A Picture of Inequality*

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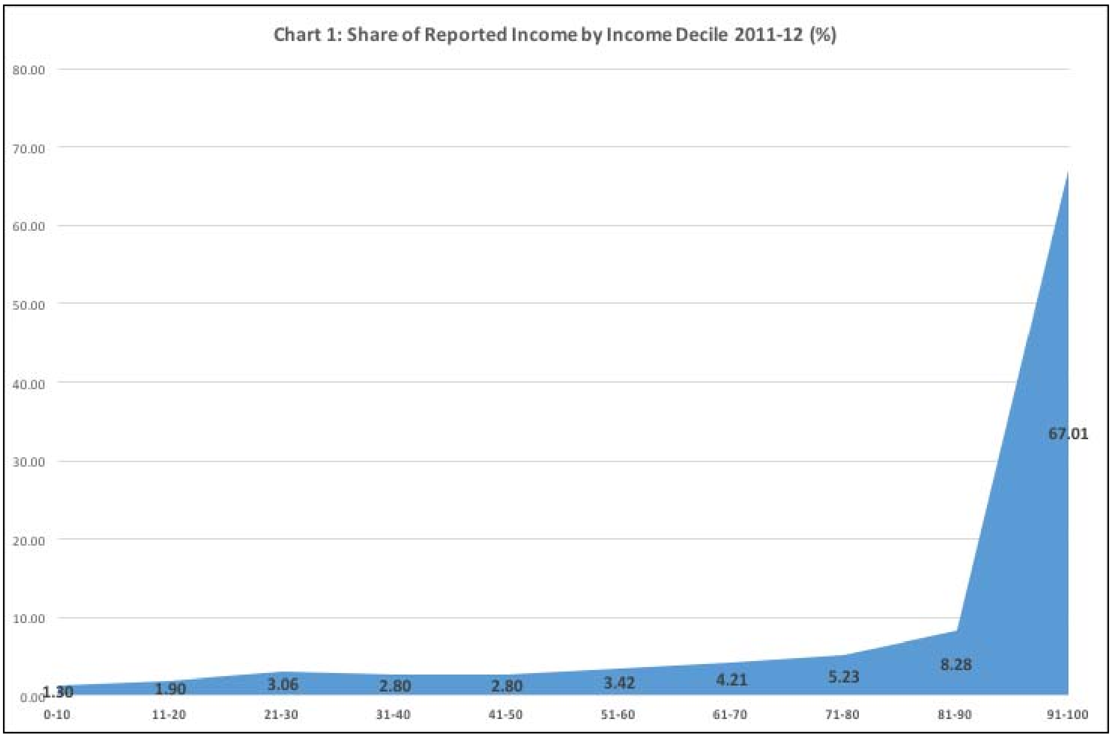
In a hesitant and partial step towards transparency the government of India has (after a long gap) released some information from past returns submitted by the country's tax payers. However, information on the distribution of aggregate income across tax payers in different size classes of reported income has been provided only for one year: 2011-12 (Assessment Year 2012-13). While this precludes an assessment of recent trends in inequality over time within the tax-paying population, it provides a point-of-time, photographic picture of such inequality for a recent year.

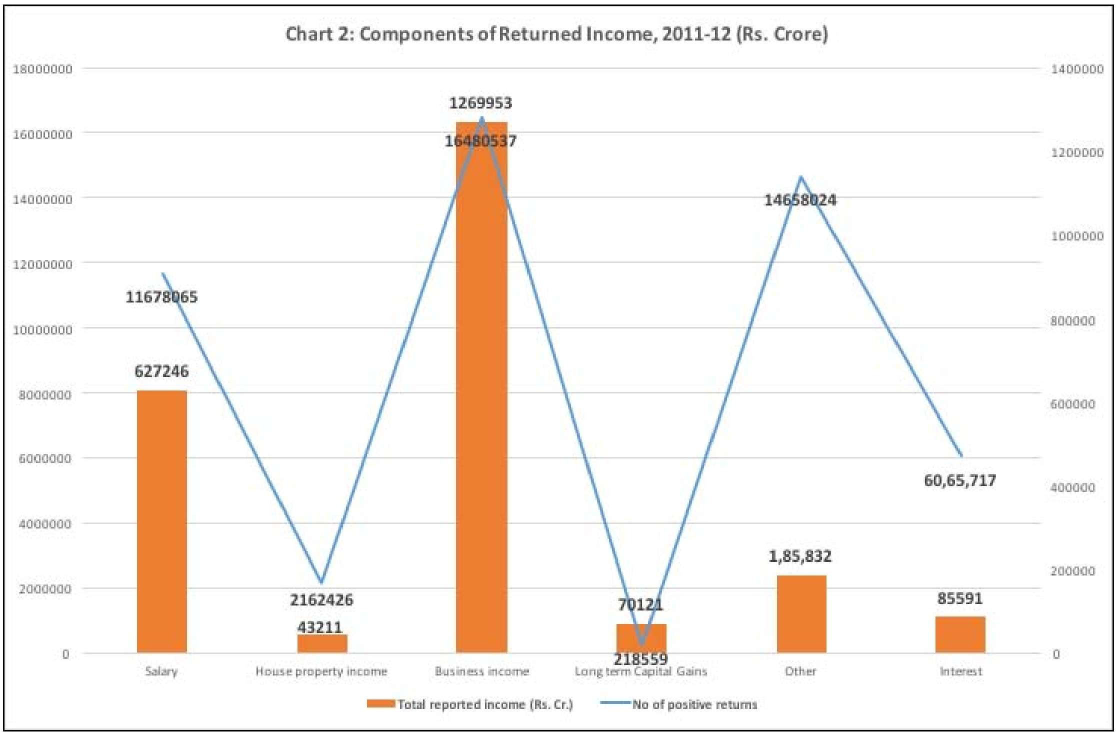
This is of some significance because, thus far, estimates of inequality have been restricted to measures of inequality in consumption based on the quinquennial large surveys of the National Sample Survey Organisation (NSSO). Such measures obviously underestimate inequality because saving, which is largely by the rich, is not covered. Moreover, coverage of consumption of the upper income groups in the NSS surveys is known to be unsatisfactory. So these surveys are considered useful for estimating the incidence of poverty, but not for measuring inequality. Hence, even the partial release of tax data is a step forward.



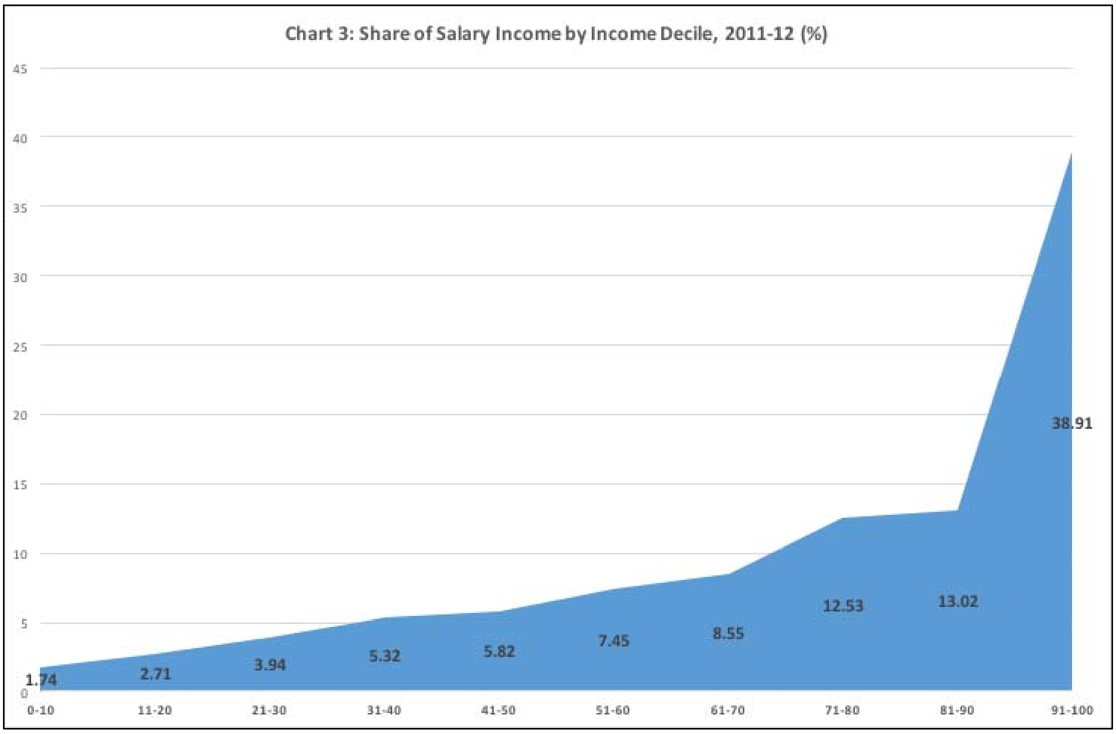
Tax returns provide only a small sample on the basis of which to assess inequality. The total number of returns reporting positive incomes for 2011-12 was 3.04 crore or around 2.5 per cent of the total population and 6.4 per cent of the workforce. What is being captured, therefore, is the extent of inequality within this section of the population. However, given the fact that a substantial proportion of those outside the tax net would be earning incomes lower than that earned by the less well-to-do among the tax payers, and that there are those who evade or avoid the tax net, inequality estimates based on tax return data would underestimate overall income inequality.

What is striking about the data is the high degree of inequality in incomes among the tax paying population. The top 10 per cent of income earners among those paying taxes get 67 per cent of the total income earned by taxpayers (Chart 1). On the other hand, the bottom 50 per cent account for just 11.9 per cent of aggregate income. This is indeed a very high level of inequality even by global standards. Thus, according to Thomas Piketty, on the eve of World War I when inequality had touched a high, the top decile's share of national income was around 45-50 per cent in Europe and just above 40 per cent in the United States. That is far below the figure we get for India in 2011-12. In the Indian case, Piketty's figures suggest that in the most egalitarian phases during the period 1910-1950 the top 1 per cent earned between 15 and 18 per cent of aggregate income in India. Going by the tax figures alone the top 1 per cent of income earners garnered as much as 32 per cent of total incomes in 2011-12. If true, that points to a significant increase in income inequality.

The sources of income for which disaggregated information is available include Salary income, Income from house property, Business income, Income from Long Term Capital Gains, Interest, and Other income. What is noteworthy is that those reporting Salary and Business incomes overwhelmingly dominate the income tax paying population. Salary income earners accounted for 22.8 per cent of returns submitted in assessment year 2012-13 and 27.5 per cent of the incomes reported for 2011-12 (Chart 2). The corresponding figures for those reporting business incomes were 32.1 and 55.7 respectively. Thus, around 55 per cent of tax payers were in these two categories, accounting for as much as 83 per cent of reported income. What is striking is that despite financial liberalisation, rentier income, either from house property or from financial activity is only marginally captured in the tax net.

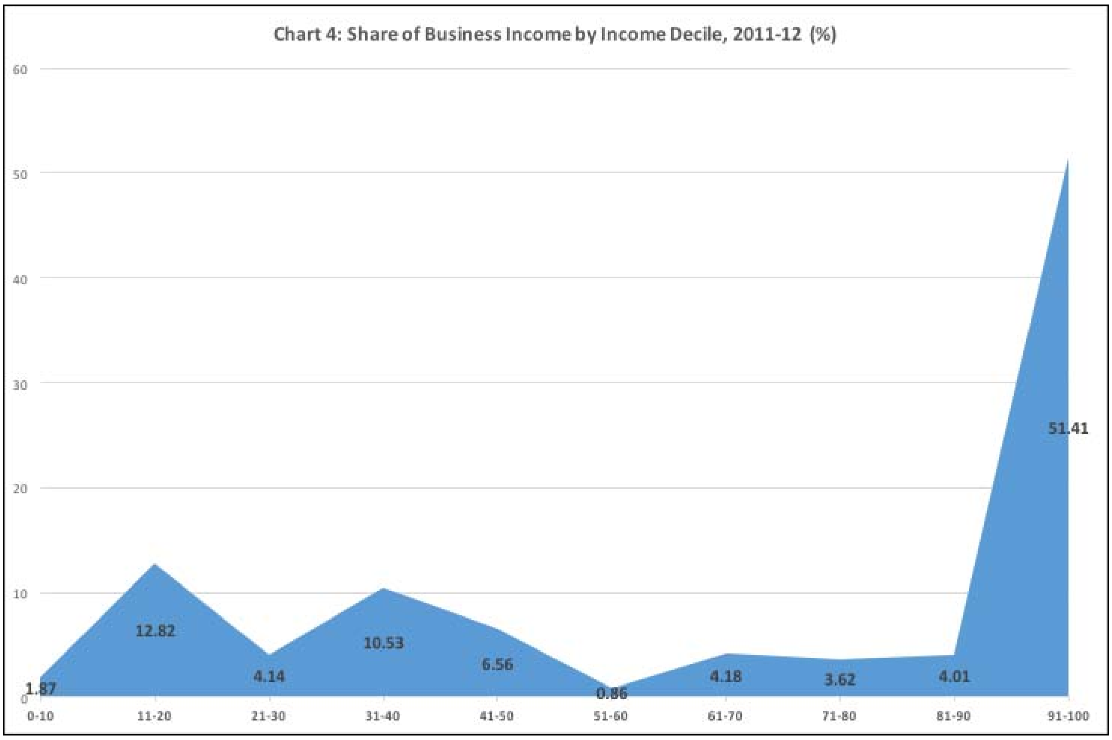


As is to be expected, the degree of inequality in the distribution of salary income is less than that in business income. However, inequality is high even among salary income earners. The top 10 per cent among them account for 39 per cent of total salary income, and the top 20 per cent for as much as 52 per cent (Chart 3). Adding on another 10 per cent at the top, we find that 30 per cent of salary earners account for almost two-third of total salary incomes.



As compared with this business incomes are concentrated largely among the top earners. The top decile among those reporting business incomes account for 51 per cent of total business income (Chart 4). If we take account of the fact that a range of tax concessions result in far greater divergence between actual and taxable incomes for this category of income earners, then the extent of inequality here is likely to be even more than visible in the figures.

To summarise, to the extent that the recently released evidence serves as a barometer, income inequality in India seems to be extreme. Inequality is high in both salary and business incomes, though the latter seems to be the principal determinant of overall inequality. Moreover, rentier income seems to avoid or evade the tax net, as suggested by its marginal presence in aggregate taxable income and contribution to aggregate tax revenues. The resulting degree of overall inequality seems incongruous, given India's decision to adopt parliamentary democracy as its framework for political and social governance.



The absence of time series data does not allow us to arrive at any conclusions on trends in inequality. However, because of adjustments to the structure of income tax rates and the processes of deregulation in the financial and real sectors since 1991, and the rather unusual growth trajectory that India experienced during 2003 to 2011, it is likely that inequality worsened significantly during those years.

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