THE WALL STREET JOURNAL.

January 21, 2012

Is Income Disparity Slowly Fueling the Next Global Crisis?

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The recent years have seen the occurrence of an unprecedented series of catastrophes and crises over a very short period of time. Terrorist attacks in New York, Madrid, London and Mumbai; massive deadly natural disasters in one country after another: not only hurricane Katrina causing $200 billion of economic losses in the US in 2005 and the massive earthquakes in Haiti, Chile, New Zealand in 2010 and the one on March 2011 in Japan -- which had important consequences on global supply chains and national nuclear production strategy worldwide--but also historical large-scale floods in Australia, China, Pakistan and more recently Thailand and their impact on commodity price volatility; from a global financial crisis that still has enduring effects on many economies to wide-spread fiscal crises in a number of (quasi-bankrupt) states.

What's happening and what's new? For many years we all celebrated globalization and its fantastic benefits. But we may have underappreciated its flip side: risks are becoming more global too, so that each one of the aforementioned events had major ripple effects on other parts of the world than where it originated. Managing these risks alone, as the CEO of a business and the head of state, has become a 'mission impossible'.

What can be done? The World Economic Forum last week issued its 7th Global Risk Report (GRR). It aims at helping top decision makers better understand the perceived likelihood and severity of a number of global risks which could materialize, or become more severe, in the coming ten years. It also shed some light on the level of interdependence among those risks and what unintended consequences they could have. The GRR 2012, which will be widely discussed in Davos next week, focuses on 50 global risks and rank them based on the response gathered from a survey of nearly 500 top decision makers in the public and private sectors and experts from leading research institutions.

What tops the list this year? Income disparity. Today we have reached a 50/1-1/50 situation: the poorest 50% of the global population owns barely 1% of the global wealth, while the planet's top 1% owns close to half of the world's assets. If this gap continues to rapidly stark, this will have serious consequences. Indeed many governments don't have the financial strength to support large welfare programs and counter-cyclical spending anymore.

Don't think this is only Occupy Wall Street... A live example is China. The income disparity in China has been slowly on the rise since the late 1970s when Deng Xiaoping started his market-oriented reforms. In addition to the differentials between the rich and the poor in general, the income disparity in China also manifests itself in regional income gaps and urban-rural income gap.

For example, while the eastern/coastal provinces have always been economically more developed than the western/inland provinces, the differential has grown over the years. In 1980, the per capita GDP of the coastal provinces was about 80% higher than that of the inland provinces, and in 2008, that number grew to 144%. Similarly, data released this week by the National Bureau of Statistics of China (NBSC) indicated that the average income of a Chinese urban resident was 313% of a rural resident, compared to 186% in 1985. In the late 1970s before the reform started, very few Chinese citizens had any quantifiable personal assets, but in 2010, China had 271 known billionaires, second only to the US.

This multi-faceted income disparity has far-reaching implications to the Chinese economic, social and political dynamics, and presents a serious risk. The most obvious example is related to migrant workers. NBSC estimated this week that, in addition to about 100 million rural laborers who work in nearby cities, there are currently 150 million migrant workers in localities far from their rural homes. These rural labors migrate to other cities or provinces in search of better economic prospects. In their new urban homes, however, they frequently face long work hours, substandard work conditions, severe restrictions about what types of jobs they can do and where they are allowed to live, lack of education opportunities for their kids, and lack of credible mechanisms for labor disputes, among other problems. The widely reported 18 attempted suicides during a ten-month period in 2010 at Foxconn, a primary manufacturer of iPad and other products for Apple, Dell, HP, Motorola, Nintendo and Sony, highlighted the level of despair migrant workers might have been facing.

These risks have not gone unnoticed by the ruling Communist Party. As early as 2005, the Party started to list 'harmonious society' as a strategic objective. The Twelfth Five-year Plan that was launched last year placed a heavier focus on the quality of life and resident income over GDP growth.

In the long term, how these measures would reduce the risks in China, and impact the rest of us, remain to be seen. In the short term for China, the 2011 economic data that was just released yesterday by NBSC offered some ground for cautious optimism. For the first time in China's thousands of years of history, more Chinese people live in cities than in rural areas, reflecting a continued urbanization process through which more people move to cities with better living standards. The urban-rural income differential dropped slightly from 333% two years ago to 313% for 2011. NBSC data also showed that, after two years of various policy measures, the housing prices in most Chinese cities start to drop, making housing more affordable to the Chinese.

In Davos next week, several panel sessions are set up to discuss global risks. Many crises in the past were triggered by stand-alone and disruptive catastrophes. In the crisis-fatigued, just-in-time and interdependent world today, what risks are more likely to cause the next shock to the world? Would they be the risks you manage everyday that you think could destabilize your organization or your country, or would they be those you decide to ignore, conscientiously or not, because you believe they do not matter much? Would they be stand-alone, sudden and disruptive traditional risk events as we saw in the past, or would they be interconnecting and slow-building trends that people take for granted, for a long time until the time they actually cause a crisis?

Is income disparity slowly bleeding the world into the next crisis?

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