Essay on Globalisation and Inequality

Evaluate the extent to which globalisation inevitably leads to a rise in income inequality in one or more countries of your choice (25)

Globalisation is a process through which countries, businesses and people become more inter-connected and inter-dependent via an increase in trade in goods and services, cross-border investment and labour migration from one nation to another. Income and wealth inequality can be measured in various ways including the Gini coefficient and the Palma Ratio. The latter is a good indicator of the depth of inequality since it tracks incomes flowing to the top ten percent of households and divides by the incomes for the bottom forty percent. In South Africa, that figure is 7.1 whereas for Germany the Palma Ratio is just over 3.

One way globalisation can increase inequality is through the effects of increasing specialisation and trade. A rise in trade-to-GDP ratios signifies an increase in the volume and value of trade between countries and regions. Although trade based on comparative advantage has the potential to stimulate economic growth and lift per capita incomes, it can also lead to a rise in relative poverty. For example, if a country can now import cheaper steel from elsewhere, then there will be a contraction in domestic supply and a fall in employment and real incomes in that industry. This can lead to higher rates of structural unemployment and a decline in real living standards. Real wages come under downward pressure and inequality can increase. We see this in regions of the UK for example where de-industrialisation has taken place leading to much higher rates of long-term unemployment and a worsening of economic and social deprivation. In the United States, the share of national income claimed by the top 1% of the population climbed from 11% in 1980 to 20% in 2014, compared to just 13% for the entire bottom half of the population.

However, one could argue that the benefits of globalisation can be used to offset this. If trade generates faster GDP growth, then the government will see an increase in tax revenues which might then be used to fund capital investment in public goods and merit goods and services including finance for re-training programmes and improvements to infrastructure in economically-depressed areas. Much depends on whether a government has sufficient resources and political will to implement an active regional and industrial policy to improve employment prospects for those negatively affected by globalisation.

Globalisation might also increase inequality because it usually leads to higher profits for multinational corporations such as Apple, Google and Facebook which feed into
generous pay-outs for senior executives and increasing dividends for shareholders. Multinationals matter - they generate 10 percent of the world’s annual GDP and more than 50 percent of the value of world trade. One of the hot political and economic issues of the age has been the ability of businesses operating in more than one country (a transitional company) to use shadow pricing and other forms of legal tax avoidance to reduce their liability to pay tax and thereby increase the return to those with an equity stake. Because of tax avoidance, national governments do not generate the revenues needed to pay for public services and welfare systems - both of which can have a progressive effect on the final distribution of income. The UK government has estimated that, in 2017, multinational businesses managed to avoid paying nearly £6 billion in tax revenues. Oxfam estimates that tax avoidance costs developing countries $170 billion a year whereas $100 billion could provide an education for 124 million children and pay for healthcare services that could prevent the deaths of at least six million children annually.

In evaluation, there are steps that governments can take to increase their tax take. This can range from introducing country-by-country financial reporting so that it becomes clearer where the profits are being made, to introducing restrictions on interest rates charges from one subsidiary of a TNC to another. There are also moves to reduce the amount of intra-company loans made by TNCs which can shift profits to countries with lower corporation tax. In the US, they have introduced a one-off tax on the off-shore cash held by US businesses after it was found that US companies had built up almost $2.6tn in untaxed cash held offshore. Developing countries can also improve their governance so that multi-nationals investing pay a proper rent for the ownership of land and are less vulnerable to corruption from elected officials.

A third way in which globalisation can create increased inequality is by increasing the demand for and returns to higher-skilled work and lowering the expected earnings of people in relatively low-skill and low-knowledge occupations. One of the driving forces of foreign direct investment is that resources tend to flow where the unit cost of production is lowest. This is the case with light manufacturing for example where a lot of investment is flowing to countries such as Vietnam, Bangladesh, Ethiopia and Indonesia. FDI creates more formal employment and incomes for people employed in these sectors but perhaps at the expense of similar workers in higher-income countries whose skills are no longer in such demand. They are therefore at greater risk of unemployment and persistent relative poverty; many have been pushed into poorly paid jobs in services linked to the Gig Economy. People affected often feel that they have been left behind by the forces of globalisation and their votes may have been a factor behind the Brexit outcome and the election of Trump who has adopted a “protectionist approach” to trade policy since becoming President.
That said, it could be argued that it is technological progress – which has raised demand for skilled workers relative to unskilled workers – rather than trade and globalisation which has had most impact on these workers. Often the people who lose jobs as a result of technology are not the ones who get the new ones and the result can be hysteresis in the labour market with deep pockets of long-term unemployment and hit relative poverty. Automation threatens many jobs - ranging from fork-lift drivers to workers in farming and production lines. The onus is on government to implement and fund the right supply-side policies designed to improve the human capital of people affected including lifting investment in human capital and entrepreneurship.

In conclusion, it is not inevitable that globalisation increases inequality of income and wealth. We have seen big changes in the workforce and in earnings between different groups but in my view, these are not solely the consequence of globalisation. One paradox of globalisation is that it has probably reduced inequality between countries but increased it within nations. What matters is how governments respond to the challenge of improving access to knowledge and skills and in making sure that the benefits from cross-border trade and investment provide enough tax revenues to pay for high quality and affordable public services. In this way, more of the positives from globalisation can be turned into a ‘public good’ rather than a ‘public bad’.