FINANCIAL GLOBALIZATION THE RISE OF INCOME INEQUALITY IN INDIA

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ABSTRACT

Globalization of finances has been one of the agents that drive the economies in the world, including the Indian economy. This paper aims to assess the correlation between financial globalization and income inequality in India covering the period from the early 1990s up to the present. The liberalization policies since the 1990s intended to globalize the Indian economy have impacted capital flows, foreign investment and economic growth. However, these benefits have not reached across the population; this means the so called "stationary" people have benefited enormously, while the rest have continued to deteriorate. With the major involvement of the South Asian Association for Regional Cooperation (SAARC), the BRICS group, and Asian Development Bank (ADB) of a regional and international nature among others.

Financial globalization has however brought economic opportunities such as cross border capital movement and foreign investment into India with the social costs being a rise in income inequalities. From the perspective of SAARC, and within the context of regional cooperation, how the processes of regional financial integration and regional economic policies may impact on income distribution, within member countries, including India itself. Furthermore, the effect of BRICS association of emerging economies is also analysed in order to reveal its overall economic influence on the increase in inequality coefficients through strategies and investment. The Asian Development Bank's functions are studied to determine how its contributions of loans and development projects support and/or undermine India's endeavour to overcome the income distribution problem.

Also, Foreign Direct Investment (FDI) and Portfolio Investment have mainly concentrated on the urban sector especially in technology and service sectors while the rural dominated agriculturally has not benefit in the same proportion. This has consequently brought about a politically acceptable income divide between the urban and rural areas. Furthermore, liberalization of financial markets, and the growth of MNEs have frequently resulted in

increased wage inequality, where the demand for high skilled workers increases while the minimum wage inequality still persists. Based on the analysis of the financial globalization impact on income inequality, the paper includes some recommendations. Such measures include supporting the inclusive approach of development which refers to a broader manner in which development is carried out to ensure that each and every individual benefits from globalization, improving the education and the skills development programs to prepare the workforce for the global demands and putting in place social policies to protect vulnerable groups in society. This way, it will be possible to establish a more equal distribution of income and control the negative consequences of globalization: growth inequality by providing people with opportunities required for personal development in an interconnected world.

Chapter 1: Introduction

I. Financial Globalization: Concept and Evolution

Financial globalization is the interconnectedness of national financial systems within the global economy. This process is characterized by several key factors:

- **Increased capital mobility:** The free movement of money across borders, including investments in stocks, bonds, and other financial instruments.
- **Financial deregulation:** The loosening of government regulations on financial institutions and markets, allowing for greater competition and innovation.
- **Rise of global financial markets:** The development of interconnected worldwide financial markets, facilitating the efficient allocation of capital on a global scale.

These factors have led to a more integrated and interdependent global financial system, with both benefits and risks[1].

II. Evolution of Financial Globalization

The development of financial globalization has progressed through several key stages:

[1] Mishkin, F. S. (2009). *Globalization and Financial Markets*. In *The Handbook of International Financial Terms* (pp. 289-295). Oxford University Press.

- **Bretton Woods Era[2]:** "Following World War II, the Bretton Woods system established a fixed exchange rate system and international financial institutions to promote economic stability".

- **Deregulation:** In the 1980s and 1990s, many countries relaxed regulations on their financial sectors, allowing for greater capital flows and competition.

- **Digital Era:** The current era is characterized by the increasing use of digital technologies in finance, including fintech innovations that are transforming the way financial services are delivered.

III. Income Inequality: Definitions and Measures

Income inequality means that people in a society have different amounts of income. This can be measured by looking at how income is distributed among the population, and it often involves comparing the income of the wealthiest to the poorest. Income inequality can be measured using different tools, like the Gini coefficient, Lorenz curve, and Theil index. These tools help us understand how income is distributed among people in a society and how it changes over time.

IV. Global Perspectives on Financial Globalization and Inequality

Financial globalization can have a significant impact on income inequality, but the effects vary significantly across countries. In developed nations, increased capital mobility can lead to a concentration of wealth among the top earners, as capital flows to sectors and regions with higher returns. Additionally, the outsourcing of jobs to lower-wage regions can contribute to wage stagnation and income distribution.

Furthermore, the downside of financial globalization on income distribution can be impacted by a variety of factors such as government policies, labor market institutions, and social safety nets. Countries with strong labor unions and social welfare programs may be better able to mitigate the harsh effects caused because of income inequality[3].

[2] Bordo, M. D., & Eichengreen, B. (2008). *Globalization in Historical Perspective*. University of Chicago Press
[3] Rodrik, D. (2011). *The Globalization Paradox: Democracy and the Future of the World Economy*. W. W. Norton & Company.

India's experience with financial globalization and income inequality is a complex one, marked by significant economic reforms since the 1990s. These reforms, which included liberalization, privatization, and the opening up of the economy to foreign direct investment, have led to rapid economic growth and increased income disparities.

While these reforms have undoubtedly contributed to India's economic development, they have also had a profound impact on income disparities. The economic growth that we have attained have not been divided properly with the wealthy and politically connected benefiting disproportionately from the liberalization of the economy. All this has increased the gap between the rich and poor as with the top 1% of earners capturing a significant share of the country's income.

Beside these economic factors, social, political and other factors have also played a role in exacerbating income inequality in India. The caste system, which continues to shape Indian society, can limit opportunities for individuals from lower-caste backgrounds, contributing to persistent inequality. Moreover, the lack of adequate social safety nets and public services, particularly in rural areas, can further disadvantage the poor and marginalized.

While India has made significant progress in reducing poverty and improving living standards, the growing income inequality poses a significant challenge. Addressing this inequality requires a comprehensive approach that addresses both economic and social factors. This could include policies to strengthen labor unions, improve access to education and healthcare, and promote inclusive growth that benefits all segments of society[4].

Chapter 2: Historical Background

I. Economic Liberalization in India (1991 Onwards)

India's economic liberalization began in 1991 with the introduction of structural adjustment programs. This marked a significant departure from the previous state-controlled economy, known as the License Raj.

[4] Panagariya, (2008). *India: The Emerging Giant*. Oxford University Press.

Key features of this liberalization included:

- **Dismantling the License Raj:** This system of government permits and licenses, which had stifled economic growth, was gradually phased out.
- **Reduction of import tariffs:** Lower tariffs encouraged imports and increased competition, leading to lower prices for consumers.
- **Deregulation of industries:** Government control over industries was reduced, allowing for greater private sector participation.
- **Encouragement of foreign investment:** FDI was promoted to attract capital and technology.

These reforms aimed to boost economic growth, increase efficiency, and integrate India into the global economy[5].

II. Impact on the Indian Economy

In 1991, India started to change its economy from one controlled by the government to one that is more open to businesses. This meant reducing government control over industries, allowing more foreign companies to invest in India, and making it easier for Indian companies to trade with other countries.These changes helped India's economy grow faster, created more jobs, and helped reduce poverty. India also became more connected to the global economy[6].

III. Growth of Financial Globalization

India opened its economy to foreign businesses and investments in 1991. This allowed foreign companies to invest in India and for Indian companies to trade more freely with other countries. This helped India's economy grow faster, created more jobs, and reduced poverty. It also helped India become more connected to the global economy.

[5] Ahluwalia, M. S. (2002). *Economic Reforms in India Since 1991: Has Gradualism Worked?* Journal of Economic Perspectives

[6] Panagariya, A. (2008). *India: The Emerging Giant*. Oxford University Press.

After India opened its economy to foreign businesses and investments, it also changed its financial system. This included:

- **Freeing interest rates:** Banks were allowed to set their own interest rates, rather than having them set by the government.
- **Developing the stock market:** The stock market was made more accessible to investors, which helped businesses raise money and grow.

IV. Key Policy Changes and Their Impacts

India made it easier for foreign companies to invest in certain sectors of its economy, like telecommunications, insurance, and retail. This meant that foreign companies could own more of these businesses. This allowed India to attract more foreign money and technology, which helped its economy grow and become more connected to the global economy[7].

V. Banking Sector Reforms

India made some big changes to its banking system. They let banks set their own interest rates, created new types of bank accounts and investments, and made the rules for banks stricter. These changes helped make the banking system in India better and more efficient.

VI. Impact on Inequality

While India's economy did better after opening up to the world, the good things that happened didn't benefit everyone equally. Some people became much richer, while most of population didn't. This widened the gap between rich and poor people even larger in cities compared to villages[8].

[7] Sahoo, P. & Dash, R. K. (2009). *Foreign Direct Investment in South Asia: Policy, Impact, Determinants and Challenges* Springer.

[8] Pal, P. & Ghosh, J. (2007) *Inequality in India: A Survey of Recent Trends*. Economic and Political Weekly

Chapter 3: Financial Globalization and Economic Growth

I. Mechanisms of Financial Globalization

Financial globalization can significantly contribute to economic development by facilitating increased capital flows. This includes Foreign Direct Investment (FDI), where foreign companies invest in domestic businesses, and portfolio investments, such as buying stocks and bonds. These capital inflows can lead to higher investment in infrastructure, technology, and industrial development.

However, we can say that the benefits of arisen from financial globalization are not always evenly distributed. Developing countries may face challenges in attracting FDI and may need to implement appropriate policies to maximize its benefits. Additionally, excessive capital inflows can sometimes lead to financial instability. Therefore, countries need to carefully manage their financial liberalization process to ensure that it contributes to sustainable economic growth

When foreign companies invest in a country, they often bring new and better ways of doing things. This can help the country's businesses learn new things, make things more efficiently, and create new jobs[9].

When a country becomes more involved in the global financial system, it can improve its own financial system. This means having better banks, more money available for investment, and more types of financial products. This can make the country's economy more stable and help it grow.

II. Impact on Economic Growth in India

a. **GDP Growth and Economic Reforms:** After India opened its economy in 1991, it started to grow much faster. This was because foreign companies invested more money in India, Indian companies could sell things to other countries more easily, and there were more opportunities for businesses to grow[10].

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[9] Borensztein, E. De Gregorio, J., & Lee, J. W. (1998). *How Does Foreign Direct Investment Affect Economic Growth?* Journal of International Economics

[10] “Balakrishnan, P. (2004). *Economic Growth in India: History and Prospect*. Oxford University Press”

b. **Productivity Gains:** When foreign companies invest in India, they often bring new and better ways of making things. This helps Indian businesses make things more efficiently, produce more, and sell things at a lower price. This has helped India's economy grow, especially in manufacturing and services.

c. **Macroeconomic Stability**: Although India's economy has grown stronger because of its connection to the global economy, it has also become more vulnerable to problems in other countries. For example, when there were big financial problems in Asia in 1997 and around the world in 2008, India also felt the effects. This made India realize it needed to make its financial system stronger to protect itself from such problems in the future[11].

Chapter 4: Income Inequality in India

I. Measurement of Income Inequality

a. **Common Measures**: When we want to know how much inequality there is in India, we can use different tools to measure it. These tools include the Gini coefficient, the Lorenz curve, the Theil index, and the Atkinson index. Each tool gives us a different view of how income is distributed among people in India[12].

b. **Data Sources and Challenges**: To understand income inequality in India, people use information from different sources like the National Sample Survey, the India Human Development Survey, and income tax records. However, these sources can sometimes be inaccurate because people might not report their income correctly, there might be missing data, and different ways of measuring income can give different results[13].

c. **Adjustment for Cost of Living and Inflation**: When measuring income inequality, it's important to consider that things cost different amounts in different places and that prices can go up over time. This is because even if two people have the same income, their buying power can be different depending on where they live and how much things

[11] Prasad, E.S. & Rajan R. G. (2008). *A Pragmatic Approach to Capital Account Liberalization*. Journal of Economic Perspectives.
[12] , F. A. (2011). *Measuring Inequality*. Oxford University Press.
[13] Deaton A. & Kozel, V. (2005). *Data and Dogma: The Great Indian Poverty Debate*. The World Bank Research Observer

cost. So, to get a more accurate picture of income inequality, we need to adjust for these factors.

II. Trends in Income Inequality in India:

Since India's economic liberalization in the 1990s, income inequality has increased significantly. While the reforms led to rapid economic growth, the benefits were not evenly distributed. The gap between the rich and poor, especially in urban areas, has widened. Since India opened up its economy in the 1990s, the gap between the rich and poor has grown. This is because the richest people have gotten even richer, while the poorest people have not seen their incomes grow as much. The growth of the services sector, like IT and finance, has helped the rich get richer, while wages in agriculture and manufacturing have stayed about the same.

III. Urban vs. Rural Income Inequality

The urban-rural income gap in India has widened significantly over the past several decades, driven by a variety of factors. The concentration of economic opportunities in urban areas, such as manufacturing, services, and technology, has led to higher wages and greater job prospects for those living in cities compared to rural regions. Additionally, urban areas tend to have better infrastructure, including transportation, education, and healthcare, which can further enhance economic opportunities and quality of life.

Addressing the urban-rural income gap requires a multi-faceted approach that involves investing in rural development, improving infrastructure in rural areas, promoting inclusive growth, and addressing social inequalities. By investing in rural development, governments can create new economic opportunities and improve the quality of life for rural residents. Additionally, investing in infrastructure, such as roads, railways, and irrigation systems, can help to connect rural areas to urban centers and improve market access for rural producers. Moreover, promoting inclusive growth that benefits all segments of society is essential for reducing the urban-rural income gap. This involves implementing policies that support small and medium-sized enterprises, promote entrepreneurship, and ensure equitable access to education and healthcare. Finally, addressing social inequalities, such as caste discrimination and gender bias, is crucial for creating a more equitable and inclusive society[14].

In rural India, many people are poor because they don't own much land, their farming is not very productive, and they don't have access to good schools or hospitals. Also, farmers are often struggling because they earn less money and have more debt. These problems make the gap between the rich and poor even bigger in rural areas[15].

IV. Policy Responses

Even though the government has programs to help people who are poor, it's still hard to fix the problem of income inequality in India. This is because the problem is deep-rooted and has to do with how the economy and society are structured.

Some of the biggest challenges are:

- **Deep-rooted problems:** The gap between cities and villages, the fact that most economic opportunities are in certain places, and the problems of caste, class, and gender all contribute to income inequality.
- **Not working as well as they should:** Even though government programs can help, they don't always work as well as they could because of corruption, people not knowing about them, or not having enough money to run them properly.
- **Short-term solutions:** Many government programs only help people for a short time, but don't solve the underlying problems that cause inequality. This can lead to people becoming dependent on these programs and not being able to improve their situation[16].

To solve the problem of income inequality, India needs to take a big and long-term approach that addresses both the symptoms and the underlying causes. This could include:

- **Investing in rural areas:** Helping rural areas develop, improving infrastructure, and creating more jobs in the countryside.

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[14] Himanshu (2011). *Employment Trends in India: A Re-examination*. Economic and Political Weekly.
[15] Jodhka, S. S. (2017). *Agrarian Change in India: The Making of Rural Distress*. Orient BlackSwan.
[16] Dreze J. & Sen A. (2013). *An Uncertain Glory: India and its Contradictions*. Princeton University Press.

- **Better social safety nets:** Expanding and improving programs that help people who are poor, such as food, housing, and healthcare.

Chapter 5: Impact of Financial Globalization on Income Inequality

Many studies have examined the ways that the financial globalization affects income distribution. Some research shows that financial globalization can make the rich even richer, while other studies suggest it might help reduce inequality by creating jobs and boosting the economy[17].

To study how financial globalization affects income inequality in India, researchers use data from different sources. They look at information about households from the National Sample Survey, and they also use data from the World Bank and IMF. Plus, they use surveys like the India Human Development Survey and the World Inequality Database to learn more about income distribution and inequality.

One problem with studying income inequality in India is that the data isn't always consistent. Sometimes people don't report their income accurately, and we don't have enough up-to-date information about wealth distribution. Also, the numbers from different sources, like national and international data, might not match up perfectly, making it impossible to some extent to tackle the situation prevailing.

I. Effects of Financial Globalization on Income Distribution

Studies show that financial globalization has both good and bad effects on income inequality in India. It has helped the economy grow, but it has also made the gap between rich and poor wider, especially in cities where businesses that use a lot of technology and capital are located.

II. Policy Implications

The studies suggest that India needs to take steps to reduce the downside effects of financial globalization on income distribution. This could include things like improving

[17] Jaumotte, F. Lall S. & Papageorgiou, C. (2013). *Rising Income Inequality: Technology, or Trade and Financial Globalization?* IMF Economic Review, 61(2), 271-309

social programs, making education and healthcare more accessible in rural areas, and promoting economic growth that benefits everyone, not just the rich.

Chapter 6: Policy Implications and Recommendations

Review of Existing Policies

a. **Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA):** The MGNREGA program guarantees jobs to rural households. It has helped a lot of poor people in rural areas, but it hasn't done much to reduce long-term income inequality[18].

b. **Public Distribution System (PDS):** The PDS program provides subsidized food grains to help poor people have enough to eat. Even though it reaches a lot of people, it has problems like inefficiency, corruption, and waste, which make it less effective at reducing poverty and inequality.

c. **Direct Benefit Transfer (DBT):** DBT is a program that sends subsidies directly to people's bank accounts. This is supposed to help prevent waste and make sure the money goes to the right people. It has shown potential for improving welfare programs, but it needs a strong financial system and infrastructure to work well.

i. Social Welfare Programs

There are many social welfare programs in India, like PMJDY and PMUY, that aim to help more people have access to financial services and basic necessities. These programs have been good, but it's still being studied how much they help reduce long-term inequality.

ii. Policy Recommendations to Address Income Inequality

a. Enhancing Education and Skill Development

b. Strengthening Social Safety Nets

c. Promoting Inclusive Economic Growth

[18] Dreze, J., & Khera, R. (2017). *Recent Social Security Initiatives in India*. World Development, 98.

d. Reforming the Tax System

Chapter 7: Conclusion & Suggestions

Financial globalization has had a multifaceted impact on income inequality in India. While it has contributed to economic growth, it has also exacerbated existing disparities, particularly in urban areas.

Key findings include:

- **Urban-Rural Divide:** The urban-rural income gap has widened due to financial globalization. Capital-intensive industries concentrated in urban areas have benefited disproportionately, while rural populations have lagged behind.
- **Sectoral Disparities:** The outcome of financial globalization on income distribution varies across sectors. Sectors with greater exposure to international trade and investment have generally experienced higher growth but also higher income inequality.
- **Policy Effectiveness:** the already existing policies such as the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), the Public Distribution System (PDS), etc. have provided essential safety nets for the poor but have not been sufficient to address the root causes of inequality.
- **Direct Benefit Transfer (DBT) Schemes:** DBT schemes have shown promise in improving the efficiency of welfare programs and reducing leakages, but their effectiveness depends on robust financial inclusion and infrastructure.
- **Social Welfare Programs:** While social welfare programs like PMJDY and PMUY have improved financial inclusion, their impact on long-term inequality is still under evaluation.

In conclusion, financial globalization has presented both opportunities and challenges for India**.** Effective policies are needed to distort the downside outcomes and ensure that the benefits of financial globalization are more equitably distributed. This may involve a combination of targeted social welfare programs, improved financial inclusion, and policies that promote inclusive growth in rural areas.

Suggestions

To understand the long-term outcomes of financial globalization on rural income distribution in India, we need to:

- Examine rural-urban linkages.
- Assess land reforms and agricultural productivity.
- Analyze remittances from migrant workers.

Comparative studies with other developing countries, like China, Brazil, and Sub-Saharan Africa, can provide valuable insights. By identifying common trends and unique challenges, we can develop more effective policies to address rural income inequality in a globalized context[19].

[19] Dollar D. & Kraay A. (2004). *Trade, Growth, and Poverty*. The Economic Journal, 114(493).