

# World Economic Disparity and China's Stance: What Should China do to Solve Economic Disparity?

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**Abstract:** The world's leading economies, China and the United States are experiencing high economic growths. However, some other developing economies around the world aren't growing as fast. This causes economic disparity, where the gap between developed countries and developing countries are exacerbated by the pandemic.

**Keywords:** Macroeconomics; Economics; Economic Disparity

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## Background Information

Economic disparity, or wealth inequality, can be defined as the inequality of the distribution of wealth in a given area, such as a country, a state, or even in between different nations. Some of the major causes of economic disparity between countries includes famine, political instability, and wars. Moreover, this wealth inequality have catastrophic effects on both national and international levels. On the national scale, countries that suffer from economic disparity can experience lower long-term GDP growth rates, higher crime rates, poorer public health, increased political inequality, and lower average education levels (Birdsong, 2015). On the international aspect, economic disparities may challenge global financial stability. This is an idea that has been emphasized by several economists, which essentially can be summarized in two phenomena – “an increasing demand for debt by poor households in reaction to stagnating income, and a higher supply of savings by wealthy households (Monnin, 2019);” these two phenomena eventually generate bubbles in the debt market, and ultimately trigger financial instability.

## 1. Impact of Economic Disparity

### 1.1 Interest Rate

When there is high income inequality, the rich will have a higher marginal propensity to save. According to Keynesian Economic theory, more savings will decrease the demand for money and increase the overall interest rate. In the short-term, this will increase investment because the cost of borrowing from banks decrease. However, in the long term, too much capital that should be spent is accumulated in banks. This will cause low economic growth. This is known as the “paradox of thrift”.

### 1.2 Balance of trade

While developed nations focus on importing raw material and processing goods, developing nations mainly export goods to stimulate economic growth. In developed nations, the trade openness is lower than that of developing nations; 42 in developed nations and 69.9 in developing nations (United Nation, 2012). In short terms, trade makes up more of the economy in developing countries. We know that developing nations have a higher ratio of exports because of the current account balance; -0.6 in developed nations showing higher imports than exports, 2.3 in developing nations showing that they have a higher ratio for exports. The higher number of exports will increase their GDP growth (Kramer, 2022), but low imports also indicate a poor economy and low domestic demand.

## 2. China's Stance/ Recommendation for Chinese Government

### 2.1 Trade and One Belt One Road

Theoretically, trade makes everyone better off, an example will be how the USA helped China decades ago. The high demand for cheap labor and manufactured materials in the USA allows China to increase its export, while USA uses cheap manufactured materials to explore advanced technologies.

As a result of trading between countries, the nations' currency will inevitably spread around the globe. An example will be oil trading between Saudi Arabia and China, where the transaction is made using RMB. In 2020, China imported more than 60 million tons of crude oil from Iraq last year (Jangiz, 2021), and all the trades were in RMB. This is a substantial achievement as it signifies the internationalization of RMB.

A primary goal of the Chinese government in the short term will be to expand the international usage of RMB and eventually make it an internationally used currency. The benefit of an internationalized RMB will be that it can allow a lower foreign exchange reserve and offer an alternative from the dollar for global trade. Although having only one currency for global trade can still function the economic system, the lack of diversity will create many problems. For example, the U.S. government completely controls the dollar, and with the increasing proliferation of unilateralism in the U.S. political system, it is difficult to predict the long-term stability of the dollar as a reputable currency. Furthermore, countries that are not on good diplomatic terms with the U.S. may look for another currency to safeguard its trade in case of sanctions. The internationalization of RMB will provide another medium of exchange for global trade, and countries that are not on good diplomatic terms with the U.S. will have another to be engaged.

To achieve these goals and internationalize the usage of RMB, China introduced the concept of One Belt One Road in 2013. China's goal of the One Belt One Road Initiative is to connect Africa, Asia, and Europe through land and marine time trade routes to improve regional integration, increase trade and stimulate economic growth (*Belt and Road Initiative (BRI)*, n.d.). The Chinese government developed many infrastructure projects for developing nations that would ultimately connect the trade routes. Investments in infrastructure are an exceptionally effective type of government spending that is categorized as a fiscal policy since it boosts the effectiveness of private capital and labor, leading to a higher output (Paulson, 2021). In short, the benefit of government spending is that it will boost the aggregate demand. In the case of the BRI, China is lending money to the governments of developing nations for them to spend on infrastructure projects.

The benefits of BRI are unmistakable, which it reduced the economic disparity between countries. A prominent example will be Pakistan that ever since Pakistan joined the BRI in 2013, its GDP started to grow drastically resulting in higher living standards, increased income, and the ability to allocate resources to services such as education and healthcare. In fact, Pakistan's monthly income has increased from 9685 PKR in 2005 to 41545 PKR in 2019 (CEICdata.com, 2021), while for the social facilities, Pakistan is willing to fund more on the educational system will ultimately contribute to the increase in standard of living on the scholastic aspect. These pieces of evidence directly corroborate with the concepts of multidimensional poverty monetary poverty rate mentioned above; the increased income contributes to the improvement of monetary poverty, while the increased expenditure on education will alleviate the multidimensional poverty, and consequently, decreases the disparity of Pakistan compared to other nations. Hence, the introduction of BRI positively impacted the participated country, benefiting them on both the social and economic scale, reducing their economic disparity compared to other developed countries.

## **2.2 Industrial Upgrading**

Now that China has become one of the world's leading economies, it is no longer beneficial for China to focus too much on exporting cheap manufactured goods. It is time for China to experience an industrial upgrading, where the focus should be shifting towards technology and advanced infrastructures.

When China had the economic reform in 1979, the balance of trade was consistently positive, which made prominent contributions to the economy in the following years. This is a result of exporting cheap manufactured materials to countries such as the United States, where at that time, it seemed like the best thing to do to boost the economy. However, now that China is already one of the biggest economies in the world, the balance of trade should be neutralized, and the focus should be shifted towards technology and other industries that require capital and intelligence. This can be seen by the slowly progressing trade

balance in China's economy for recent years, which although it had reached a peak in 2015, where this trade-balance did not grow over the summit of 2015 for the next few years (Statista, 2021), not only due to the fact of several geopolitical conflicts, disease outbreaks, and terrorism, but also because the demand for cheap manufactured materials started to neutralize, which the quantity demanded of low-priced manufactured goods become a stable and fixed value.

China should import cheap fundamental resources from other developing countries such as Vietnam. This will be beneficial to the exporters of the resource and China, where the exporter will experience the growth of domestic product, and ultimately export more goods to China; this also creates more employment opportunities within the country. For China, the benefit will be a lower inflation rate, where the CPI in China would decrease. This is because the imported cheap materials allow firms to produce goods at a lower cost, resulting in a decrease in consumer prices. Since the China Central Bank does not need to worry about the inflation rate anymore, the interest rate could be lowered. A decrease in interest rates will lower the opportunity cost of holding cash, thus promoting investment, ultimately increasing the GDP in China.

### 3. Cost of Recommendation

Despite all the benefits stated above, there are still certain downsides of Industrial Upgrading. As mentioned up, when experiencing industrial upgrading Factories that produce goods that doesn't require technology and capital will be shut down, and workers will be laid off.

Furthermore, the income inequality will be exaggerated by how industrial upgrading benefits people disproportionately. Technology-related companies, capitalists, and traders will benefit more than all others, exaggerating wealth inequality.

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