Toward Understanding the Nature of Inequality in India in Terms of Changing Perceptions on Its Sources and Solutions

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Abstract This paper enquires about changing perceptions of inequality in terms of its sources, consequences, and the solutions that have been thrown up by the emerging research findings on the issue. The conception of inequality is a dynamic one and has seen many transitions. This paper surveys this transition starting from Aristotle to Piketty and shows that the shift to multidimensionality of inequality, besides locating the issue in historical context in terms of social, political, and economic dimensions also calls for differentiation of types of inequality. The conventional wisdom that inequality is the result of the differences in skills and talents is questioned and other sources of inequality, mainly policies and politics, are brought into debate. The relationship of inequality with growth, poverty, and labor market outcomes is analyzed and it is shown that inequality is a constraint on growth and poverty reduction. If one were to simplify the problem of inequality into two dimensions, viz., inequality of opportunities and inequality of outcomes, perhaps there is no other country in the world other than India which faces the inequality of opportunities as deep, because of its centuries of history, and as wide because of its universal nature across all regions of the country. India is one of the very few countries which do not collect information on income through household surveys. This paper uses many alternative data sources for India and shows that there is a clear phenomenon of 'hollowing out' of the middle class. Fiscal policy, especially taxation, has an important role in reducing inequality. But, reliance on fiscal policy only may not be sufficient and there is a need for radical policy and political mobilization.

1 Introduction

In recent times, there has been growing evidence that ever since the unfolding of the process of economic globalization in countries under neoliberal economic regimes that witnessed retreat of the state and the entrenchment of privatization, there has

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N. K. Mishra (ed.), *Development Challenges of India After Twenty Five Years of Economic Reforms*, India Studies in Business and Economics,
https://doi.org/10.1007/978-981-15-8265-3_5

been unbridled increase in inequality of income and wealth, even as large sections of people remained poor and deprived. This has drawn widespread mobilization and protests in many countries, especially in Latin America, correctives did bring about positive changes in favor of better life for the marginalized and the working class in general (Roberts 2012). In India, even as it is revealed that there has been growing inequality of income and wealth, and even as it is increasingly clear that the accelerated growth of the last few decades, instead of "trickling down" in an inclusive way to the lower rungs of the society, it has actually been adding wealth to the top rungs of the rich. There is a continued obsession with "growth", and hardly any larger debate on the ramifications of growing inequality on the prospects of progress of the democratic polity that would ensure equitable and fair access to the fruits of growth to people. The limited objective of this paper is to help inform the debate on the changing perceptions on inequality in terms of its sources, consequences, and the solutions that have been thrown up by the emerging research findings on the issue. Based mostly on the review of recent literature and secondary sources of data, the presentation of this paper is divided into five sections. The brief introduction is followed by the second section that deals briefly with the changes in the conceptualization of inequality. The third section refers to the changes in the perceptions about the sources or drivers of inequality, which apparently are much against the conventional wisdom. It also brings together the findings on the adverse effects of inequality. Based on these emerging findings on the various ramifications of inequality, the fourth section presents the trends in inequality in India. The last section is about the emerging policy perspectives on containing inequality within reasonable bounds that would make growth fair, inclusive, and sustainable.

2 Inequality: A Concept in Transition

The concept of inequality has changed over time. Amartya Sen asserts: "concepts of equity and justice have changed remarkably over history, and as the intolerance of stratification and differentiation has grown, the very concept of inequality has gone through radical transformation …I should argue that the historical nature of the notion of inequality is worth bearing in mind before going into an analysis of economic inequality as it is viewed by economists today"[1] (Sen 1973). In a comprehensive account of inequality from Aristotle to White (2003) brings out as to how Aristotle conceptualized inequality in ethical framework, and how ethical considerations continued to dominate the Classical school particularly J. S. Mill's egalitarian framework, only to be challenged by the framework of subjective methodological individualism of the Neoclassical school. And again, it was the turn of Sen to revive the normative ethical framework in discussing inequality in the context of well-being.

[1]The reference "today" should be seen as 1960s and early 1970s around which it was written and at which point the Pareto dictum that inequality changes but "stable in the long run" was still dominant mainstream conception.

Mill differentiated between “earned” income, and property obtained from free use of mind and body, and “unearned” income from rent. He was for equal distribution of income by taxing land. Mill insisted on equality of opportunity and the role of education in achieving it. By the latter half of nineteenth century, there emerged a shift from the classical economics to neoclassical rational value-free approach, and all ethical and egalitarian considerations were sought to be purged out. For Marshall and J.B. Clark income distribution was to be seen solely in terms of marginal productive theory. “No matter how unequal the income distribution is, as long as it follows the marginal productivity rule, it is a good and just income distribution. …with the rise of Pareto and the ordinalist approach to welfare economics, this non-egalitarian criterion comes to dominate mainstream economics” (White 2003). For Pareto, the only basis for preferring a more equal income distribution over a less equal one was “sentiment.” Interestingly, Pareto who was known for his theoretical contributions, was also, perhaps, one of the earliest empirical researchers. In 1895, he conducted an empirical study of the distribution of income in different European countries and cities at different times in the nineteenth century and concluded distribution of income was roughly constant across these times and places. His interpretation was that “the income distribution may change over time, but it is remarkably stable,” and become the Pareto Law. His proposition was that attempts to decrease inequality by redistribution of income were futile in the long term (White 2003). Pigou, based on better empirical evidence questioned Pareto’s findings and theory. But Pigou’s arguments, since it was based on utilitarian approach, were vehemently dismissed as unscientific by Lionnel Robbins (White 2003). And Pareto’s proposition that, changes notwithstanding, income distribution would be stable in the long run, continued to rule as the law for the neoclassical mainstream and to inequality and income distribution were relegated as issues of not much importance in economics. But yet the growing evidence of increasing inequality and deliberate efforts to ignore the same, remained an embarrassment.

It is at this historical context in the career of inequality analysis, in the 1950s Kuznet’s undertook a systematic analysis of interpersonal income inequality with a particular focus on the behavior of the share of the upper income groups on the basis of innovative sources of data.[2] Kuznets used for the first time a combination of the income tax returns (USA introduced income tax in 1913) and national income tables for the USA, in the construction of which he played a pioneering role. He presented his results in his famous presidential address, ‘Economic Growth and Income Inequality’ (Kuznets 1955) to the American Economic Association. According to his findings, income inequality evolved along an inverted “U,” increasing in the initial stages of development and narrowing later on, which has become the famous “Kuznets Curve” or “inverted U” hypothesis of income inequality and economic growth relationship. But in the existing cold war context of the 1950s, Piketty (2014) points out, some of Kuznets observations that his finding would help to “keep the underdeveloped countries within the orbit of the free world” acted as a political weapon, and he was seen as a bearer of good news in the face of the spectre of Marx’s proposition that dynamics

[2]Part of this paragraph draws from Haque (2019).

of private capital accumulation inevitably lead to the concentration of wealth in ever fewer hands, resulting in a kind of apocalypse of capitalism. Though there was hardly any work on inequality in the mainstream economics at that time, Kuznets' hypothesis which in a way resonates with "Pareto Law" that changes notwithstanding, inequality will be stable in the long run—came to be treated as an empirical anchor for the neoclassical *a priori* proposition. Thus, "Kuznets Curve" came as an ideological boost to the mainstream economics profession which hastened to convert it as a "natural law" of development and distribution (Lee and Gerecke 2012).

The irony is that Kuznets' more circumspect and cautious remarks were totally ignored. Kuznets in his lecture did caution that his proposition was of speculative nature based on "5% empirical information and 95% speculation, some of it tainted by wishful thinking." He went on to emphasize that inequality was much larger issue and closed his lecture with the following words: "Effective work in this field necessarily calls for a shift from market economics to political and social economy" (Kuznets 1955, p. 28). Mainstream economics, instead of initiating new research with a broader framework suggested by Kuznets, used his findings as settled conclusions and propagated the notion that with the turnaround from underdevelopment to development, growth would bring about decline in inequality and hence "growth should take the driving seat and distribution the back seat" in economic development (Lee and Gerecke 2012). In the mainstream neoclassical economics, the place accorded to research on inequality has since been virtually closed. Though die-hard mainstream may hold on to it, the impact of over three decades of globalization with growing market orientation through deregulation and privatization, there has been relatively high growth in most of the developed and in the large emerging economies, but there was no sign of inequality wearing off in the latter stages of development. On the contrary, there has been growing evidence that income disparities within countries have been on the increase, and in many cases, to the levels inconscionable. The paradox is that multilateral agencies such as the International Monetary Fund, which promoted the neoliberal agenda across countries, are the very agencies that are sponsoring extensive research on the impact of inequality and policy interventions to overcome the same (IMF 2007; Oxfam 2017a). Beginning with 2000, there has been a great spurt in research on various dimensions of inequality. But the real breakthrough in terms of methodology in the true Kuznetsian spirit came with Piketty: "…no one has ever systematically pursued Kuznet's work, no doubt in part because the historical and statistical study of tax records falls into a sort of academic no-man's-land, too historical for economists and too economistic for historians. That is a pity, because the dynamics of income inequality can only be studied in a long-run perspective, which is possible only if one makes use of tax records" (Piketty 2014, p. 17). By emphasizing that inequality is complex and multidimensional, Piketty's work liberates inequality research from narrow economic confines and orients toward understanding capital and power relations by drawing from wide range of information sources including income and wealth accounts, household income and wealth surveys, fiscal data coming from tax sources, inheritance, wealth data including wealth rankings, and of course, national income data. In broadening the scope of inequality research "…it makes one think about the

overwhelming cultural-ideological-economic-political complex that power of wealth creates which conditions the public to emulate values that make people band together any threats to possession of wealth, however unequal it might be." (Piketty 2017, p. 545).

The shift to multidimensionality of inequality, besides locating the issue in historical context in terms of social, political, and economic dimensions also calls for differentiation of types of inequality. Conventionally, the focus has been on the functional and interpersonal distribution of income. In the classical political economy, including Marx, the emphasis was on income and its functional distribution among social classes based on their role in the production system as workers, capitalists, or owners of land receiving incomes in the form of wages, profits, and rents. While functional classification still assumes continued importance, there was a shift in emphasis in the neoclassical period toward interpersonal distribution of income, which overtime has come to assume significant importance in public policy both for the purposes of measurement of inequality (UNCTAD 2011), and for public intervention for taxation or public fiscal transfers. While both in the functional and the personal distribution, the focus has been on the outcomes, viz., income and wealth, which are also seen in vertical distribution at different levels. The growing inequalities, and along with it certain social classes or groups suffering persistent low income or wealth in spite of overall growth, have brought the dimension of inequality of opportunities or the horizontal inequality to the fore in recent times. Horizontal inequalities refer to inequalities between groups with specific characteristics that their members and the others recognize as important aspects of their identity. These groups could be defined by culture, gender, ethnicity, religion, race, caste, geographic location, and age, among other characteristics. These are the results of systematic discrimination and exclusion, and they can prevent individuals within marginalized groups from achieving their full potential, and in contributing to society's prosperity. Horizontal inequalities manifest themselves in unequal opportunities and outcomes across socioeconomic, political, and cultural dimensions (UNDP 2013, p. 27).

3 Changing Perception on Sources of Inequality

The broadening of the scope of research on the multidimensional nature of inequality has also resulted in questioning the conventional wisdom that inequality is the result of the differences in skills and talents. For over three decades, it was argued that income inequality in the USA centered on the dispersion of wages and the increased premium for skilled or educated workers, due to varying skill-based technological change and globalization. But research in recent years has brought out that much of the inequality is due to shift of income and wealth to the very top 1 to 10%. "Stories based on the supply and demand for skills are not enough to explain the extreme top tail of the earnings distribution; nor is it earned incomes" (Alvaredo et al. 2013). Piketty did emphasize the role of politics and policy: "One should be vary of any economic determinism in regard to inequality of wealth and income. The

history of the distribution of wealth has always been deeply political, and it cannot be reduced to purely economic mechanisms" (Piketty 2017, p. 545). The Economist (2014), supposed to be largely on the mainstream path, also endorses by pointing out that "skill-based technological change" or "superstar economics" are incomplete explanations of rising inequality, and they may actually leave out the more interesting half of the story.

Stiglitz (2015) discussing the origins of inequality points out that during the eighteenth and nineteenth centuries, there were two views on inequality, one was the Marxist view that attributed it to exploitation and market power and the other was neoclassical view based on their marginal productivity theory of distribution attributing to the differences in productivity linked earnings. In the late nineteenth and the twentieth centuries, the concern about inequality was linked to monopoly capital. He points out that today's capitalism is different, and that USA "inequality is not, for the most part, the result of economic forces. It is not, in this sense, the result of inexorable economic laws" (Stiglitz 2015, p. 427). But it is because of policies and politics, and much of the rents are derived by using political influence in land grants, modification of zoning of urban land, preferential provision of tax laws, giving away of country's natural resources and in the financial sector, insider trading and sophisticated front running, fees for credit/debit card monopolies (Stiglitz 2015, p. 432). Stiglitz feels that the "real issue is not capitalism in the twenty-first century, but politics in the twenty-first century." Under the neoliberal regimes, state acts as the agency to shift incomes from citizens to the capital (Baker 2014). A study of inequality in India blames squarely the policy flaws as the source (Shetty 2018).

The World Inequality Report 2018 (Alvaredo et al. 2018) brings out that in recent decades, especially since 1980s, income inequality increased in almost all regions of the world with different speed, ranging from the lowest in Europe to the highest in the Middle East. Role of national policies and institutions significantly influenced income inequality. By 1980s, the postwar egalitarian era came to an end in most of the countries. Globalization and the ensuing neoliberal regimes witnessed extensive shift toward deregulation and privatization. Tax systems grew less progressive and declining share of public investment brought about massive educational inequalities. Between 1980 and 2016, top 1% captured almost 50% of the growth in income. Increasing economic inequality has been largely due to unequal ownership of capital. Increasing privatization and income inequalities fuelled rise in wealth inequality. Since 1980s, there have been large transfers of wealth from public to private ownership. Between 1970 and 2016, the ratio of private capital to national income increased from about 2 to 3.5 to 4 to 7 across countries. In developed countries, increase in public wealth was negative or zero, and the ratio of net public wealth to net national income turned negative in the USA and UK (Alvaredo et al. 2018).

Arrow et al. (2000) suggest that growing inequality is due to the demise of egalitarian concerns in public policy and refer to three sources of the demoralization of the egalitarian project in the USA. First is the moral dimension, i.e., the concept of fairness, which no longer enjoys consensus on what it entails and therefore does not provide much guidance in egalitarian support. Second is the shift in public knowledge

of causes of inequality. Poverty and inequality, once considered systematic impediments such as discrimination and class bias in schooling and employment, are now sought to be explained by either cultural or genetic factors. The third reason for the demise of egalitarian consensus is the shift in public understanding of the underlying causes of inequality, seen simply as immune to public policy to improve employment, training and expanded education. A study on rising inequalities in Asia points to the inequality of opportunities in the form of discrimination and social exclusion as the main source of inequality (ADB 2012). Corak (2013) draws attention to the phenomenon of the "The Great Gatsby Curve"—more inequalities arising due to less mobility across generations. In a more polarized labor market like that of the USA, the substantial rise in the income shares of the top 1% will result in access to high quality of human capital investment in their children. The intergenerational transmission of employment and wealth would mean higher rate of transmission of economic advantage to the top and more deeper inequality.

One of the main dimensions of contemporary political economy is the emergence of finance capital and the complex role of finance, property (especially, real estate) and the avoidance of taxation as the drivers of inequality. According to the Organisation for Economic Cooperation and Development (OECD), the off-shore registration of companies in low-tax jurisdictions is estimated to cost $240 billion annually, equivalent to 4–10% of global corporate tax revenue, to the treasuries of G-20 nations (Jones 2017). There is growing evidence that current levels of extreme inequality exceed what can be justified by merit in terms of talent, effort, and risk taking. Jacobs (2015), in a very significant paper that challenges the merit as the source of inequality, reviews several sources of extreme wealth through an analytical framework known as "the ladder of demerit." The six rungs of the ladder from higher to lower—consists of crime, cronyism, inheritance, monopoly, globalization, and technology. The higher rungs are clearly not meritocratic. The lower ones, it is pointed out, reward talented people multiple times what can be justified based on merit. By drawing empirical evidence largely from *Forbe's* list of billionaires, he provides a tentative indication of the relative importance of each rung: "Fifty percent of the world's billionaire wealth is found to be non-meritocratic owing to either inheritance or a high presumption of cronyism. Another 15 percent is not meritocratic owing to presumption of monopoly. All of it is non-meritocratic owing to globalisation. By contrast, crime and technology are found to be negligible sources of extreme wealth" (Jacobs 2015). Monopoly rents from sectors such as telecommunications, air travel, and broadcast frequencies fuel excess returns to owners and shareholders at the expense of the rest of the economy (Jacobs 2015; Oxfam 2017; Oxfam 2018). A study on the sources of wealth in India finds a similar pattern: "Out of India's forty-six billionaires in 2012, twenty had drawn their primary wealth (at least originally) from sectors that can be classified as 'rent thick' (real estate, construction, infrastructure or ports, media, cement, and mining). The remaining twenty six billionaires had drawn their primary wealth from 'other' sectors (IT/software, pharmaceuticals and biotech, finance, liquor and automotives, and so on). Overall, 43% of the total number of billionaires, accounting for 60% billionaires' wealth in India,

had their primary sources of wealth from rent-thick sectors" (Gandhi and Walton 2012).

3.1 Adverse Impact of Inequality

There is growing evidence on the adverse consequences of rising inequality. Some of the early studies like that of Berg and Ostry (2011) provide evidence as to how inequality could undermine growth process and its sustainability. Their findings show that "growth spells" are likely to be shorter in countries with higher inequality, and reduced inequality and sustained growth may thus be two sides of the same coin. Stiglitz (2012) supports these claims by showing that income inequality is associated with unstable economies and unsustainable economic growth. Rajan (2010) argued that the 2008 financial crisis was a consequence of high-economic inequality. His proposition was that as the inequalities increased the U.S. consumers in the lower rungs of income reacted to a decrease in their permanent incomes since the early 1980s by reducing saving and increasing borrowing. The debt-driven consumption demand could not be sustained after a while, resulting in a financial bubble creating the crisis. An extensive review paper of the IMF is devoted to the studies sparked off by these findings (Treeck and Sturn 2012). There have been a number of studies on the impact of inequality on labor markets. For instance in a major collection of studies on labor markets, institutions, and inequality, Berg (2015) shows that between the early 1990s to the early 2010s, except in Latin America and some African countries, inequalities increased in most of the regions, including China and India. Jaumotte and Buitron (2015) report a rise in inequality in labor markets in advanced economies, with particular concentration of incomes at the top of the distribution. During the same period, there was erosion of labor market institutions, decline of unionization, and decline of minimum wages. Interestingly, it is also shown that there exists a strong negative relationship between unionization and top earners' income shares.

Lanker et al. (2019) using data from 164 countries comprising of 97% of the world's population presents a scenario of global poverty from 1981 to 2030. The findings show that declining income inequality is likely to be more effective in reducing poverty than rise in growth rate per se. It also finds that it would be difficult to achieve the Sustainable Development Goal-10 of reducing global poverty to 3% of the population by 2030 without addressing reduction in inequality. UNDP (2013) examining inequality from the perspective of well-being brings out the adverse consequences of growing inequality. It finds inequality undermines development by hindering economic progress, weakening democratic life, and threatening social cohesion. Inequality, it is argued, is not only intrinsically unfair, but it makes achievement of widespread well-being difficult, if we include not only material but also relational and subjective well-being. "Increases in income inequality over the last 20 years have been largely driven by broad globalisation, but domestic policy choices have played an important role too" (UNDP 2013).

4 The Indian Context[3]

If one were to simplify the problem of inequality into two dimensions, viz., inequality of opportunities and inequality of outcomes, perhaps there is no other country in the world other than India which faces the inequality of opportunities as deep, because of its centuries of history of discrimination, and as wide because of its universal spread across all regions of the country. The inequality of opportunities was the primary challenge with which the new Republic of India came into existence in 1950 and the Constitution did engage with the issue and addressed it with the world's first comprehensive provisions of affirmative action. While the progress on the desired lines has been acceptably limited, there exists a system of Directive Principles of State Policy (DPSP) by effective implementation of which could be faced upto a certain extent, if there is political will. The inequality of outcomes was expected to be taken care by the strategy of growth with distributive justice in tandem with DPSP. The available evidence does show that the strategy which was to a large extent the framework for policies and programs, though was not up to the expectations, in spite of relatively low levels of growth did bring down inequality for the first three decades (Reddy 2019). However, with the early winds of liberalization in the 1980s and a complete regime change toward neoliberalism and globalization since early 1990s, there has been unbridled surge in inequalities in income and wealth with exasperating impact on inequality of opportunities as well.

India is one of the very few countries which do not collect information on income through household surveys. And hence it has rightly earned the snide remark that India has entered the digital age without any surveys for collecting income data from households (Chancel and Piketty 2017). For quite some time, consumer expenditure data based on all-India consumer household expenditure by the NSSO served as the proxy for income inequality estimates. But it is well known that consumption expenditure as a proxy for income would be gross underestimation of income especially of the higher income groups. Notwithstanding these limitations, the consumption Gini as a proxy for income did bring about one thing, that is, a tendency for inequality to decline in the pre-liberalization era from mid-1950s (0.35) to mid-1970s (0.30) but started rising later to 0.33 in 1993–94, and further to 0.37 in 2011–12 (Mahendra Dev 2017, Barbosa et al. 2016). In the later period, the consumption expenditure gap between different consumption classes also showed an increase. For instance, the share of top 10% in the total consumption expenditure increased from 27% in 1983 to 33% in 2011–12.

The only other source of household income data is the India Human Development Survey (IHDS)[4] available since 2005. Though IHDS data do not cover the entire country, the sample size is considered fairly large enough to provide indicative measures of distribution of income. The IHDS results showed income inequality of 0.54 Gini in 2004–05, and it further increased to 0.55 by 2011–12. The IHDS data

[3]This section draws partly from the author's joint paper on a larger theme (Haque and Reddy 2019).

[4]IHDS has been jointly organized by researchers from the University of Maryland and the National Council of Applied Economic Research (NCAER), New Delhi.

act as a shock to the comfort with which the consumption expenditure based Gini was used as a proxy to show that inequality in India was very low. Now it is clear that India is in the highest income inequality zone, and the current estimates show that income inequality is the second highest in the world next only to South Africa and some Middle East countries (Milanovic 2016; Alvaredo et al. 2018).

For the estimation of household wealth in India, the only source available as of now is the NSSO decennial All India Debt and Investment Survey (AIDIS). However, there are some measurement issues, comparability problems, under-reporting of wealth, under-sampling of the super-rich, etc., which point to the limitation of the data (Jayaraj and Subramanian 2006; Anand and Thampi 2016). Yet the data do help in capturing the broad trends, and the datasets are put to extensive analysis of inequalities of not only of wealth but also income over a period across different social groups and urban–rural areas (Anand and Thampi 2016; Vamsi 2010). The AIDIS data on wealth reveal that the level of inequality which was already at a very high level (Gini 0.65) by mid-1990s, has steeply increased since the middle of the first decade of 2000s to reach the extreme level of 0.74. The wealth shifts have been increasingly toward upper deciles: "Considering wealth inequality by deciles revealed that only the topmost decile increased its share in asset ownership after 2002… this trend of wealth consolidation has worsened since then, and narrowed to the top 10% and perhaps even lower; by 2012, the top 5% alone owned half of the wealth" (Anand and Thampi 2016). This is corroborated by the other sources, such as Forbes' Indian Rich lists, according to which the wealth of the richest Indians that it reported amounted to "less than 2% of national income in the 1990s, but increased substantially throughout the 2000s, reaching 10% in 2015, and with a peak of 27% before the 2008–09 financial crisis" (Chancel and Piketty 2017). A more interesting and revealing aspect is the demystification of the notion of talent and risks that are widely propagated as the sources of high income and wealth. As pointed out earlier, out of India's 46 billionaires in 2012, 20 had drawn their primary source of wealth (at least originally) from sectors that can be classified as "rent-thick" (real estate, construction, infrastructure or ports sectors, media, cement, and mining) (Gandhi and Walton 2012).

The major breakthrough in the analysis of inequality comes from Piketty's pioneering efforts along the path set by Kuznets in utilizing innovative sources of data and simplified methods of presentation of the results. In the case of India, income tax data since 1922,[5] the NSSO consumption expenditure survey data, the National Accounts data, the IHDS income, and consumption data and the UN statistics population data are utilized to estimate the levels and trends in income inequality (Chancel and Piketty 2017; Alvaredo et al. 2018). The data enable long-term analysis right from 1922 to 2013–14, and bring as to what difference that a regulatory regime of growth with distributive justice in the prereform period could make compared with the neoliberal regime with the market forces and private profit seeking as the main driving forces of growth. Table 1 shows that there was actually an increase in the share of bottom 50% of the adult population in the national income from 19% to 24% in the first three decades from mid-1950s to mid-1980s. And the middle-income group

[5]In India, income tax was introduced in 1922.

Table 1 Changes in income of different classes as a share of GDP (%) in India

Income Group	Mid-1980s	1982–83	2000	2013–14
Top 10%	40	30	40	55
Middle 40%	40	46	40	29.6
Bottom 50%	19	23.6	20.6	14.9

Table 2 Share of different groups in the total national income generated in India: before and after liberalization (in percentages)

Income group	Before Liberalization 1951–1980	After Liberalization 1980–2014
All	100	100
Top 10%	24	66
Middle 40%	49	23
Bottom 50%	28	11

Source Chancel and Piketty 2017

too experienced an increase in the share while the share of the top 10% declined from 40% to 30%. But the trend was completely reversed since mid-1980s with all the increase in the income moving up to the rich top 10% while rest of the population experienced sharp decline in the share especially since the early 2000s.

Table 2 captures the growing inequality of incomes during the three decades under the neoliberal regime compared with the three decades of the prereform period. What is striking is that not only that all the rise in income was shifting to the top 10% or the steep decline in the share of the middle class from about one-half of the national income in the first 30 years to less than one-fourth in the later period. The classification of ‘middle 40%’ includes a substantial proportion of ‘lower middle class’ and a thin section of a relatively a rich urban middle class that enjoyed the benefits of the globalization. Thus, it is a clear phenomenon of “hollowing out” of the substantial section of the middle class as well. It is widely believed that it is the middle income group that helps to boost the demand and sustain economic growth. It would be interesting to see how the middle-income group is faring in China in comparison with India. Table 3 shows the pace of growth of the adult per capita income of different income groups and their respective shares in the total income generated during the period between 1980 and 2014 in India and China. China’s overall per capita income during the period was three to four times higher is not surprising. But the cause for concern is that top 10% India has been appropriating two-thirds of the total income, leaving only one-third to the rest of the 90% comprising middle- and bottom-income groups, which certainly a case of extreme inequality in income distribution, while the China’s story seems to the reserve with the top 10% getting less than one-third of the total income generated during the period. What is significant is that in China the middle 40% could get a share of 43% which is a substantial support for sustained demand and growth, while India’s middle group ends with 23% which poses a serious question on the possibility of future sustained growth.

Table 3 Adult Per Capita Income Growth and the Share Captured from the Growth of Income: 1980–2014 in India and China (in percentages)

Income Group	Growth of Income		Share Captured From Growth of Income	
	India	China	India	China
Entire adult population (100%)	187	659	100	100
Top 10%	394	1074	66	29
Middle 40%	93	615	23	43
Bottom 50%	89	312	11	13

Source Chancel and Piketty (2017) and Alvaredo et al. (2018)

In spite of the methodological improvements by way of accessing innovative sources of data and novel ways of analysis, the unraveling of the social dimensions of inequality of outcomes and opportunities in India still remains relatively little explored. Though the AIDIS data provide certain broad trends on the social dimensions of inequality of consumption expenditure and to an extent wealth, the income dimension remains a dark area. Neither income tax data nor National Accounts could help in this regard. Collection of the comprehensive income data either as a part of the present NSSO surveys or through separate explicitly designed surveys becomes an urgent imperative for deeper understanding of the nature of inequality in India.

In recent years, there has been increasing number of studies on inequality in India. There are special issues of journals, and focused thematic reports with a comprehensive collection of studies, like, for example, *India Social Development Report 2018* with a theme "Rising Inequalities in India," (Haque and Reddy 2019). The complexity and the spread of deep rootedness of the nature of inequalities in India could be seen from the evidences brought as attempted to bring together in this report, in terms of differences by gender, interstate and intrastate, rural–urban, agricultural—nonagricultural, intra-agricultural and in access to employment, education and health facilities. And yet there is no resonance of the concern among the people and politics. There appears to be persistence of a false hope that adding a prefix "inclusive" to each program and depicting every decimal increase in growth rates as development could carry the day. There is still obstinate resistance to recognize the deep damage the growing inequality does to the social fabric of the country, and hence hardly any effort to face it head-on. The Government of India's performance in terms of efforts at reducing inequality could best be summed up in the following observation: "In 2015, the leaders of 193 governments promised to reduce inequality as part of the Sustainable Development Goals (SDGs). Without reducing inequality, meeting the SDG to eliminate poverty will be impossible. Now Development Finance International and Oxfam have produced the first index to measure the commitment of governments to reducing the gap between the rich and the poor. The index is based on a new database of indicators, covering 152 countries, which measures government action on social spending, tax and labour rights—three areas found to be critical to reducing the gap. This preliminary version of the Commitment

to Reducing Inequality (CRI) Index finds that 112 of the 152 countries surveyed are doing less than half of what they could to tackle inequality. *Countries such as India and Nigeria do very badly overall*, and among rich countries, the USA does very badly. At the same time, countries such as Sweden, Chile, Namibia and Uruguay have taken strong steps to reduce inequality" (Oxfam 2017, emphasis added).

The dualistic nature of Indian society, perpetuated by the neglect of Dalits, Adivasis, and ethnic minorities, inequality in the distribution of education and health care and lack of these facilities in rural areas where the poor are concentrated, disguised unemployment, and low-labor productivity in agriculture, high incidence of open unemployment in urban areas, slow pace of growth of rural infrastructure and nonfarm activities, and above all inappropriate choices of investment, technology and policies come in the way of balanced and egalitarian social and economic development. Besides, the major challenge is the income and wealth inequalities that have been surging at an unprecedented pace. Unless India's policymakers come to grips with these problems, there will continue to be large pockets of poverty, high degree of economic inequality as well as continued marginalization of some social and ethnic groups. Political inequality among various social groups may further accentuate the problem, because unequal distribution of control over resources and of political influence would perpetuate institutions that protect the interests of the most powerful, to the detriment of the have-nots.

5 Policy Perspectives

Ever since the notion that inequality is only a transitory phenomenon and that it would wither away with growth and development is challenged, there has been a range of measures that have been commended as a part of the policy interventions, including policy shift that would envisage more space for state in the affairs of the economy. Fiscal policy assumes highest priority, followed by strengthening of labor market institutions. And of course, a kind of precondition for their effectiveness is social and political mobilization and a broad consensus against inequality. The fiscal measures suggested to reverse the growing inequality range from steeply progressive income taxation, taxes on wealth and estate duties, increased public expenditure on social goods such as education and health, fiscal transfers such as universal social security, basic income transfers, and so on (Piketty 2014; Baker 2014; IMF 2017a; Milanovic 2017; Oxfam 2018).

A study of the impact of tax and expenditure policies with a sample of 150 countries for the period between 1970 and 2009 (Martinez-Vazquez et al. 2012) shows that progressive personal income taxes and corporate taxes reduce income inequality. But it also found that the impact of corporate taxes eroded in open globalized economies. Interestingly, with the entrenchment of neoliberalism between 1990 and 2009, the net effect of tax policies was to increase inequality by 1.53 points of Gini, but it was moderated by political compulsions of welfare expenditure policies

that brought a decrease of inequality by 0.97 of the Gini. However, with the background of decades of fiscal policies that prioritized fiscal consolidation at the expense of social expenditure and progressive taxation, the shift to progressive fiscal policy becomes challenging (UNDP 2013). There have been steep cuts in corporate taxation in the name of making domestic economies attractive for capital. Globally, average corporate tax rates were reduced by almost half from 49% in 1985 to 24% in 2019. For instance, in recent years, corporate tax in India has been reduced from 35 to 25%. Further, there has been a steep decline in income tax rates and tax burden (Shetty 2018). Since 1960s, countries that witnessed largest reductions in marginal income tax rates are also (like USA, UK) countries that have experienced the largest increase in top incomes, but there is no evidence that reduced tax rates increased growth rates. Interestingly, it shows that high-income earners respond to lower top tax rates, not by increasing productive work effort as pointed by the standard supply-side story but instead by finding ways to extract a larger share of economic pie at the expense of others in the economy (Saez 2017). In India, the marginal rates of income tax which reached a peak of over 75% in the early 1970s declined to about 60% by 1990, and since then it has been reduced down to 33% which is much lower than that of most of the developed countries.

There are two major challenges to the shift toward more progressive taxation measures to reverse the process of growing inequality. One is the need for political commitment to overcome the resistances to bringing back progressive income taxation from the present comfort of the rich which is used to the neoliberal low tax regimes. The second is an innovative restructuring of the entire income tax system that internalizes the emerging knowledge on the sources of inequality, which means a progressive tax system that differentiates "earned income" from "unearned income" or "rents," that which recognizes the role of inheritances in aggravating inequality, that which responds to the need for plugging the loopholes in the international tax system in which MNEs operate, and that which is designed with appropriate institutional mechanisms, both at the national and international levels to negotiate and implement the shift.

As pointed out earlier, the present research on sources of inequality has also thrown up new thinking on the concept of "income" and "wealth" and to differentiate "income" and "wealth" by their source for treatment of regulation as well as taxation. There is growing consensus that income from labor and income from capital should be differentiated and taxed differently. With the exception of the salaries and bonuses of employees like investment managers, most of the income from wages and salaries should be treated as "earned income" and subjected to relatively less steep rates of income tax. Most of the earnings from capital, with some exceptions, should be treated as "unearned" income and subjected to steeply progressive taxation. It is argued that major unearned income in the form of rents stem from government interventions in the economy that have the effect of redistributing income upward. The sources of such rental income would include financial sector, monopolies in pharmaceuticals, telecommunications, etc. Taxing these sources (rents) would act to an extent in reversing upward redistribution of income (Baker 2014). Stiglitz (2015) differentiates returns to capital into four types, viz., pure rate of interest, returns to

risks like capital market speculation, excessive remuneration to the positions like investment managers, and rents arising from monopoly power and suggests steeply progressive taxation on such capital incomes. He also suggests that high levels of taxes on land (real estate) and capital gains on land would also reduce inequality by encouraging more investment into real economy and enhance growth. Atkinson (2015), based on his life-long experience in the study of inequality, made 15 comprehensive proposals toward public policy that would contain inequality. One that is of far-reaching significance is in terms of differential treatment of earned and unearned income. He suggested "Earned Income Discount," once the income is differentiated into "earned income," "capital gains," "interest," and "profit" for tax purposes. In effect, it would mean progressively steeper taxes with the increasing element of "unearned" nature in income.

One of the major proposals that is gaining wider support relates to inheritance and wealth taxes (Stiglitz 2015; Saez 2017; Atkinson 2015; The Economist 2017). Globally, there is a kind of paradox relating to inheritance tax policy. Even as the role of inheritances is seen as the increasing source of inequality of wealth, and consequently earning the epithete for the present capitalism as "patrimonial capitalism," there has been growing resistance to inheritance taxes in most of the countries. Except in Japan, there is decline in inheritance taxes, even as inheritances are increasing. For instance, flow of inheritances has tripled in France since 1950s, and among Europe's billionaires' half have inherited their wealth. And this proportion is rising. In OECD countries, share of inheritance taxes in public revenue declined from about 1% in 1960s to less than 0.5% presently. Many countries including India, Norway, Australia, Canada and Russia abolished inheritance tax, and (it is scheduled to go in USA by 2015) in the US (The Economist 2017). After a survey of the state of inheritance taxes across countries, The Economist (2017) concludes: "A fair and efficient tax system would seek to include inheritance taxes, not eliminate them." Atkinson (2015) suggested broader tax on wealth differentiated by source, namely, inheritance, gifts, and property with differential tax rates.

6 Inequality and Reforms in International Tax System

One of the major sources of tax revenue loss to both developed and developing countries is the international tax system, which enables the multinational enterprises to shift their profits from the countries where they earn to locations widely known as off-shore "tax havens" with low tax or hardly any tax. The evolution of tax havens has been made possible by the "arm's length" principles of international corporate tax system laid down under League of Nations almost a century ago. This system treats multinational enterprises as loosely connected "separate entities." This, it is by now, well known is a fiction. Multinationals with a wide network of their affiliates that are tightly connected by the present hyper technology of communications draw great strength by their "unitary" nature. But use this so-called "arms length" separate entity fiction to shift profits from their affiliates operating in high-tax locations to their

affiliates in low-tax locations, causing enormous corporate tax losses to countries where the economic activity is actually carried out. There are varying estimates of tax losses caused to countries by the multinational enterprises under the facility of tax havens. These range from $500 billion to $600 billion a year, of which the share of the low-income countries could be as high as $200 billion (Shaxson 2019). Besides corporates, rich individuals also take advantage of tax havens where they could stash their illicit fortunes.

Though there have been growing reports of the corporate tax losses through the system of multinational enterprises being treated as "separate entities" not much concerted action was taken against it for a long time. But since 2008, financial crisis the world has woken up to the fact that tax losses though tax havens have been huge and required global action. The result has been several initiatives. One is the Common Reporting Standard (CRS), initiated by the OECD. This is a regime to exchange financial information automatically across the countries so as to help tax authorities track offshore holdings of their taxpayers. Though there are limitations, it is reported that by July 2019, the CRS enabled sharing of tax information by 90 countries on 47 million accounts with about 20–25% of tax haven deposits which also resulted in voluntary disclosures that yielded $95 billion additional tax revenues to OECD and the Group of 20, which includes India. The second initiative of OECD was the "base erosion and profit sharing" (BEPS) project, to realign taxation with economic substance. But it failed because it was within the old principle of "arm's length" that treats multinational enterprise affiliates as separate entities. The Independent Commission for the Reform of International Corporate Taxation (ICRICT), which includes scholars and tax experts, including Piketty and Stiglitz, has proposed an alternative to the failing BEPS system. The proposal is based on the fact that multinationals (MNCs) are groups of entities that are under a single management control and have a single set of owners and should therefore be taxed as "unitary firms." A unitary approach would mean apportioning MNC's global profits to different countries on the economic basis of their share in the combined global production and sales. The ICRICT proposed "unitary tax with formulary apportionment" (ICRICT 2019; Ocampo 2019), and it is considered as simpler, fairer, and more rational than the current system (Shaxson 2019). There has been wider support for change in the existing system. In March 2019, the then IMF Chief, Christine Lagarde called the "arms' length" principle "outdated" and "especially harmful to low-income countries." She urged "fundamental rethink" and move toward formula-based approach to allocate income for corporate taxation (Lagarde 2019). Hope is that change would come and help countries for better action against growing inequality through growing international pressure. The other dimension is the regular intervention of financial flows much of which hunts speculative profits from stock markets. There has been a revival of the demand for "Tobin Tax" or financial transactions tax like the one in force in countries like Japan (Piketty 2014; Baker 2014).

The other side of fiscal policy in addressing inequality relates to the public expenditure policy. The extent of fiscal redistribution as a corrective to inequality, besides progressive direct taxes, would depend on the "in-kind transfer spending (such as education and health), which can reduce the inequality of "full income" (that is

disposable income adjusted for in-kind transfers). "In-kind transfers such as those for education and health also affect market income inequality over time by changing the distribution of human capital, including across generations by promoting social mobility" (IMF 2017a, p. 6). There is growing evidence on the relationship between expenditure on education and health and reduced inequality. A study of 13 developing countries shows that "spending on education and health lowers inequality and its marginal contribution to the overall decline in inequality is, on average, 69 percent" (Lustig 2015). There are other studies on the relationship between income inequality and education expansion. Educational expansion would reduce educational inequalities which in turn put strong downward pressure on income inequality (IMF 2017a, p. 9). Public expenditure toward achieving nationally appropriate social protection systems for all (ILO 2017) would also be a critical part of mitigating inequality.

7 Beyond Fiscal Policy

Atkinson, while strongly supporting the role of fiscal policy believes that reduced inequality cannot be achieved solely through fiscal measures (Atkinson 2015). Emphasizing the need for moving beyond tax and transfer instruments, Atkinson pleads for a radical policy to reduce inequality that engages the whole of government, would include, besides taxation, technology, employment, wages, and social security that would have an impact in reducing inequality. Though these proposals are made with specific reference to UK, these have wider policy relevance to most of the developed as well as developing countries. Atkinson argues that the direction of technological change need not be assumed as being entirely exogenous but could be subjected to policy control. Hence it should be the explicit concern of policymakers to invest in publicly funded research toward innovations in technology that would lead to employability of workers and take into consideration the human dimension of service provision. Since in a market economy, the balance of power is weighed against consumers and workers, the role of trade unions should be reinforced by founding a Social and Economic Council involving all the social partners. There should be a national pay policy consisting of two elements: a statutory minimum wage set at a living wage and a code of practice for pay above minimum wage, agreed as a part of "national conversation" involving the Social and Economic Council. The employment policy should aim at reduced unemployment and guarantee public employment at minimum wages for those who seek it. Social security measures should be strengthened and child benefit should be paid to all children. Atkinson was optimistic that these proposals are eminently doable within the capitalist system.

While the emerging fiscal and other policy measures provide a concrete basis to move toward mitigating inequalities, and achieving fair and inclusive growth, in countries like India the equally challenging task is to engage with deep-rooted inequality of opportunities because of centuries of history of widely prevalent social discrimination. Reducing horizontal inequalities, tackling social inclusion and ensuring equity in access to opportunities will further require strengthening the agency, voice and

political participation of groups that experience disadvantage on account of their identity (UNDP 2013). Finally, the discussion of the policy strategies would be incomplete and end up as mere aspirational without any promise of its practical prospects, if we do not find any answers to the following questions: Is the social and political mobilization against inequality, and in favor of the shift in policy agenda possible in the face of present entrenched neoliberalism? Are there any recent instances of public intervention reversing the rising trend in inequality and moving toward more inclusive development?

For these questions, we do get fairly clear answers from the economic and political developments of one region in the world, i.e., Latin America. Roberts (2012) in his very illuminating study of politics of inequality and redistribution in Latin America provides a graphic picture of the developments with the neoliberal entrenchment in the last two decades of the twentieth century (1980s and 1990s) and the developments in the "post-adjustment" period (2002–2010). He calls the earlier period, 1980s and 1990s, as a period of "dual transitions" to political democracy and to market liberalization, and the latter period, 2000–2010, as the period of "repoliticisation of inequality" and redistribution. In the first period, there was an electoral turn in most of the political groups including left, and toward democratic governments but with political hegemonies. On the economic front, there was almost obsessive liberalization of trade, investment, and financial markets. The process of international integration was near complete (Maia 2014). There was privatization of public enterprises, shift in employment from formal to informal (UNCTAD 2011). By 1990s, 85% of job growth was informal in nature. There was increasing labor market segmentation, weakening of unions with sharp decline in trade union density. Labor market reforms were more towards flexibility, and health care increasingly shifted from state to private. There was welfare interventions first in the form of poverty relief and later in the form of conditional cash transfer to keep children in school. Marketization had demobilizing effect on collective activity despite democracy (Bellinger et al. 2011).

Economic downturn at the end of the twentieth century paved the way for political mobilization and leftist electoral victories since 1998. Between 1998 and 2011, there were leftist presidents in 11 different countries accounting for two-thirds of Latin American population. The "left" turn appears to be with a kind of Latin American characteristics: "…Latin America did not turn left politically because more people came to identify as leftist; it turned left because many citizens who did not identify themselves as leftist nevertheless began to vote for leftist candidates and parties" (Roberts 2012, p. 10). Another characteristic that was typical of Latin America was, in spite of neoliberal policies, citizens' emphasis was on state, and LA remained statist and there was strong support for state in enterprise ownership, job creation, health care, and citizen welfare. In the later period, social mobilization resulted in building up support for social democratic parties. Indigenous groups developed collective strength to militate for change, celebrating indigenity, developing horizontal identities, and foreign alliances across desperate ethnic groups. Evans (2017) observes that "inequalities increased if poor people internalize stigmatized identities, but through association and exposure to egalitarian discourses, people may revise

their self perception and believe they deserved dignity.” The revival of social mobilization from below and mass protest helped “repoliticize” inequality, “politicize” social deficits and bring redistributive policies to central place on the political agenda (Roberts 2012). The result was equity gains both under conservative governments as well as leftist ones. The positive trend toward reduced inequalities, and secure and better conditions of living for workers were witness across the region. LA that had high levels of inequality of per capita incomes experienced a declining trend from a Gini of 0.55 in 2000 to 0.496 in 2012, largely due to longer years of schooling, larger and more progressive transfer payments ranging from 17 to 21% of GDP, lower dependency ratio, and higher work participation rates especially of women (Lustig et al. 2015). Latin American experience of inequality reduction through progressive policy turn brings to the fore the role of social movements and ideational shifts. As Alice Evans (2017) hopes, publicizing Latin American collective success (during 2000–2010) in reducing inequality might embolden campaigns elsewhere for a movement against growing inequalities. Hopefully, these could be lessons for countries like India as well.

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