Proceedings of ICFTBA 2024 Workshop: Human Capital Management in a Post-Covid World: Emerging Trends and Workplace Strategies
DOI: 10.54254/2754-1169/113/2024.LD18568

Comparison and Countermeasures on the Impact of Income Inequality on Economic Development in China and the United States

Yujie Song[1,a,*]

[1]*Chongqing Foreign Language School, Chongqing, 400050, China*
a. atkinsb2@nwfsc.edu
**corresponding author*

Abstract: This paper analyzes that the effect of income inequality on economic growth in China and the US, summarizing the economic development of the two countries. As the economy grows, income inequality increases. When income inequality increases, it affects several aspects in a variety of ways, including education, the development across regions, the differentiation of consumption power, and social stability. Based on these potential influences, China and the US have similarities and differences. The similarity is that income inequality has a negative impact on consumption and education. The difference is in the political system, which means that there are many factors that lead to differences in the implementation of policies in the true life. Therefore, their respective solutions are also different. This paper focuses on the poverty alleviation policy from China, which has solved the most basic problem of poverty and narrow the gap between the high-income people and the low-income earners. From the perspective of the US, with an experienced and mature tax system, US is able to implement progressive taxation to collect more taxes on high-income people and reduce the pressure on low-income people.

Keywords: income inequality, economic development, taxation policy, regional economic disparities.

1. Introduction

Income inequality has been a concerning problem worldwide and is also an important factor in global economic development, which is closely related to social development. For decades, the disparity between the rich and the poor has been changing all over the world, which relates to several aspects of each country, such as the fundamental level of initial economic development, education opportunity and social welfare.

According to the Organization for Economic Cooperation and Development (OECD), the report presents data for 31 OECD countries from 1970 to 2010 and shows that income inequality has a significant impact on growth in the economy [1]. For example, inequality in some countries rose more than 2 Gini points on average between 1985 and 2005, and this increase is estimated to have reduced economic growth rate between 1990 and 2010. This suggests that income inequality is negatively related to economic growth. However, it is also true that sometimes the gap between rich and poor have beneficial effects. The reason why income inequality can have a positive impact on economic

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growth is because when the gap between rich and poor becomes larger, it stimulates the pursuit of higher economic returns. Then, people with higher incomes invest in more industries, which will lead to technological innovation and progress [2]. Therefore, income inequality sometimes promotes economic growth.

Nevertheless, in the fast-paced world today, the effects of income disparity are usually negative. In recent years, it has been explored how income inequality hinders economic growth, such as the impact of income inequality on the society, often combining case studies and empirical data to illustrate its contribution to social disturbances and political instability. Effective government policies can mitigate the negative social impacts of income inequality.

This paper focuses on two of the world's largest economies, China and the United States, to explore and compare the current income inequality between the two countries. In addition, it explains how to improve the problem in their own countries by narrowing the gap between the rich and the poor and promoting economic growth, and the paper suggests countermeasures accordingly. Specifically, this paper analyses the economic development history of China and the United States, and the impact of income inequality on education, regional development, and the corresponding policies. The two countries can learn from each other in terms of taxation policy and regional coordination, and the development of poverty eradication.

2. Economic Development and Income Inequality in China

In 1978, China started to implement the Reform and Opening-up policy, and from this period onwards, China's economy began to grow steadily. Until 1978, China's Gross Domestic Product (GDP) was 149.54 billion dollars. With the reforms and market opening, economic growth was boosted with GDP increasing to 360.86 billion dollars in 1990, according to the World Bank. China's economy started with a fast-paced growth from 1992, because of the establishment of a comprehensive market, and China began to participate in the global economic system, such as the joining of the World Trade Organization (WTO) in 2001. In 2000, China's GDP was already 1.21 trillion dollars. In the 2008 global financial crisis, although it had some impact on China's economy, China maintained economic growth through fiscal stimulus and efficient monetary policy. China’s effort in ensuring the sustainability of counter-cyclical fiscal policy during the recession and promoting supervision also foster the publication of a Supervisory Focus Note by the International Monetary Fund (IMF) [3].

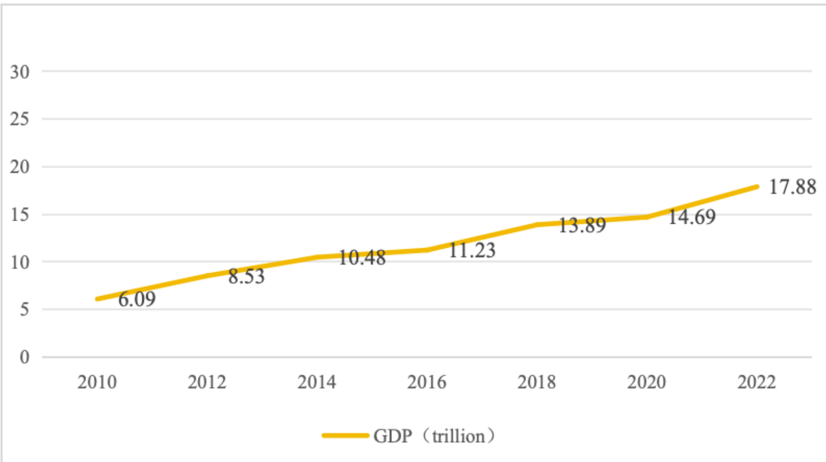

Figure 1: China's GDP from 2010 to 2022 (Data Source: World Bank).

Under that condition, China's GDP exceeded 6 trillion dollars in 2010, allowing it to become the second largest economy in the world. Besides, since 2010, China's GDP has continually increased for the next 10 years, as shown in Figure 1.

Based on the inverted U-shape hypothesis of the Kuznets curve, it has shown that at a certain point, income inequality grows as the economy grows, and China is going through this phase [4]. China's GDP is rising but income inequality is still increasing since 2015 after a drop between 2012 and 2015, as shown in Figure 2.

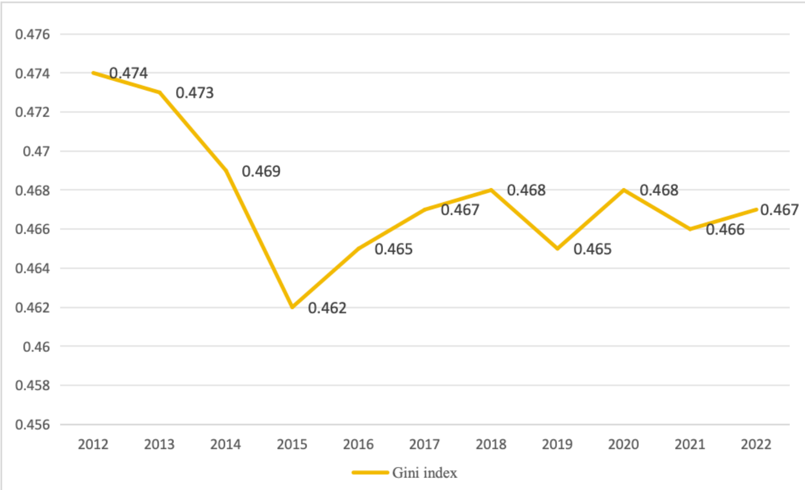

Figure 2: China's Gini index from 2012 to 2022 (Data Source: National Bureau of Statistics).

According to the National Bureau of Statistics, between 1989 and 2006, Gini coefficient of China increased by about 12 percentage points. After 2006, China's Gini coefficient did not show a noticeable change, and surveys show that it was all around 0.5. However, the Gini coefficient at more than 0.4 is already an excessive income disparity. Hence, income inequality in China has been high for a very long time [5].

3. Economic Development and Income Inequality in the United States

The economic development of the United States began with revolutionary changes in science and technology. In the early 1980s, the United States experienced a rapid development of technology, especially in the field of the Internet, a large number of technological innovations and technology companies such as Microsoft and Apple emerged. In the 1990s, globalization accelerated, and the US economy became increasingly linked to the world economy, which facilitated international trade and investment. It was not until the 2000's that US's economic development began to be hindered. Due to the rapid growth of Internet technology in 1990, investors were so optimistic about the prospects of Internet companies that they overlooked the real operations of those companies, which eventually led to the bursting of the Internet company bubble. In 2008, the global financial crisis caused by the mortgage crisis hit the US economy hard again, with the GDP dropped from 14.77 trillion-dollar in 2008 to 17.48 trillion-dollar in 2009, according to the World Bank. It was not until 2010 that the US economy began to recover and grow steadily, as shown in Figure 3.

In terms of income inequality, according to the World Bank, although the US's Gini coefficient declined in 2019, from 0.415 in 2019 to 0.396 in 2020, it remains around 0.4 since 2020, which suggests that the US still has some degree of serious gap between the rich and the poor, as shown in Figure 4.

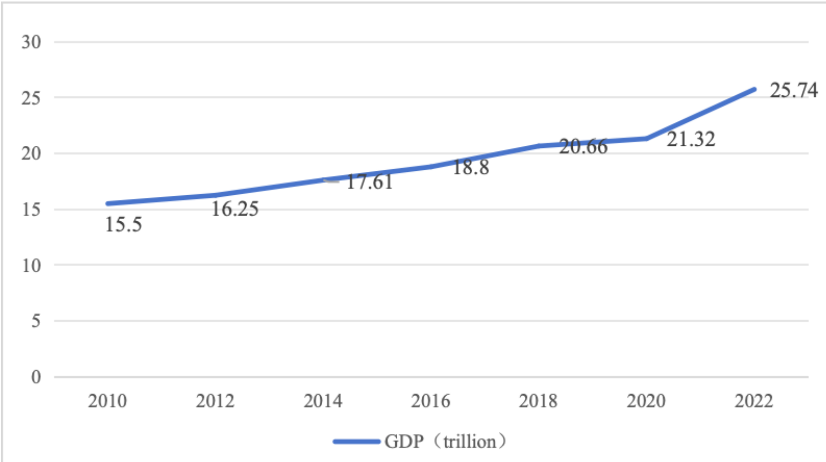

Figure 3: US's GDP from 2010 to 2022 (Data Source: World Bank).

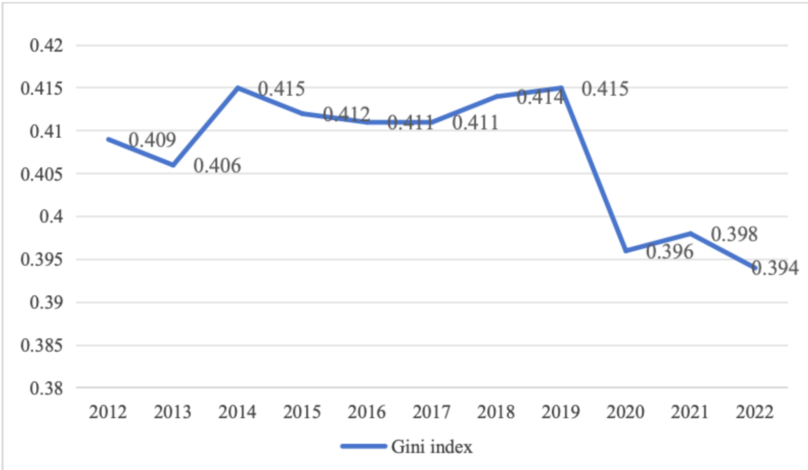

Figure 4: US's Gini index from 2012 to 2022 (Data Source: World Bank).

4. Comparison

The relationship between China and the United States between income inequality and economic growth is significant different. Not only trends in income inequality, but also its relationship with economic growth manifests differ in the two countries. Moreover, the differences are determined by diverse factors, such as structures of the economy, policies and social institutions.

In China, income inequality has led to lower levels of consumption but a higher consumption propensity among low-income people, while high earners have a lower demand for consumption and a greater tendency to save, which inhibit economic growth [6]. In terms of education, high-income people have the ability to invest more in education and gain more effective skill advancement. Nevertheless, low-income people often do not have access to the same educational opportunities. In the long run, the gap in education levels will widen, and the difference in skill levels will lead to a reduction in efficiency and productivity. Fewer people will be employed from highly sophisticated industries, and more will be engaged in low-income and low-demand industries, with a reduction in human resources, which affects economic growth.

Expanding differences in income levels between China's different regions also hinder economic development. In Western China, for example, despite policies like the Western Development Program, the remoteness of the region has limited resource development and the lack of infrastructure also has affected industrial progress, leading to poor economic development. However, the eastern part of the country is more developed compared to the western part. According to the National Bureau of Statistics, the disposable income per capita in 2022 was 47,026.7 dollars in the East and 29,267.4 dollars in the West, and the East have a per capita income of at least 12,000 dollars per year more than the West [7]. Therefore, income inequality exacerbates the economic gap between the eastern and western regions in China, affecting development of across regions and limiting economic growth.

To address income inequality, the Chinese government has adopted various measures and policies, including poverty alleviation, income policy reform and regional development. China has implemented many policies in taxation, such as the implementation of progressive taxes and wealth taxes, which the government has increased the tax rate on high-income earners in order to narrow the gap between the rich and the poor. By implementing the strategy of targeted poverty alleviation, the development of distinctive solutions for solving the problems of different impoverished rural areas is the most central and effective way, since it truly achieves the precise provision of resources and help to the places that truly need these resources [8]. According to the actual situation of the local poverty areas, the development of unique projects include employment, education assistance, infrastructure construction and medical protection are necessary. In order to support the development of special industries in the countryside, the government provides technology and helps create market demand, so that poor households can have jobs and independently achieve the success of poverty alleviation. In order to effectively reduce the imbalance of educational opportunities and resources caused by income inequality, the government focuses on education in poor areas, providing scholarships and student loans, etc., to help more children in poor areas to receive education. Through poverty alleviation policies, the income gap of rich people and poor people can be effectively reduced. Despite China achieved the goal of total eradication of poverty in 2020, income inequality still exists.

Income inequality in the US is the same as in China in terms of its impact on suppressing consumption and education. Income inequality leads to a lower propensity to consume among high income groups, while the consumption needs of lower-income groups are limited by income and cannot be satisfied. Thus, there is a lack of overall demand for consumption, which limits economic growth. Besides, income inequality leads to the inability of lower income families to bear the cost of high-quality educational opportunities, which restricts the children's future development and hinders human capital, which further affects economic growth.

The difference, however, is that the United States has also experienced income inequality to a greater extent due to globalization. Despite the fact that globalization has boosted US global trade, it has also increased competition in the US labour market, especially in manufacturing. China, for example, has a strong advantage over the US in manufacturing exports, and foreign competition cause lower wages in these fields, but wages in some high skill professions are relatively higher [9]. The difference between China and the US is also reflected in the political system. The Chinese government's policy response to the problem of income inequality is more active and practical, such as poverty alleviation policies or regional coordinated development policies. Furthermore, because these policies interfere to alleviate the problem of salary disparity, the government has also been effective in stabilizing social harmony. However, in the United States, income inequality tends to cause social division, which affects the implementation of policies. In addition, the high earners in the US has strong political influence, and this also affects the implementation of policies. Nevertheless, due to the better initial economic development in the United States, the impact of income inequality on economic growth is not a major problem. However, it can cause social disturbance and contain potential problems [10].

In general, China can learn from the United States taxation policy, because the United States has more experience in tax administration with mature management. The United States has mainly implemented progressive tax, increase the tax on high-income groups, and reduce the economic

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pressure of low-income groups [10]. The United States can learn from the actions taken by China in eliminating poverty, such as the targeted programme for geographically different situations to reduce poverty and inequality.

5. Conclusion

With the development of global economy, income inequality undoubtedly becomes an obstacle to economic development, social stability and national prosperity for the whole world. This paper explains the history of economic growth, the level of income inequality and the impact of inequality on economic growth. By analyzing the economic development of China and the United States and their own income inequality across regions, education and social policy, this article demonstrates the impacts, solutions, and compares the differences between China and the US on economic structure, policy and social system. Finally, China and the US can learn from each other in taxation policy and regional coordination, which they could transform each other's policies according to their own national conditions in order to deal with their own unique income inequality problems. On the way of cracking the problem of income inequality in the world, there would be many measures which can help each country to learn from each other. With the efforts of all countries, the world will develop better.

Although the article describes various aspects of economic development, as well as income inequality between China and the United States, it still has shortcomings. For example, this article does not include quantitative analysis or complex data modelling. Moreover, income inequality exists in the whole world, but this paper only analyses two countries, which cannot completely prove the suitability of countermeasures for other countries. Besides, the countermeasures need to be adapted to local conditions. To narrow the gap between the rich and the poor, it is still necessary to do research on more countries, comparing, analyzing, and considering exploration of each country's various problems.

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