Preferences, spatial prices and inequality

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Abstract
Much of the recent welfare analysis in the development literature has focused attention on poverty. This is especially true for India which has seen a large proliferation in the poverty literature. This study departs from this tradition and focuses on inequality. It is based on the premise that as a country develops and experiences high growth rates, the focus should shift from poverty to inequality. Rising inequality leads to increasing marginalisation and greater social tension even while there may have been a general decline in poverty rates. The study examines the effect of prices on inequality. It does so in the heterogeneous country context of rural India during the recent period of economic reforms and beyond. It proposes a framework for calculating preference based "exact" price indices and shows its usefulness by consistently calculating spatial prices and regionally varying temporal prices that take into account both differences in preferences between states and changing preferences over time. The "exact" price indices are based on the recent "Exact Affine Stone Index" (EASI) demand system. This paper provides evidence on the usefulness of the proposed procedures by finding that the nature of inflation has been regressive during the first half (1999/2000 – 2004/5) and progressive during the second half (2004/5- 2009/10).The study also provides evidence based on panel estimation that suggests that while temporal price inflation has a positive effect on inequality, the effect of spatial prices on inequality is qualitatively quite different. The study also documents the positive role that rural developmental spending can play in reducing inequality. In contrast, an increase in non-farm labour productivity increases inequality. The sharp rise in inequality during the second half of our time period when India recorded high growth rates and falling poverty rates highlights the need for a closer look at inequality and its determinants as in this study.