic Growth (KHEG), results in changes in inequality. During various stages of development a structural shift of agriculture to manufacture (ATM) or manufacturing to service (MTS) is responsible for the turning points in the Kuznets’-U-process. Theories of growth and distributional change have emphasized the role played by economic shifts from the traditional rural sector to the modern urban sector. A sectoral interdependence of economic activities may thus enhance or retard its direct effect on inequality, for overall inequality is a population weighted average of sectoral inequalities. It will be of interest to look at the relationship between economic development measured in terms of per capita income and economic inequality, because of its wide-ranging implications for poverty reduction and through it for the economic reforms initiated vigorously in most of the developing economies and particularly in India in 1991. It is argued that when the share of secondary sector increases during the second stage, inequality declines due to shifts of ATM thus, an inverted U-curve occurs. Another turning point occurs during the third stage of development, which corresponds to MTS, and thus it becomes an augmented inverted U-curve.
Of late Datt (1999) has examined the trends in poverty in India and concluded that in the post-reforms period, rural poverty has remained stagnant whereas urban poverty has declined. However, according to Ahluwalia (2000) the interstate inequality (measured in terms of the Gini coefficient) was fairly stable upto 1986–87 and it started increasing in the late 1980s and continued upto 1997–98. The increase in the Gini coefficient from 0.16 in 1987–88 to 0.228 in 1997–98 was substantial. It plummeted subsequently to 0.225. The overall growth rate of Gross State Domestic Product (GSDP) was 5.24 per cent during 1980s, which reportedly rose to 5.94 per cent during the period 1991–92 to 1997–98. This establishes the fact that there exists a positive correlation between development and Gini coefficient. In the light of these findings, several attempts have been made to explain the rising trend in inequality and the number of persons below poverty line during the last decade. The major objective in this chapter is to provide explanation for an increase in inequality in India during the last two decades, especially after 1990–91. The following section describes the findings of other studies on the empirical relationship between inequality and level of income. In section 18.2 we describe the methodology. Section 18.3 presents data description along with our results and discusses their implications. Conclusions are given in section 18.4.

### 18.2 Review of Literature

A stylized model describing the relationship between development and distribution was first sketched by Kuznets (1955) and later formalized by Anand and Kanbur (1993). Using an ambitious model, Greenwood and Jovanovic (1990) have shown that income distribution and growth are correlated over time due to financial development. A relationship between a measure of inequality and the level of income to test for consistency of the original Kuznets' hypothesis allows its partial revival. Accordingly, there appears to be a U-curve relationship between development and inequality. Expressing inequality as a polynomial in income marks a complete revival of what has been termed as the Kuznets' process by Anand and Kanbur. Results obtained do validate the correct parabolic shape both for all countries and for developing countries alone but were not statistically significant. However, it may be taken as evidence of inherent tendencies toward greater inequality when the economic restructuring from low levels of income takes place, hence resulting in an augmented Kuznets' curve.

The idea that both low-income and high — income economies would have lower inequality was initially advanced by Kuznets (1955), and was re-examined mathematically by Anand and Kanbur (1993). The stylized