

theirview

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## The insecurity of inequality

In our globalized world, inequality cannot be left to markets and local communities to solve any more than climate change can

Global inequality today is at a level last seen in the late 19th century—and it is continuing to rise. With it has come a surging sense of disenfranchisement that has fuelled alienation and anger, and even bred nationalism and xenophobia. As people struggle to hold on to their shrinking share of the pie, their anxiety has created a political opening for opportunistic populists, shaking the world order in the process.

The gap between rich and poor nowadays is mind-boggling. Oxfam has observed that the world's eight richest people now own as much wealth as the poorest 3.6 billion. As US senator Bernie Sanders recently pointed out, the Walton family, which owns Walmart, now owns more wealth than the bottom 42% of the US population.

I can offer my own jarring comparison. Using Credit Suisse's wealth database, I found that the total wealth of the world's three richest people exceeds that of all the people in three countries—Angola, Burkina Faso and the Democratic Republic of Congo—which together have a population of 122 million.

To be sure, great progress on reducing extreme poverty—defined as consumption of less than \$1.90 per day—has been achieved in recent decades. In 1981, 42% of the world's population lived in extreme poverty. By 2013—the last year for which we have comprehensive data—that share had dropped to below 11%. Piecemeal evidence suggests that extreme poverty now stands at just above 9%.

That is certainly something to celebrate. But our work is far from finished. And, contrary to popular belief, that work must not be confined to the developing world.

As Angus Deaton recently pointed out, extreme poverty remains a serious problem in rich countries too. "Several million Americans—black, white and Hispanic—now live in households with per capita income of less than \$2 per day," he points out. Given the much higher cost of living (including shelter), he notes, such an income can pose an even greater challenge in a country like the US than it does in, say, India.

This constraint is apparent in New York City, where the number of known homeless people has risen from 31,000 in 2002 to 63,000 today (the true figure, including those who have never used shelters, is about 5% higher). This trend has coincided with a steep rise in the price of housing: Over the last decade, rents have been rising more than three times as fast as wages.

Ironically, the wealthy pay less, per unit, for many goods and services. A stark example is flying. Thanks to frequent flyer programmes, wealthy travellers pay less for each mile they fly. While this makes sense for airlines, which want to foster loyalty among frequent flyers, it represents yet another way in which wealth is rewarded in the marketplace.

This phenomenon is also apparent in poor economies. A study of Indian villages showed that the poor face systematic price discrimination, exacerbating inequality. In fact, correcting for differences in prices paid by the rich and the poor improves the Gini coefficient (a common measure of inequality) by 12-23%.

The better-off also get a whole host of goods for free. To name one seemingly trivial example, I can't remember when I last bought a pen. They often simply appear on my desk, unintentionally left behind by people who stopped by my office. They vanish just as often, as people inadvertently pick them up.

A non-trivial example is taxation. Rather than paying the most in taxes, the wealthiest people are often able to take advantage of loopholes and deductions that are not available to those earning less. Without having to break any rules, the wealthy receive what amount to subsidies, which would have a far larger positive impact if they were allocated to the poorest people.

Beyond these concrete inequities, there are less obvious—but equally damaging—imbalances. In any situation where, legally, one's rights are not

enforced or even specified, the outcome will probably depend on custom, which is heavily skewed in favour of the rich. Wealthy citizens can not only vote; they can influence elections through donations and other means. In this sense, excessive wealth inequality can undermine democracy.

Of course, in any well-run economy, a certain amount of inequality is inevitable and even needed, to create incentives and power the economy. But, nowadays, disparities of income and wealth have become so extreme and entrenched that they cross generations, with family wealth and inheritance having a far greater impact on one's economic prospects than talent and hard work. And it works both ways: Just as children from wealthy families are more likely to be wealthy in adulthood, children of, say, former child labourers are more likely to work during their childhood.

None of this is any individual's fault. Many wealthy citizens have contributed to society and played by the rules. The problem is that the rules are often skewed in their favour. In other words, income inequality stems from systemic flaws.

In our globalized world, inequality cannot be left to markets and local communities to solve any more than climate change can. As the consequences of rising domestic inequality feed through to geopolitics, eroding stability, the need to devise new rules, redistribution systems, and even global agreements is no longer a matter of morals; increasingly, it is a matter of survival.

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## A brief history of time

The sun will eventually run out of fuel, ending time and space as we know it, but hopefully not for extraterrestrial émigrés

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In an era where humans are overloaded with information 24x7, if a reasonably informed member of the species were to encapsulate our history in a thousand words to a pen pal in another world, it might consist of about a dozen major epochs as follows:

Our understanding is that Time began with the Big Bang and the origin of the Universe about 13.77 +/- 0.059 billion years ago. Time was measured in nano seconds. We don't know why and how this happened and whether this was a one-off event. From the beginning of time, the universe began expanding, forming stars, galaxies, solar systems and planets, including our own. Oceans and continents were formed, triggering continental drift and plate tectonics.

Life on Earth is estimated to have originated over four billion years ago in the oceans. Again, nobody has a clue as to why and how this happened, whether this was endogenous or seeded from extraterrestrial sources. Living matter was measured at the molecular and subcellular level till about 1.5 billion years ago.

The Golden Age of Evolution saw the multiplication and global expansion of animal, plant and insect species from the original unicellular organism through reproductive processes, sexual differentiation and speciation, with amphibious creatures making the first crossing over to land.

The Reptilian (Limbic Brain) Revolution, marked by the emergence of complex motor movements, occurred around 300 million years ago. The Golden Age of Reptiles lasted till the end of dinosaurs around 64 million years ago.

The Mammalian (Emoting Brain) Revolution occurred some 200 million years ago, culminating in the emergence of frugivorous, brachiating ape-like creatures around five million years ago.

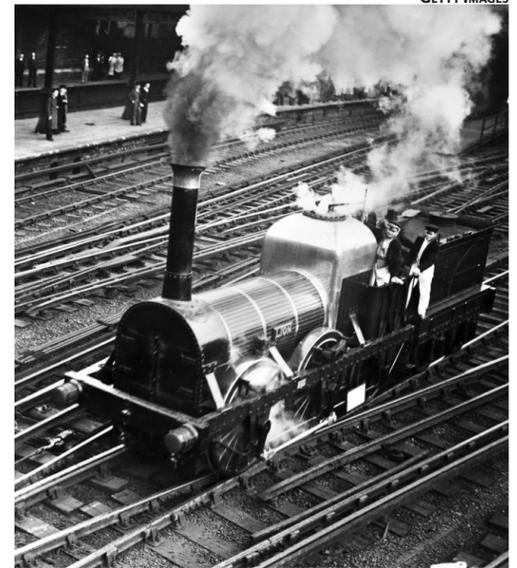
The Homo Sapiens (Bipedal and Neocortex) Hunting Revolution culminated in the emergence of modern humans around 200,000 years ago. With humans came logical and self-conscious thought, the capacity for good and evil, and complex interpersonal communication that put them at the top of the food chain as peripatetic hunter-gatherers, albeit at very low densities. This was aided by the controlled use of fire, fabricated tools and the domestication of the wolf into the modern dog.

The climate on our planet has seen sharp fluctuations. The end of the last Ice Age around 10,000 BC marked the global expansion of humans and the Neolithic Revolution. With agriculture and domestication of farm animals came permanent settlements, a surge in human population through demographic cycles of high birth rates punctuated by catastrophic events, and the emergence of complex cooperative forms of social organization, and trade and exchange through barter.

Proto-historic civilizations began with villages, populous riverine urban settlements, grand public monuments, complex hierarchical societies facilitated by the origin of the state, kingdoms, early empires, and religion; use of bronze and copper in tools, weapons, artefacts and art; pottery, textiles, and handicrafts; invention of astronomy, money, the wheel and irrigation. Transport was limited by animal traction on land, and by wind and human traction on water. Recorded history began with the invention of writing and the emergence of the classical civilizations of Greece, Persia, Egypt, China and India.

With the Iron Revolution came early empires and civilizations which, with the notable exception of the Chinese and Indian that lasted into modern times, yielded to transcontinental empires, namely Pax Romana, Arab, Turk, Mongol and European, facilitated by the invention of the horse stirrup, gunpowder, major advances in road, bridge, stone architecture and use of wind energy, including ocean-faring vessels, leading to the discovery of the New World. Till very recently, however, most people never left their place of birth, except for traders, religious preachers, scholars, rulers and roving armies and navies. Material life, even of the ruling classes, remained at very basic levels.

The current epoch began with the Enlightenment and Industrial Revolution in Western Europe around 17th century AD, incorporating scientific advances in the Middle East, China and India. This



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culminated in a virtuous cycle of accelerating growth and innovation based on inanimate energy; a new system of cooperative mass production and mobility of people, goods, services and knowledge based on a new concept of industrial time that replaced natural cycles; and major architectural advances through the use of structural metals (iron and aluminium alloys) and nano technology. The second age of transcontinental empires culminating with Pax Britannica paralleled the decline of old world agricultural civilizations in the Middle East, India and China through growing divergence in technology and per capita incomes before converging again through the global spread of the virtuous cycle unleashed by the Enlightenment and Industrial Revolution.

Peering ahead into the current epoch, the rapid global spread of the Industrial Revolution that is leading to anthropogenic climate change through an explosion in growth, exploitation of natural resources, and population, would likely be reversed by increasing use of Artificial Intelligence and demographic transition to below replacement birth rates. With the nation state in terminal decline, beginning with regional unions, such as the European, and effective governance shifting to local institutions, a loose global federation could emerge, tending to greater global integration accelerated by extraterrestrial contact.

The *Star Trek* evolution of the human species could occur in the distant future on the lines of the eponymous science fiction serial, marked by Artificial Intelligence, end of death as we know it and migration of humans to other planets/solar systems where they further evolve through technological advances, including the end of agriculture as man breaks free of the constraints imposed by the Neolithic Revolution. Alternatively, a catastrophic event, man-made (such as global warming or nuclear war) or natural (such as a comet/meteor that wiped out dinosaurs), could destroy the human species, even all life on earth, before their evolution into extraterrestrial civilizations.

The sun will eventually run out of fuel, extinguishing life on earth as it expands into a Red Giant after about five billion years, and evolving into new-generation stars before it is consumed into a black hole. This would end time and space as we know it, but hopefully not for extraterrestrial émigrés.

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## Rich Keralite, poor Kerala conundrum

BEHAVIOUR BY BRAIN

BIJU DOMINIC

Kerala, which gets more than Rs1 trillion in remittances from its emigrants, has an empty state treasury. Despite this large inflow of money, Kerala is one of the least industrialized states in India and has one of the highest unemployment rates in the country. Why?

The quantum of remittances that flowed into Kerala is almost three times the money that flowed into Maharashtra, four times the inflow into Tamil Nadu and almost 10 times the inflow into Gujarat in the form of foreign direct investments. While these states have managed to build a strong, growing economy, why is it that the huge cash flow into Kerala has not turned into productive investments in the state?

According to studies by the Centre for Development Studies, Thiruvananthapuram, conspicuous consumption is the hallmark of a Kerala emigrant. The majority of remittances that flowed into Kerala over the past several decades have only been used to build dead investments like palatial houses and owning depreciating assets like automobiles and consumer goods. Kerala clocks one of the highest sales of luxury cars in the country and is the big-

gest consumer of gold. Although the profile of the Kerala emigrant has changed over the years, from low-skilled and illiterate to more educated professionals, the tendency to spend their hard-earned salaries on ostentatious living continues.

Behavioural economics could provide an explanation for this sad state of affairs in Kerala.

Professor Richard Thaler of The University of Chicago Booth School of Business put forward the concept of mental accounting to explain how humans deal with money. Mental accounting refers to the tendency of people to separate their money into separate mental accounts based on a variety of subjective criteria, like the source of the money and intent for each account. Unlike what was believed so far, money is not fungible, that is money does not easily move from one mental account to another. The propensity to spend is influenced a great deal by which mental account the money belongs to. So, the money one gets as bonus is spent differently from the money one gets as salary. Or, in other words, the decision on where the money goes or where it is spent

depends greatly on where the money comes from.

How does the theory of mental accounting explain the life of a Kerala emigrant?

Let us take the example of nurses from Kerala. Close to 60,000 of them work in places like the US, Europe and the Gulf. The median salary of a nurse in India is about Rs2.5 lakh per year. The median salary of a nurse in the US is about \$71,000. The median salaries of nurses in any of these countries comfortably allow them to fit into the middle-class lifestyle of that country.

But the moment an emigrant nurse lands in Kerala, a huge transformation happens. Thanks to currency arbitrage, a salary that would have allowed the person to enjoy the lifestyle of a middle-class household in the country of work, now

suddenly gets transformed into an income equivalent to one of the highest-paid professionals in India. This is more like a windfall gain. How does this sudden increase in the perception of one's income affect one's spending behaviour?

A 1994 study by Hal R. Arkes, Cynthia A. Joyner and Mark V. Pezzo has shown that people have a greater marginal propensity to consume from windfall earnings than money earned through normal work. Another study in 2009 by John Beshears and Katherine Milkman found that people are more likely to spend windfall money on non-routine purchases. A 2012 study in rural Tanzania by Lei Pan and Luc Christiaensen has shown that money earned through windfall gains is more likely to be spent on non-basic consumption of goods

like alcohol and tobacco than basic consumption goods or education. So, it shouldn't come as a surprise that the windfall gains the Kerala emigrant receives from currency arbitrage are spent on building palatial houses and buying luxurious consumer goods.

Windfall gains normally happen when someone gets an unexpected monetary gain by winning a lottery or getting an unexpected inheritance. Windfall gains are normally transitory in nature. The windfall gains of a migrant Keralite too are transitory. They happen only when he is in India, away from his place of work. Only on those occasions does the mental account look far bigger than normal. Once he goes back to his place of work, he goes back to his normal self.

This insight that where the money goes depends on where the money comes from is a universal insight that guides one's financial behaviour. It was also found in the behaviours of Indian mutual fund investors and the millions who opened new bank accounts under the Pradhan Mantri Jan-Dhan Yojana (PMJDY).

The government of India is focusing a

lot on building a robust infrastructure for direct benefit transfer. No doubt this infrastructure will ensure that the money meant for the poor will no longer be gobbled up by the corrupt middlemen. But this is only half the job done. The government needs to ensure that the money that reaches the poor does not end up in liquor consumption or other wasteful expenditure.

It is here that the learning from the behaviour of the emigrant Keralite—that the source of funds affects one's spending pattern—holds a lesson for policymakers. How does one frame the source of the money in our direct benefit transfer programme so that the money received goes into the education of the girl child or for buying healthy food for the whole family?

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