Economic Disparity and Global Governance Failures – the Most Important Risks in the Coming Decade

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Abstract. Globalization has generated sustained economic growth for a generation. It has shrunk and reshaped the world, making it far more interconnected and interdependent. Although growth of the new champions is rebalancing economic power between countries, there is evidence that economic disparity within countries is growing. Issues of economic disparity and equity at both the national and the international levels are becoming increasingly important. There is also a growing divergence of opinion between countries on how to promote sustainable, inclusive growth. To meet these challenges, improved global governance is essential.

Key words: economic disparity, developed countries, developing countries, global governance, gross national income.

Motto: *As the world grows together, it is also growing apart.*
(WEF. Global Risks Report 2011)

The world is in on position to face major, new shocks. The financial crisis has reduced global economic resilience, while increasing geopolitical tension and heightened social concerns suggest that both governments and societies are less able than ever to cope with global challenges. According to the World Economic Forum [16], the major risks faced by world's countries are climate change, fiscal crisis, storms and cyclones, extreme energy price volatility, geopolitical conflicts, corruption, flooding and water security. Nevertheless, economic disparity and global governance failures were perceived as both very likely, of high impact and the most interconnected risks - thus, the most important risks in the coming decade.

This makes them central to the visualization of risk interconnections. It also makes them central to our understanding of global risk as it implies that they are particularly important in shaping the contemporary risk context, creating or exacerbating other global risks and inhibiting effective response.

Interestingly, the distribution of their interconnections differs substantially. Global governance failures directly impact a large number of other risks, and are perceived predominantly as an influencer of other risks. Economic disparity, on the other hand, has stronger interconnections with a smaller set of risks and there is more evidence of perceived feedback loop dynamics (figure 1). So, they influence the context in which global risks evolve and occur in two critical ways: first, they can exacerbate both the likelihood and impact of other risks; second, they can inhibit effective risk response.

Global inequality is a relatively recent research topic. According to World Economic Forum, ***economic disparity*** is defined as wealth and income inequalities, both within countries and between countries, threaten social and political stability as well as economic development. Wikipedia [17] defines economic inequality (or "wealth and income differences") as it comprises all disparities in the distribution of economic assets and income. The term typically refers to inequality among individuals and groups within a society, but can also refer to inequality among countries. The first calculations of inequality across world citizens were done in the early 1980s [2, p.728]. This is because in order to calculate global inequality, one needs to have data on (within-country) national income distributions for most of the countries in the world, or at least for most of the populous and rich countries. But it is only from the early to mid-1980s that such data became available for China [9], Soviet Union and its constituent republics and large parts of Africa.

Economic disparity is a global concern that frequently fuels hatred, violence, and terror. Having drawn upon our own experiences in our countries, we have concluded that the great financial differences

between nations, socio-economic classes, members within the same class, and in a family cause unequal access to resources and the failure to fulfill the basic necessities of life. Equal access to resources and the fulfillment of these necessities create equal opportunities. However, without equal opportunities the poor feel deprived after seeing the potential they cannot reach, and feel they live in unjust societies. This economic disparity leads to feelings of inferiority, humiliation, and frustration.

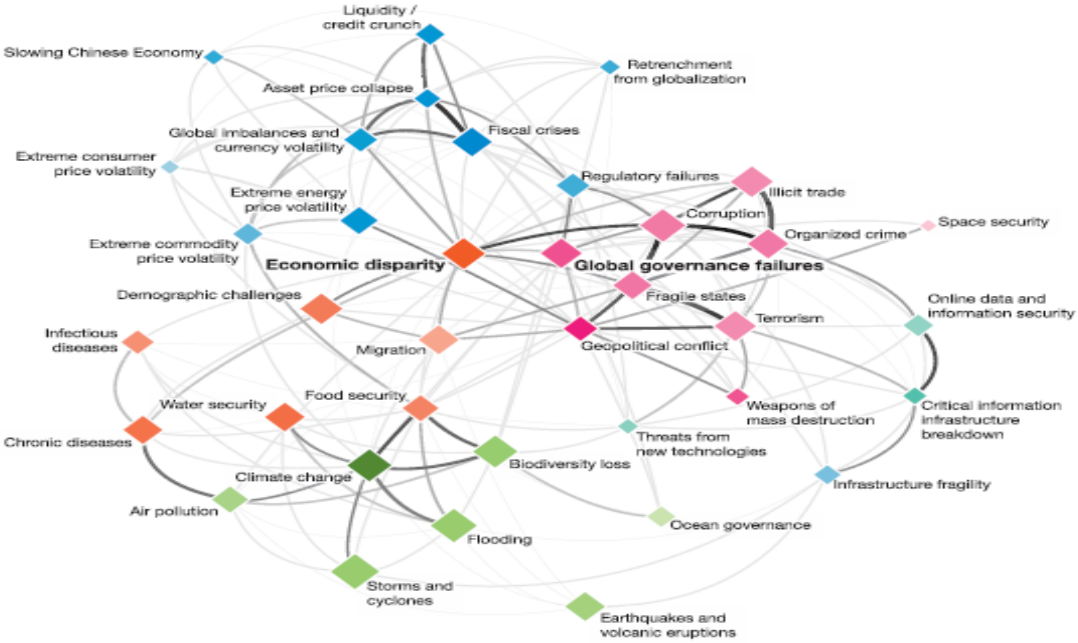

Figure 1. Risks Interconnection Map. 2011

Source: WEF. Global Risks 2011. Sixth Edition. An Initiative of the Risk Response Network. Geneva, Switzerland. 60p.

As a result, the desperation caused by these negative feelings will lead people to turn to violence and terror as their last resort. Economic disparity is tightly interconnected with corruption, demographic challenges, fragile states, global imbalances and asset-price collapse. Respondents perceived economic disparity as influencing chronic diseases, infectious diseases, illicit trade, migration, food (in)security, terrorism and weapons of mass destruction. They saw economic disparity as influenced by climate-change related risks and global governance failures. The data indicate that economic disparity and geopolitical conflict reinforce one another.

Economic disparity plays out between and within countries. The figure represented below shows that while income inequality (as measured by the Gini coefficient) between countries has fallen sharply, within-country inequality has increased slightly. (figure 2)

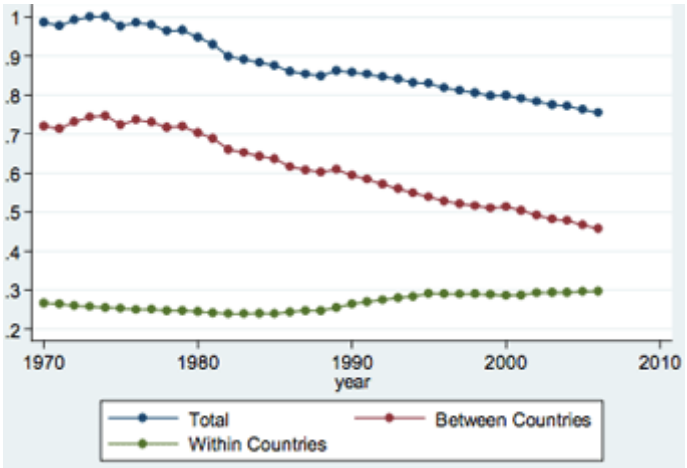

Figure 2. World Inequality, Within and Between Countries

Source: Pinkovskiy M., Sala-i-Martin X. Parametric Estimations of the World Distribution of Income. NBER Working Paper No. 15433 Issued in October 2009 (http://www.nber.org/papers/w15433)

Income inequality as measured by the Gini Index over the past decade has also increased rapidly in emerging economies such as India, China, or Indonesia. This is explained partly by growing gaps between urban and rural areas due to rapid industrial growth, though the slow growth of agriculture and increasing returns to higher levels of schooling have also contributed. In Sub-Saharan Africa inequality generally worsened during the economically difficult 1980s then improved substantially during the growth period of the late 1990s and 2000s.

In Latin America and the Caribbean historically high inequality has been linked to unequal distribution of land and education, higher returns to skilled workers, high fertility in poorer households and regressive public spending. But several countries—among them Brazil, Ecuador and Paraguay—have begun to successfully tackle this inequality. For most people around the world the largest components of income are wages and earnings. Income from capital, by contrast, is often highly concentrated among the wealthiest. The relative shares of labour and capital income are thus of interest in any discussion of inequality. According to UNDP's HDR labour shares declined in 65 of 110 countries (roughly 60 percent) over the past two decades, contrary to the previous assumption of stable labour shares over time [8]. Some large countries—notably India and the United States—saw substantial declines, of up to 5 percentage points, from 1990 to 2008, driving a drop in the average world labour share of 2 percentage points.

In the good times, these divisions didn't seem problematic, but after the financial crisis, when 'too big to fail' bankers were bailed out by the rest of society, the mood has changed. And the communications revolution makes wealth gaps more visible than ever, prompting disillusionment and anger. Ease of communication has made inequalities between countries more visible. Despite robust growth in some emerging economies, many countries remain trapped in a cycle of poverty with tremendous implications ranging from lack of access to basic social infrastructure such as good education, healthcare and sanitation to political fragility of the state. Stakeholders also expressed concerns over evidence of rising economic disparity within countries, in advanced and emerging economies alike. Economic analysis by the OECD and others suggests that real income growth of the top income quintiles of the populations in Finland, Sweden, the United Kingdom, Germany, Italy, and the USA was twice as large as that of the bottom quintiles between the mid-1980s to mid-2000s [15]. While such studies are subject to methodological criticisms and there is disagreement over the findings, the risk of rising economic disparity, even in terms of perception alone, is concerning. Within countries rising income inequality is the norm: more countries have a higher Gini coefficient now than in the 1980s [20]. For each country where inequality has improved in the last 20–30 years, it has worsened in more than two.

Nevertheless, the gap between wealthy and poor is quite wide in most places. The wealthiest 20% of the world's population consumes 76.6% of the world's goods while 80% of humanity gets the remainder [15]. More, the poorest 20% of the world's population receive only 1.0% of the global income and the richest 5% enjoys 40% of all income, alarming, yet no myth, is the reality gripping our world today.

Table 1. Top 10 highest and lowest income countries

Top 10 highest income countries			Top 12 lowest income countries		
Rank	Country	GNI (PPP) per capita,2010, $	Rank	Country	GNI (PPP) per capita,2010, $
1	Luxembourg	63,850	1	Congo, Democratic Republic of	310
2	Norway	57,1305	2	Liberia	330
3	Singapore	4,700	3	Burundi	390
4	Switzerland	49,180	4	Eritrea	540
5	*Hong Kong*	47,300	5	Niger	700
6	United States	47,020	6	Central African Republic	760
7	Netherlands	42,590	7	Togo	790
8	Denmark	40,140	8	Sierra Leone	830
9	Sweden	39,600	9	Malawi	850
10	Austria	39,410	10	Mozambique	920
			11	Madagascar	980
			12	Guinea	980

Source: Elaborated by the authors according to World Bank. World Development Indicators database, 2010.

Recent figures show that the per capita income (GNI (PPP) per capita) of the highest income country in 2010 (Luxembourg – 63 850$) is 206 times greater than that of the lowest income country (Congo, Democratic Republic of – 310$). Moreover, the GNI per capita of Luxembourg is higher than GNI per capita of 41 least developed countries. Statistics also show that 8 economies have per capita income exceeding $40,000, compared to 12 countries with per capita income less than $1000 (Table 1).

It is not difficult to realize that behind the recent economic figures lie untold miseries of hundreds of million of living souls. To give the reader a sense of the magnitude of the hardship experienced by the Least Developed Countries (LDC), additional statistics may help. 47% of the population of the second most populous nation on earth lives under the international poverty line of $1 a day, and 87% below $2 a day. This adds up to over 700 million human beings.

Factors determining the economic disparity between developed and developing countries.

Many factors may have contributed to this trend within countries, including the erosion of employment culture, the decline of organized labour, and failures of education systems to keep pace with the increasing demands of the workplace. Economic disparities are also seen as contributing to a broader process of global social fragmentation. Among the most representative determinant factors we mention:

1. The volatile character of international trade is one of the main factors on the list. Dependence on the export of primary products and raw material e.g. copper, iron ore, timber, sugar cane and coffee which are declining in demand and are becoming less favored in the world market (with the exception of oil exporting countries) compared to manufactured goods remains the most feasible explanation. Moreover, alternatives for these products e.g. synthetic rubber and plastic killed off further hopes for a revival. Since 1955, LDC's export of agricultural raw materials, which made up 20.5% of their total exports have fallen drastically to only 7.6% in a span of 30 years. While the sources of the growing economic gap are multifarious, policies and decisions made by developed countries are one important and crucial source. For example, despite solemn promises to give most-favored-nation concessions, both tariff and non-tariff, to LCDs, developed countries—particularly the G-7 countries—continue to use tariff and non-tariff measures to bock import from LDCs. This is particularly so with regard to products that originates in Africa and the Middle East. Tariff average on textile fibers and garments produced in African and Middle Eastern countries are four times higher than those imposed on similar products from G-7 countries;
2. Apart from trade, loans made by developing countries from bodies such as the World Bank and the International Monetary Fund also play important roles in their ongoing plight, plunging them in an almost infinite debt crisis. The trend in developing countries is to loan money heavily with distant hopes that they are able to accelerate development overnight. Often, poor management of budgets, unwise government spending and corruption will result in unsuccessful attempts to lay out the foundation for development to take place. This means that almost all of the revenues earned by these countries will be used to settle their debts, leaving only little for education, medical care and social betterment.
3. Foreign aid, a blessing in disguise, more politically motivated than one would think, is another factor which maintains the gap between the developed and developing nations. Peter Gottschalk and Sheldon Danziger in their article published in the American Economic Review echoed this when they said, "Foreign capital and foreign "aid" thus fill up the holes that they themselves created. The real value of this aid however is doubtful. The gravity of the situation becomes even clearer if we consider that these credits are used to finance North American investments, subsidize foreign imports which compete with national products, introduce technology not adapted to the needs of underdeveloped nations. . . the hard truth is that underdeveloped countries have to pay for all the "aid" that they receive" [7, p.155]. Persistent in-flow of foreign aid and investment which 'allegedly' serves to improve the situations of developed and underdeveloped nations would, as argued by many, be detrimental to development as it would eventually lead to dependency. Developed by the members of the Dependency school, they assumed that underdevelopment is caused by the "dominant influence exercised by developed capitalist countries as a result of certain political and economic institutions which lock poor LDCs into a dependent relationship". Braun agreed to this when he said that dependency will result in backwardness, misery and social marginality. This can be seen in several African countries like Somalia and Kenya who depended heavily on foreign aid. Another hidden threat with dependency is that it is used by core (developed) countries, elites as well as large multinational corporations (also known as trans-national corporations or TNCs) to fulfill their political and economic agenda. This is evident in the dependency school's theory when they mentioned that foreign controlled economies would strengthen the iron grip of ruling elites with the owners of foreign capital and eventually results in income inequality and economic stagnation. Some even argue that they do not care as much about the well being of the LDCs as counting their profit.

4. Penetration of foreign investment, mostly by Multinational companies, also has its fair share of danger for the developing countries. Bornschier and Chase-Dunn concluded from their empirical studies that foreign capital penetration in 1967 had a negative effect on GNP of the host countries [1]. From other studies done by pro-dependency scholars, it can be said that the "penetration of foreign capital promoted a host of negative effects on the penetrated economy" Often, multinational firms discouraged the local industries from growing, possessing the deadly capability to manipulate weak LDC governments towards their own advantage.

5. Another factor worth looking at is cultural values and how it can be detrimental to economic development. McClelland (1953, 1961) hypothesized that some societies gave less emphasis on economic achievement compared to others. This perhaps can explain the low economic development in both Africa and Latin America. To justify this, US scholars doing a study of Latin American underdevelopment have compared it with the development in the US and Western Europe, they agreed on the notion that "traditional attitudes and institutions stemming from the colonial past have proven to be serious, if not fatal, stumbling blocks to any indigenous effort to develop economically, social or politically." And that "values of Catholicism, of large Indian populations, or of aristocratic rural elites have contributed to 'irrational' patterns of behaviour highly detrimental to modernization". K.H Silvert, a leading authority on Latin America also agreed to this in his text on the impact of traditional values on their economy and politics when he stressed that "there is something in the quality of the Latin American man and his culture which has made it difficult for him to be truly modern" [14]. Argentina is a good example where traditional sentiments reign supreme in halting economic progress where land ownership and labour are strongly based on traditional grounds. But then, cultural values alone is not the most integral explanation, where national stability is another deciding aspect

6. Wars, unrests, bloody protests and other forms of instability can also be a major contributing factor towards halting development. Civil wars in several third world countries like Rwanda, Somalia and Lebanon have severely affected any hopes for progress. In the present, Iraq is also on the verge of a civil war (some speculate that it has already started) which is between the Shiites and Sunnis; this has also greatly downplayed their hopes for economic development, where Iraq is known to have a substantial amount of oil reserves.

7. Lastly, let us briefly look at the reasons as to why several countries, though devoid of resources are able to achieve steady development by looking at the case of Japan. The reasons responsible for their outstanding performance are their productivity drive linked to their amazing technological progress, integration of industrial with foreign trade policies permitting constant industrial modernization vis-à-vis other highly advanced countries, harmonious cooperation between the private and public sector and also the absence of the burden of military expenditure. Coupled with high aspirations to succeed, strong commitment and dedication along with efficient governing and management, this is the scenario seen in many of the developed countries which remains the most vital link towards their success.

Thus, we now acknowledge the main factors responsible and how they operate to maintain the spatial inequality in terms of income between developed (core) countries and developing (peripheral) countries. Though hard for us to believe, these negative forces still emit a formidable aura that is strongly felt to this day. The good news is that steps are taken by world bodies such as the United Nations to tackle and reduce this global crisis, and hope for an egalitarian development where everyone in this world, regardless of their location, would taste the same amount of success and experience the same levels of development. But, the increasing levels of corruption, fresh occurrences of wars and bloodshed, the continuing instability of the world market and the ever-widening technological gap seem to tell us a different story, where inequality and injustice will persist. Unless we all join hands and work together at a global level to resolve these issues, the desire of achieving an egalitarian development will forever remain a distant dream.

Is there a link between globalization and global inequality?

It is often implicitly assumed that the changes in global inequality can be interpreted as telling us whether globalization leads to widening or shrinking income differences among individuals in the world. However, the causal link between globalization and global inequality is very difficult to make. To see this, consider several ways in which globalization affects inequality among individuals in the world.

The first channel goes through globalization's effects on within-country distributions. As we would expect from economic theory, the effect varies between rich and poor countries. In the simplest Hecksher-Ohlin world, globalization would increase demand for, and the wages of, low-skilled labour in poor countries and the wages of high-skilled workers in the rich world. Consequently, we would expect income distribution in poor countries to become "better" and income distribution in rich countries to get 'worse'. This is not, however, consistent with what has been observed over the last twenty years when

distributions in poor, middle-income and rich countries have tended to grow more unequal [3, p.37]. This is an issue which has recently been studied a lot and is still the subject of intense debate: Is openness to blame for increasing wage and income differences in the US? Is openness associated with rising income inequality in poor countries? For example, Milanovic [10] and Ravallion [12, p.3247] find that openness is associated with increased inequality in poor countries, and lower inequality in rich countries, while Dollar and Kraay [5, p.198] argue that there is no systematic effect of openness on inequality [18, p.103].

Then, and this is the second channel, globalization may differently affect mean incomes in poor and rich countries: in other words, it might lead to divergence or convergence in country incomes. There is no unanimity on this point either. Most authors agree that openness is positively associated with mean income growth, but some of them [19; 13, p.186] find the effect stronger for poor countries, while others [4; 6, p.45] argue that the openness premium has been larger for rich than for poor countries during the last twenty years [6, p.53]. The first group of authors would expect openness to lead to shrinking differences in national mean incomes. Therefore, they have to explain away the observed divergence in mean country incomes by the lack of openness among the laggards. According to the second group of authors, the divergence is an indication that the effects of openness might change over time, and that openness, even if positive for all on balance, may exacerbate inter-country inequality.

Third, the effects of globalization may vary between populous and small countries. This area has not been much explored except in the context of the rather limited (in scope and number) studies of small island economies. Yet, one can imagine that globalization may play out differently in populous countries with large domestic markets, or in small niche economies like Hong Kong, Singapore or Luxembourg, than in middle size countries.

And finally, and possibly, most importantly, the effect of globalization on global inequality will depend on history, that is on whether populous countries happen to be poor or rich at a given point in time. To see this, assume for a moment that globalization has a positive impact on the growth rates of populous and poor countries, and has no effect on within-country income distributions. This will, in the current constellation of world incomes, mean that India and China would be expected to catch up with the rich world, while their national distributions will not change, and global inequality will tend to decrease [9].

There would be both mean-income convergence and reduction of global inequality. But let us decouple the poor and populous countries. Suppose that India and China are rich (and still populous) and let most poor countries be relatively small. Now, mean income convergence will continue, but the effect on global inequality will be ambiguous. China and India will benefit from the pro-big bias of globalization, but since they would be rich, globalization will be less beneficial to them than to poor countries. These two effects will pull in opposite directions, and global inequality may go down or up. Moreover, if populous countries are generally poor, the convergence effect is nil, globalization on average favours small countries and leads to the widening of national income distributions, then the overall effect must be to increase global inequality. This illustrates a key point: even if the effects of globalization on within-country inequality, mean income convergence, and populous vs. small countries, are unambiguous and do not change over time, globalization's impact on global inequality will vary depending on where along the international income distribution, countries with different attributes happen to lie at a given point in time. The implication is, of course, that all statements about the relationship between globalization and global inequality are highly time specific, contingent on past income history, and not general.

Globalization has led to different groups within countries having divergent economic interests, undermining a sense of broader national solidarity. At the same time, transnational associations are becoming more important in individual and group identity, enabled by the internationalization of media and communication. Traditional forms of association have been eroded. Trust in institutions seems to have dropped. In part, it may be that vertically-integrated national societies are being replaced by more fluid, transnational societies. This naturally offers a range of opportunities for cross-cultural communication and community-forming unhindered by geography. However, it also creates tensions within countries that lead to global risks, and undermines governments' political capacity to respond to local manifestations of those risks.

It is very vital—if we are to have a positive impact on the process of globalization—to realize that the growing economic disparity does not stem from natural forces inherent in social conditions, but is the result of structural distortions and erroneous policies, and are hence open to reversion and corrections.

While risks are increasingly globalized and interconnected, global governance capacities are highly fragmented. ***Global governance failures*** (weak or inadequate global institutions, agreements or networks, combined with competing national and political interests, impede attempts to cooperate on addressing global risks) create and exacerbate systemic global risks, Survey results showed strong interconnections between global governance failures and regulatory failures, corruption and economic

disparity, with retrenchment from globalization and global governance failures being seen as mutually reinforcing.

The global financial system is one example of a global governance system that failed. The difficulty is that there are a lot of divergent interests, different norms and values so it is difficult to align the world around one system. As a result, we see failures such as the Doha Development Round of the World Trade Organization (WTO) and the lack of international agreement at the Copenhagen Conference on climate change; lack of progress on some of the Millennium Development Goals and challenges to frameworks designed to prevent the proliferation of the capability of nuclear weapons. There is a growing sense of paralysis in responding to global challenges. The Washington Consensus is no longer accepted as the baseline model for economic development, but neither has it been replaced by an alternative set of unified values. The G20 is seen as the most hopeful development in global governance but its efficiency in this regard has not been proven.

The United States' National Intelligence Council and the European Union's Institute for Security Studies recently concluded that current governance frameworks will be unable to keep pace with looming global challenges unless extensive reforms are implemented. Increasingly, emerging economies feel that unfairly they have insufficient influence in international institutions as they are currently designed. Yet there is uncertainty over the ability and willingness of rising powers to shoulder a greater share of global responsibilities, as well as reluctance on the part of established powers to recognize the limits of their own power.

It is uncertain whether global governance will muddle along with an increasingly ill-fitting institutional framework, whether we will find the capacity and will to embrace more agile structures enabled by global networks and new forms of collaboration, or whether the idea of coordinated global governance will be discarded entirely. Effective global governance is also held back by ineffective decision-making structures at the national level. Arguably, technological and social shifts have weakened the ability of leaders to implement internationally agreed commitments which are unpalatable in the short-term, as the cost of mobilizing interest groups has fallen. The difficulties in achieving an international climate change agreement, as well as resistance to internationally coordinated macroeconomic policy measures, are cases in point. A counterbalance would be a well-informed and well-mobilized global public opinion sharing norms and values of global citizenship, but this is not yet fully developed.

In **conclusion** we can say that economic disparity has major potential impacts in the next 10 years and is also tremendously interconnected. But it is underestimated. If we do not deal with economic disparity and global governance failures we will have more problems dealing with other risks. As long as there remain people anywhere who lack the basic necessities, there will be no chance for them to have a viable and fulfilled life, a situation that is more than likely to foster violence. We are well aware that economic disparity will always exist, but we cannot allow it to engulf our world with the violence it breeds; simply because doing that will mean giving up a better and safer life for ourselves.

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