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Wealth Inequality and Its Effect on the Society

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ABSTRACT

The rapid increase of wealth inequality in the past few decades is one of the most disturbing social and economic issues of our time. Studying its origin and underlying mechanisms is essential for policy aiming to control and even reverse this trend. Widening income inequality is the defining challenge of our time. In advanced economies, the gap between the rich and poor is at its highest level in decades. Inequality trends have been more mixed in emerging markets and developing countries (EMDCs), with some countries experiencing declining inequality, but pervasive inequities in access to education, health care, and finance remain. A fundamental question in social sciences relates to the effect of wealth inequality on economic growth. Yet, in tackling the question, researchers have had to use income as a proxy for wealth. Deepening inequality has become the subject of intense debates, particularly on growth, poverty, and development. Wealth inequality reduces economic growth. In this paper, we analyze the effects of this inequality on the society.

Keywords: Economic growth, Wealth inequality, Income inequality, Emerging markets, Income disparities.

INTRODUCTION

That inequality matters is gaining ground in development affairs. Reducing income disparities across the population is on top of the agenda of many governments today. High inequality may imply large concentration of people either at the top or at the bottom of the distribution, thereby hollowing out the middle-income group. This can create social tension in society that may result in political instability and social conflicts. The widening disparity between the top one percent and the remaining 99% of a population is a persistent topic in recent literature.

A number of books dealing with various aspects of inequality have sparked interest in the impacts of uneven distribution of income on growth and development. These include The Price of Inequality (2012) by Joseph Stiglitz, Capital in the Twenty-First Century (2013) by Thomas Piketty, Inequality: What Can Be Done? (2015) by Anthony Atkinson, and The Globalization of Inequality (2015) by François Bourguignon. Inequality comes at the expense of a less stable and less efficient economic system, Stiglitz argues in his book. Piketty's book emphasizes the linkage between inequality in income and wealth while Bourguignon's focuses on globalization and inequality. Atkinson's book sets out concrete policy proposals that could bring about a shift in the distribution of income towards less inequality. These publications underscore that high inequality is undesirable in a society and thus requires appropriate policy actions [1] [2] [3] [4].

Inequality matters for two reasons: (i) rising inequality slows down poverty reduction; and (ii) high inequality could weaken the basis of growth. Changes in poverty depend on both the growth rates in mean income and inequality in the distribution of benefits from growth. While an increase in mean income reduces poverty, rising inequality exacerbates poverty; hence, the net effect on poverty reduction will be slower with increasing inequality. Higher initial inequality tends to reduce the impact of growth on absolute poverty, as [5] found in a study that examined the relationship between initial inequality and the rate of poverty reduction using cross-country data with 41 spells for 23 countries.

The impacts of income inequality on growth have been extensively discussed in the literature, but empirical findings point to different directions. While some suggest that inequality hurts growth, some argue that it actually enhances growth. A recent study by [6] suggested a significant linkage between inequality and growth of gross domestic product (GDP). Using cross-country data from 159 advanced and developing economies, the study found that if the Gini index increases by one percentage point, the growth rate of GDP slows down by 0.07 percentage points. The study also found that when the income share of the richest 20% increased by one percentage point, growth in GDP was 0.08 percentage points lower in the following five years, which suggests that that the benefits do not "trickle down".

In contrast, [7] [8] found that high inequality may increase growth if it provides incentives for people to work harder, invest, and innovate. [9] [10] also found a positive relationship between inequality and growth, as higher inequality encourages aggregate savings and capital accumulation given the rich's lower propensity to consume. Per capita GDP and related inequality measures are widely used to appraise the economic welfare of different countries. However, these measures have been subject to many criticisms because of their failure to give any indication of how the total output of an economy is distributed among the population. Many researchers in this field, most notably [11], have raised concerns whether these income measures adequately reflect the well-being of people.

[12] identified the limitations of GDP as an indicator of economic performance and social progress. In mismeasuring Our Lives: Why GDP Does Not Add Up, the authors stressed that GDP and its related measures are inappropriate as the sole measures of living standards or well-being. While GDP gives an indication of a society's economic success, it masks inequalities within societies and does not take into account the negative effects of economic progress such as the pollution of the environment. As an alternative to GDP as a measure of well-being, [13] introduced a conceptual framework for defining and measuring well-being in terms of functionings and capabilities.

Consequences of Wealth Inequality

Wealth inequality is a serious problem in itself independently of its links to poverty. It could be argued that economic inequality violates accepted norms of distributive justice and is, therefore, inherently unjust. It might again be argued that inequality needs to be reduced because it has negative effects on other important economic and social variables such as economic growth or democratic political systems [14].

Effect on Distributive Justice

Concerns about economic inequality are tied to questions about the fairness or justice of particular distributions of wealth or income. According to [15]: The economic framework that each society has—its laws, institutions, policies, etc. results in different distributions of economic benefits and burdens across members of the society. These economic frameworks are the result of human political processes and they constantly change both across societies and within societies over time. Arguments about which frameworks and/or resulting distributions are morally preferable constitute the topic of distributive justice. In economics, a distinction is often made between positive economics, which has to do with the workings of economic systems, and normative economics, which concerns value judgments about the kinds of economic policies that should be implemented. [16] suggest that normative economics is what philosophers refer to as distributive justice. In either case, the goal is to provide advice to policy-makers on the morality of policies that will inevitably have an impact on how well different individuals or groups will fare. Most of the literature on distributive justice focuses on a particular class of societies, generally relatively affluent liberal democracies, but there is also substantial interest in global distributive justice which is often framed in terms of the obligations of those in high-income countries to those in poorer countries [17]; [18]; [19].

The Economic Effects of Inequality

Economic inequality may affect economic growth and the efficient use of resources such as labour and capital. [20] argues that countries with high levels of inequality experience greater economic growth. If true, this would suggest that efforts to lower economic inequality are costly because they reduce growth and prosperity. By definition, economic growth is equal to population growth plus growth in per capita output [21].

[22] argues not only that greater inequality does not enhance economic growth but that it actually has the opposite effect. He notes that rising inequality means that greater shares of economic output flow to the wealthy who are less likely to spend their income on consumption thereby reducing aggregate demand. This might not be a problem if the economy is over-heated but in periods of slow growth, lowered consumption is likely to result in higher unemployment. Overall, [23] argues that greater inequality leads to economic instability and lower output than would be possible given a country's resources.

Inequality may also adversely affect the economy through the inefficiencies introduced by politicians responding to their high-income constituents who lobby for reduced regulations, lower public investment in scientific research and infrastructure, and economic distortions that benefit them at the expense of everyone else [24]. These inefficiencies mean that productive resources are being wasted so that less output is obtained than would be possible if there were no such distortions. In a statistical analysis of the relationship between economic growth and inequality in countries belonging to the Organization of Economic Cooperation and Development (OECD), [25] finds that greater income inequality leads to lower economic growth noting that efforts to reduce inequality will not only advance social justice but may also contribute to increased economic prosperity.

One way inequality might slow economic growth is through its impact on the behavior of economic agents. [26] set up an experiment to test whether workers in unequal settings become discouraged and reduce their work efforts. They find strong support for this "discouragement effect" and argue that such behavioral changes affect not only the individuals themselves but also the broader economy which grows more slowly.

Economic growth is affected by many factors, of course, and it may be that inequality plays only a small role in its evolution. Some studies find that causal relationships between growth and inequality are unclear. [27] highlights the difficulties in finding empirical evidence to support theories showing adverse impacts of inequality on growth noting that confounding factors such as the credit bubble that led to the Great Recession of 2008–2009 obscure the causal relationships.

On the other hand, he points to potential ties between inequality and the credit bubble itself that may lend additional weight to conclusions that there is a negative relationship between rising inequality and economic growth. [12] argue that greater inequality in low-income countries enhances economic growth through its effects on investment while the reverse is true for high-income countries. The effects of inequality on economic growth may operate indirectly through other avenues such as changes in individual behavior or public policies making it difficult to tease out

Behavioral Changes and Health Disparities

Rising inequality may influence individual behavior and such behavioral changes are likely to have an impact on a wide variety of socio-economic variables. As noted earlier, Ku and Salmon (2009) found that inequality can give rise to a "discouragement effect" that causes workers to reduce their efforts to the detriment of economic growth. [4] fears that rising inequality will result in the revival of the kind of "patrimonial capitalism" that was prominent in the 19th and early 20th centuries. He uses a story from Honoré de Balzac's 1835 novel, Le Pѐre Goriot, as illustration. In the novel, a scoundrel named Vautrin advises an ambitious young man named Eugène de Rastignac that he could never amass as great a fortune pursuing a career in law or medicine as he could marrying the daughter of a wealthy family.

For [25], this type of calculation is socially disadvantageous because it will result in less innovation and hard work as talented individuals set off in pursuit of inherited wealth rather than the construction of a socially-beneficial career. [11] argues that human beings develop understandings of their place in society through comparisons with others. Those feeling they have low status behave differently than those who see themselves as higher in the status hierarchy. In particular, Payne suggests that those at the top of the income distribution often come to believe that they deserve their good fortune because they are more worthy than everyone else while those at the bottom, seeing little prospect for the kind of lives led by the rich and famous, often adopt behaviors described as "live fast, die young" [3].

It is important to note that the behaviors developed in response to inequality have both individual and social repercussions. Air rage affects everyone on the airplane as well as the individuals directly involved and everyone shares in the social costs of behaviors that result in shortened lives or earlier pregnancies. The interaction of environmental factors that may lead to stress and individual decisions aimed at coping with difficult circumstances is complex and it can be difficult to disentangle the causes of particular social outcomes. [10] investigates the link between inequality and individual values and attitudes that might affect behavior finding that inequality does influence values related to religion and family but the relation of these values to particular behavioral patterns remains unclear.

The interaction of environmental factors that may lead to stress and individual decisions aimed at coping with difficult circumstances is complex and it can be difficult to disentangle the causes of particular social outcomes. [8] investigates the link between inequality and individual values and attitudes that might affect behavior finding that inequality does influence values related to religion and family but the relation of these values to particular behavioral patterns remains unclear. The relationship between inequality and health disparities, on the other hand, does seem to reflect the influence of risky behavior that may be brought about by the stress of everyday life for those with low status as well as by bad decisions voluntarily made by individuals.

CONCLUSION

Inequality is one of today's foremost development challenges. While the literature has extensively examined the impact of income disparities on growth and poverty, the relationship between inequality and well-being has yet to be comprehensively explored. Inequality matters for well-being and like income inequality, it is also important to be concerned with inequality in different dimensions of well-being such as health, education, employment, and living conditions, among others.

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