

# SOCIAL AND ECONOMIC DISPARITIES

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**Keywords:** Inequality, social disparity, economic growth, development, gender discrimination, human capital, overpopulation, poverty, environmental degradation, globalization, corruption

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## Summary

Why care about economic and social disparities? Because large economic and social disparities may lead to social instability, thus damaging economic development. Also, because social disparities affect human dignity, development that does not deal with reducing economic and social disparities is not worth pursuing.

This article analyzes different factors leading to economic and social disparities: the relationship between economic growth and inequality; the linkage between social disparities and environmental degradation; inequalities caused by globalization; gender discrimination and its impacts on economic growth; corruption damaging sound economic development and leading to more social disparities, etc. The article also analyzes some levers by which government can implement policies to reduce social disparities and points to new obstacles to the implementation of government policies in this field that have emerged with globalization.

## 1. Introduction

Social disparities may have many causes. At different times in history, a variety of factors have combined to determine an individual's lot. At present, income inequality largely determines social disparities, while other factors such as social class and aristocratic titles no longer matter. In other words, economic disparities determine social disparities, no matter whether these disparities are reflected in terms of inequality

between city and countryside, between men and women, or between coastal and inland regions.

To measure inequality of incomes, economists usually resort to the Gini coefficient, with 0 representing perfect equality and 1 representing total inequality. Latin America and Sub-Saharan Africa hold the world record for highest income inequality, the average Gini coefficient being 0.5 in Latin America, and slightly lower in Sub-Saharan Africa.

While people seem accustomed to seeing a high degree of income inequality in Africa and Latin America, recent changes in other countries have attracted public attention. Indeed, there have been very sharp upward movements in a number of countries. The Gini coefficient has increased by between 5% and 9% in seven countries and, by more than 20% in two countries. Very large increases in Gini coefficients occurred in economies that chose to shift from a strictly controlled system to a market system, the growing social disparities being attributed to the transition. The United Nations Development Programme (UNDP) reports that even without transition problems inequality continues to increase in many countries, to a degree that has caused widespread public concern. According to the UNDP *Human Development Report* in 1998, the 20% of the world's population living in the most wealthy countries represents 85% of worldwide private consumption, while the 20% of the world's population living in the poorest countries represents only 1.3%. In 1960, the richest 20% had an average revenue 30 times higher than that of the 20% living in the poorest countries. By 1995, the average revenue of the former was 85 times higher than that of the latter. If we take some figures to illustrate, the contrast is striking: the three most wealthy individuals in the world possess a fortune that surpasses the sum of the gross domestic product (GDP) of the 48 poorest countries; the fortune of the 15 richest people matches the whole output of Sub-Saharan Africa; the assets of the 32 richest people are superior to the GDP of the South Asian countries; and the assets of the 84 richest people surpass those of China with its 1.2 billion inhabitants. On the other side of the tracks, more than 1.3 billion people still live on less than US\$1 a day, and almost three billion people live on less than US\$2 per day.

Can this situation be sustained? And what kind of impacts does it have on our living surroundings?

## **2. Growth and Equity**

Since World War II, growth has been a major concern of policy makers. For both socialist and capitalist countries, the key to development was assumed to be faster economic growth. As socialist and capitalist countries were competing to prove the superiority of their social system, a higher rate of economic growth was considered by both to be the most important goal.

To attain a high rate of growth, socialist countries focused on rapid industrialization based on large-scale nationalization of industries and a centralized command economy, which disadvantages the agricultural sector. Although socialist countries insist on equal distribution of revenues, social disparity exists between city and countryside. Farmers

have much smaller incomes than city dwellers, due to the higher prices of manufactured goods and lower government-fixed prices of agricultural products.

Turning to the capitalist countries, competition with socialist countries forced countries on the front line (i.e. western European countries) to adopt a relatively equitable economic policy, building up a welfare state with a generous system of social redistribution. But in other countries, growth was often accompanied by increasing social disparities, with rich groups gaining the lion's share of national wealth, while the poor saw their living standards declining.

Social disparity in terms of income inequality was not a cause of widespread concern, as long as growth was not jeopardized. Indeed, under the influence of some economic theories, people believed that there was a trade-off between equity and efficiency: to distribute income too equally would undermine incentives, thus lowering the rate of economic growth, so that everyone's income would decline in the end.

This point of view was supported by another theoretical assumption called the Kuznets U-shaped curve hypothesis, named after the Nobel laureate Simon Kuznets. Kuznets postulates that in the early stages of economic development, income inequality tends to rise, because of a secular shift from low-income, low-inequality agriculture to high-income, medium-inequality industrial production. But income inequality should narrow, continued Kuznets, after reaching a peak, as the increasing efficiency of the established urban population works to decrease inequality within the industrial sector, and the poor gain growing political power to push forward protective and supportive legislation. The logical conclusion to be drawn from this theoretical deduction is that income inequality does not need to be worried about too much, poor people might have to tighten their belts at first and wait for a while, while the richer people save and invest in production, eventually stimulating growth. With increasing overall growth, national wealth will also increase, then the process will ultimately benefit everyone, including the poor (*see Mechanisms for Improving Economic and Industrial Growth in Developing Countries*).

China's experiences seem to prove this hypothesis. For a relatively long period, say between the founding of the People's Republic in 1949 and reform and opening up to the outside world in 1979, the Chinese government implemented economic policies giving top priority to equality. But when equality is absolute in an economy, it tends to swamp private incentive, and overall growth may stagnate for lack of initiative. Egalitarianism in China was not favorable to economic growth. For example, in 1950 there was a gap of US\$2265 between China's per capita gross national product (GNP) and that of developed countries. By 1975, this gap had enlarged to US\$4818. At that time, China's Gini coefficient was 0.16, among the lowest in the world. Since the 1980s, China has had a much higher rate of growth and Chinese GNP is catching up with that of developed countries; however, income inequality also began to increase, the Gini coefficient rising to 0.38 in 1995. Income inequalities between rural and city dwellers, the coast and inland areas, and between men and women are increasing with growth. Although income inequality is greater now in China than before the nation undertook reform and decided to open to the outside world, absolute poverty has been reduced, and poor people have a better living standard than in the past. So, many

Chinese economists believe that it is normal for income disparities to appear in the initial stages of an economic take-off. Policies that aim at reducing social and economic disparities in China should focus on raising the living standards of the poor by providing them with sound health care and proper education, rather than taxing the rich population too heavily.

But this conventional wisdom has been called into question by some economists who cite the experience of many Asian economies—Hong Kong, Indonesia, Malaysia, the Republic of Korea, Singapore, Taiwan, and Thailand—to support the idea that both rapid growth and relatively low inequality can occur at the same time. They said that between 1960 and 1993, the East Asian economies, excluding China, had annual per capita growth of 7.6%, while income inequality remained stable or declined. Japan and Sweden have also combined rapid growth with low inequality.

The key to East Asia's success seemed to be a relatively equal distribution of private and public assets, success being attributed to a concentration on the redistribution of wealth, instead of income, although this distinction is difficult to make. Some economists contend that what generates the income in East Asian countries is productive wealth—including human capital. Some economists claim that redistributing income more equitably takes income away from people with capital, lowering their profits and thus supposedly reducing growth. Others reply that a progressive redistribution of assets tends in fact to boost growth because it has a broad, positive effect on people's incentives. One study concluded that if in 1960 the Republic of Korea had had Brazil's inequality, its GDP in 1985 would have been 15% lower.

Whatever the theoretical debate on the relationship between efficiency and growth, it is clear that public opinion will not support an economic growth model that sacrifices equality. One UNDP *Human Development Report* pointed out that policies that focus on economic growth at all costs have aroused widespread criticism. What kind of growth do we need? What are the benefits to human development? What are the costs? Who benefits, and who pays?

Reducing income inequality and narrowing social disparities have for several years been the focus of public opinion. Governments of developed countries as well as of developing countries have had to pay attention to the reduction of poverty and a more equitable social distribution. All this is because people have suddenly realized that despite a relatively rapid and sustained economic growth rate in the world, social disparities have increased in many countries.

Since the 1990s, income inequality has been increasing in a large number of countries. Eastern Europe once held the world record for lowest income inequality (about 0.25 until the late 1980s) but after they decided to turn their economies into market-oriented systems, the average Gini coefficient rose to more than 0.3 in the mid 1990s. Although this may not appear to be a large increase, it is quite significant over such a short period of time, since Gini coefficients tend to be relatively stable for long periods in many countries.

Income inequality has also increased in some developed countries, such as in Germany,

Japan, the United Kingdom, and the United States, as well as in some emerging economies such as in Thailand and China.

What is more worrisome is that income inequality has also increased in many Asian and Latin American developing countries, while the gap between these countries and some other emerging developing countries tends to be widening. Some economists try to explain this by the disparity of growth between city and countryside. They believe that in a lot of developing countries, the rise of agricultural productivity that was a precondition for widespread industrial progress never occurred, so rural development has been far slower than expected. Furthermore, in the countryside access to land and education is unequal. Crop-growing peasants face an unequal system of land ownership or tenancy, so the system provides neither means nor incentives for efficient production. Some economists contend that income inequality is not only a worrying moral problem, but it also affects economic development. Indeed, inequality may affect economic performance in a variety of ways: citizens with low incomes and little ability to provide collateral securities may find their access to capital markets curtailed. Such a situation is likely to lead to a sub-optimal use of resources. From a political economic perspective, inequality might lead to an inefficient tax structure, which does not maximize growth prospects. High inequality may also create an antagonistic atmosphere between members of a society and breed violence.

Furthermore, a more equal distribution of income may change the composition of demands in an economy in favor of labor-intensive products, because poor people need them more. This will stimulate both growth and employment. According to this assumption, public policy must be directed not only at building up people's capabilities, but also at matching those capabilities with opportunities: linking the supply of human capital with the demand for it. In this regard, if some developing countries have a low rate of growth, it is partially because the demand for unskilled labor is insufficient. If poor people had a greater share in national wealth distribution, their demand for labor-intensive products would increase, thus stimulating the supply of labor-intensive employment. As labor is the most valuable asset that developing countries have, a more equitable distribution will trigger off a self-fulfilling development cycle, leading to more stable and equitable development. In other words, when the supply of human capital and the demand for it are in balance, a dynamic process of cumulative causation may be set in motion that can raise growth and reduce inequality.

### **3. Social Disparity and Environmental Degradation**

Income inequality also has other implications, particularly in the field of the environment.

Economic growth has been considered to be the remedy for poverty both in rich and poorer countries. Economic growth, however, does not always reduce income inequalities between rich and poorer; instead it tends in some circumstances to enlarge social disparities, and so another relationship between social disparities and environmental degradation becomes obvious. In other words, people seem aware that without protective measures growth may be environmentally destructive. This is particularly so if poor people are left to their miserable lot without social assistance,

because poverty and environmental destruction are linked in a vicious circle (see ***Impacts of Poverty and an Inability To Manage the Environment***).

There are several links between poverty and the environment.

Firstly, poor people live closely to nature; they are presumed to live essentially on the raw resources that nature provides. As their productivity is very limited, poor people tend to have a lot of children as safety insurance on the one hand, and to raise their living standard on the other hand. The increase of poor population exerts a direct pressure on the exploitation of natural resources, sometimes at the expense of natural regenerative capability, causing irreparable damage to nature.

Secondly, poor people don't have a secure livelihood. In the countryside, poor farmers don't have access to land tenure, so they are often forced for their survival to exploit marginal areas of forests or unfavorable areas in a way that is called "cut and run." As they are not able to invest in land exploitation and they can't exploit land in a sustainable way, their activities are destined to contribute to soil erosion and environmental destruction.

Thirdly, poor people don't have many assets; they cannot obtain credit from formal financial institutions in order to develop more profitable activities. This lack of financial resources forces them to resort to an informal but high interest capital market. These high interest loans represent a heavy burden for poor families, and they certainly want to be rid of this burden as quickly as possible. So they are often compelled to use the borrowed money for short-term exploitation, instead of investing in long-term projects. For instance, nomadic herders will use their loans to buy other cattle, instead of improving their meadow, activities that may result in non-sustainable herd sizes and overgrazing.

Fourthly, the destruction of the natural environment, industrial pollution, and carbon dioxide (CO<sub>2</sub>) emissions has resulted in global climate change that has particularly affected poor people's living surroundings. As poor people are very dependent on their environment, the deterioration of their living environment forces them to migrate, to look for other places to exist. Large regional migrations of poor people occur in Africa and Latin America, but also in Asia, aggravating environmental stress and scarcity of resources.

Fifthly, poverty causes social problems. In developed countries, European suburban violence and black riots in the United States are caused mainly by problems associated with poverty. The poor population may resort to violence when the contrast between the rich and the poor becomes too striking and unbearable. In developing countries, the contrast between the lifestyles of the miserable poor people and wealthy *nouveaux riches* often leads to large-scale violence, ranging from a simple military coup d'état to massive riots as in the former Zaire or in Indonesia. These kinds of social upheavals are often accompanied by massive population migration towards regions that are ecologically fragile, reinforcing the vicious circle between population, poverty, and environmental degradation.

In developed countries, public opinion seems increasingly sensitive to problems of environmental degradation. Green movements have become a significant political force. Under pressure from these political movements and other nongovernmental organizations (NGO), governments of developed countries have begun to pay more attention to solving problems that may link poverty to environmental degradation. But in developing countries the struggle against pollution and prevention of natural environment degradation are far from being people's most significant concern. International organizations try to introduce environmental protection criteria to their public assistance projects, hoping that they can accustom developing countries to environmentally protective practice. Will their efforts succeed, when in the waves of globalization developing countries seem more tempted by foreign direct investments that can bring them necessary capital and technology while creating employment? In any case, foreign investors don't seem very concerned about local environmental problems, rather they are accused by some of aggravating social disparities and causing environmental degradation.

Many developing countries in Asia and Latin America are accused of the overexploitation of natural resources, causing global environmental degradation. But if we look at these problems more carefully, we realize that overexploitation of natural resources and destruction of the environment in these developing countries are due mainly to the activities of transnational companies from richer countries. Many NGOs have denounced these activities, reporting that big Western corporations worked hand in glove with local authorities in their exploitation of natural resources, bringing destruction, corruption, division, and death to the lands of indigenous peoples.

For example, according to *Survival*, the U.S. firm Freeport-McMoRan, in association with the British company Rio Tinto and local authorities in Indonesia including ex-President Suharto, has rights to an area as big as Belgium in the world's largest gold reserve, which is also very rich in copper. Mining has polluted the rivers, destroyed one of the world's best-preserved virgin forests, and desecrated religious sites. Confronted with the protests of indigenous people against this damage, Western companies didn't hesitate to incite the Indonesian army to resort to retaliatory violence.

Furthermore, in most cases, countries that lease the exploitation right of their natural resources to foreign companies don't use the money earned by the lease reasonably to reduce social disparities, or to improve local environmental conditions. Rather, corrupt officials often take advantage of this form of foreign direct investments to grab lucrative "commissions" of their own, not caring if the exploitation will cause pollution or bring natural disasters upon the local indigenous population. In Ecuador, for instance, 13 million hectares (almost half of the country) have been leased for exploitation to international oil companies. Oil provides half of all Ecuador's exports and 40% of its national income. But its foreign debt rose from US\$217 million before the oil boom to nearly US\$15 billion by the end of twentieth century, and 70% of Ecuadorians live below the poverty line. Oddly enough, the oil fields are in the poorest parts of the country where working conditions are tough and workers badly paid.

Indigenous people affected or threatened by environmental degradation due to foreign companies' overexploitation number around 300 million across the world. In 1982, a

special United Nations working group helped to strengthen these indigenous people's networks and brought them to international attention. In 1992, indigenous people's representatives gathered in Brazil and adopted the Declaration of Kari-Oca, whose preamble states: "We, the indigenous people, maintain our inherent rights to self-determination and to our lands and territories." By this statement, they want to show their determination to win decision-making power over projects of exploitation and, if they approve them, the right to share the profits. Their battle against transnational companies has been highlighted by many human rights and pro-environment organizations, and won over public opinion in many developed countries. As a result, many people want national and international legislative powers to adopt a minimum body of laws to regulate the operations of transnational firms. So far, attempts to do this have failed or been ineffective, but public opinion is now more sensitive to this problem so the European parliament adopted a resolution in January 1999 calling for monitoring of the operations of European transnational firms, notably by holding well-advertised public hearings at which trade unions and firms can voice their grievances. Europeans would like to give a positive example in this respect.

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### Biographical Sketch

**Yifan Ding**, deputy director of the Institute of World Development, Development Research Center of the State Council, People's Republic of China, graduated from Beijing Foreign Language Institute (now Beijing University for Foreign Studies). He was awarded a Ph.D. in political science from Bordeaux University in France before returning to teach at Beijing University for Foreign Studies as assistant and associate professor. He later moved into journalism, becoming editor of Xinhua News Agency, and was sent by *Guangming Daily* to Paris as bureau chief for more than five years. Returning once again to China, he was appointed to his present position.

Dr. Ding has published many articles in various magazines and newspapers, translated several books from English and French into Chinese, and written four books about globalization and the challenges facing China, the European single currency, the knowledge-based economy, and the international financial system.