

Sources of Income, Income Inequality and Social Welfare-A Decomposition

G. Chakrabarty

1. INTRODUCTION

Conceptualisation and quantification of economic welfare of human communities have been a major concern of development economics. One variant or the other of Gross National Product (GNP) has been used traditionally as a measure of economic performance of the country as well as an indicator of social welfare. In recent years the inadequacy of the GNP as a measure of welfare has been realised and various improvements suggested. Aggregated income indicators, such as the GNP, though provide a summary picture of the country's productive capacity, ignore many other factors that have a bearing on the overall economic welfare of the society. For example a rise in GNP or per capita GNP may be accompanied by a fall in income for many individuals and a rise in income for a few. In this situation the rise in average level of income will be accompanied by widening of the disparity in the distribution of income and therefore may not necessarily lead to an increase in the overall economic welfare of the society. Thus, per capita GNP needs to be modified to take account of changes in the distribution of income. Sen (1974) proposed a measure of welfare which is a function of both average income and the inequality of the distribution of income. The measure has been modified and further generalised by Kakwani (1980, 1981). Estimates of these welfare measures for Indian income distributions are available elsewhere (Chakrabarty, 1982) which convey an overall picture of the trends in the level of welfare. However, for formulation of policies aiming to influence the level of welfare, it may be useful to analyse the welfare measure tracing it back to the sources of income and inequality which influence welfare. To achieve this objective Chakrabarty (1983) developed a procedure for decomposing Sen's welfare measure into additive components corresponding to various sources of income, the decomposition formula is an extension of the procedure followed by Fei, Ranis and Kuo (1978, 1979) and Kakwani (1977) in decomposing Gini coefficient by income components. The present exercise attempts to analyse income inequality and the level of