

How Can Declining Relative Inequality Coexist with Persistent Absolute Inequality, and What Does this Imply for Global Investment Allocation?

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Abstract

This paper examines an apparent contradiction in global inequality trends: relative inequality between countries has declined in recent decades, even as absolute income gaps remain large. Drawing on Branko Milanovic's framework of three historical eras of global inequality — the Great Divergence, the Three Worlds period, and the recent Great Convergence — the study investigates how these two measures of inequality can coexist and what this means for global capital allocation. Using the Milanovic Global Gini Database, the analysis constructs three data samples covering global inequality trends, country-specific patterns in China (including a rural-urban breakdown), and a comparative case in the United States, spanning approximately 1980 to 2015. The findings show a modest downward trend in global relative inequality alongside rising within-country inequality in both an emerging economy (China) and an advanced economy (the United States). This divergence between cross-country convergence and rising internal disparity is explained through the distinction between relative and absolute inequality measures. The paper concludes that global convergence is real but incomplete: faster growth in emerging markets narrows proportional income gaps, while structural differences keep absolute income levels far apart. These findings carry implications for global investment allocation, suggesting growth-driven opportunities in emerging markets alongside persistent risk tied to unresolved structural and distributional imbalances.

Over the past two decades, global inequality has shifted. For most of economic history, income gaps between countries have widened as developed economies grow. More recently, however, this trend has started to reverse. Rapid growth in emerging markets, particularly in countries like China and India, has led to a decline in relative global inequality when measured in relative terms. On the surface, this suggests a more balanced global economy and a narrowing divide between rich and poor nations.

However, this is only part of the story. While poorer countries are growing faster, the absolute income gap between them and richer economies remains large. A worker in a developing country may be better off relative to the past, but still far behind their counterpart in an advanced economy.

This idea has direct implications for how investors and policymakers think about growth, risk, and capital allocation across countries. If economic convergence is real, it suggests new opportunities in emerging markets. However, absolute inequality reflects structural differences across countries that limit how and where capital can be effectively utilized.

This paper asks: How can declining relative inequality coexist with persistent absolute inequality, and what does this imply for global investment allocation? By combining long-run inequality data with income

measures, the research aims to understand this contradiction and explore what it might mean for the future of global financial markets.

Background & Theoretical Framework

The Three Eras of Global Inequality

To understand current trends in global inequality, it is helpful to take a long-run perspective. As outlined in *The Three Eras of Globalization* by Milanovic, global inequality has evolved across three eras, each driven by different economic forces. The first is known as the “Great Divergence”. It began in the nineteenth century and continued on to the mid-twentieth century. During this time, the Industrial Revolution led to rapid economic growth in Western Europe and North America. This resulted in income differences between countries increasing significantly, leading to a sharp rise in overall global inequality. (Milanovic, *The Three Eras of Global Inequality*, 2023). The second era, from around 1950 to 2000, is marked by stable but high levels of inequality between countries. While some convergence took place, specifically among advanced economies, a lot of the lower-income countries stayed far behind. This period is called the “Three Worlds” system, in which income differences between rich and poor countries remained large and persistent. (Milanovic, *The Three Eras of Global Inequality*, 2023). The third and most recent era, beginning around the early 2000s, is called the “Great Convergence,” during which global inequality has started to decline in relative terms. Poorer countries began to catch up as their markets faced rapid growth. (Milanovic, *The Three Eras of Global Inequality*, 2023). Individuals have moved into higher income brackets, and the global income distribution has become less varied (Milanovic, *The Three Eras of Global Inequality*, 2023).

This situation is described as convergence¹, where lower-income countries grow faster than high-income ones, reducing proportional differences in income. However, this convergence is not uniform. An important distinction is between inequality between countries and inequality within countries. While income gaps across countries have narrowed, inequality within many countries has increased over the same period. This reflects changes in labor markets, technology, and globalization. These tend to benefit certain groups more than others, and as a result, as global inequality declines on average, disparities within national economies remain significant.

The China Effect and Global Convergence

A primary driver of this recent decline in inequality is the rise of China. Due to its large population and sustained economic growth, China has played a large role in reshaping the global income distribution. As China’s economy expanded, many individuals moved from lower to middle income levels. Because global inequality is measured across individuals rather than countries, this shift had a significant

¹ Branko Milanovic, “The Three Eras of Global Inequality, 1820–2020 with the Focus on the Past Thirty Years,” *World Development* (2023). China's growth shifted a large share of the global population out of the lowest income brackets, helping narrow the overall global income spread equalizing effect. Essentially, the growth of China shifted a large share of the global population out of the lowest income brackets, which helped narrow the overall spread of incomes globally (Milanovic, *The Three Eras of Global Inequality*, 2023). This phenomenon is illustrated by the “elephant curve,” which is a representation of global income growth between 1988 and 2008.

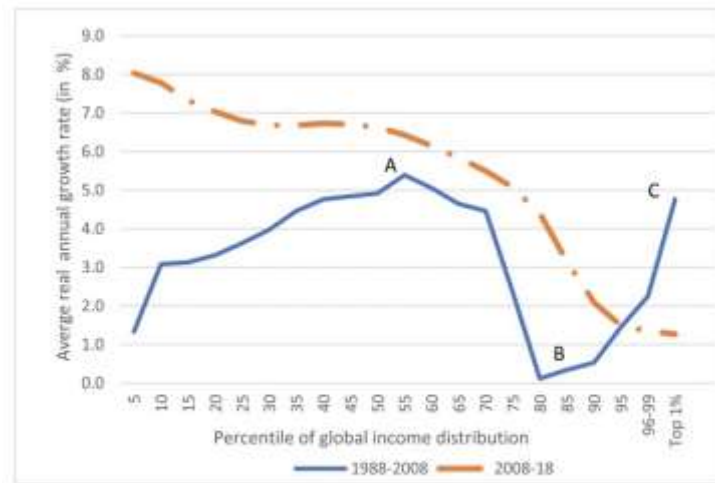


Fig. 5a. Global growth incidence curves for 1988-2008 and 2008-2018 (in relative terms).

Figure 1. Elephant Curve (Milanovic, *The Three Eras of Global Inequality*, 2023)

It shows that the largest income growth over recent decades has occurred in the global median, which is mainly composed of individuals in emerging markets. The top 1-5% globally have also experienced the same growth. However, the face (part B) portrays a simultaneous decline for the middle class in advanced economies. The winners in this situation are, therefore, developing countries as well as the top 1-5%, while the losers are the middle class of rich countries.

Even though China has been a major force behind global convergence, the impact also highlights the uneven nature of this process. Not all developing countries have experienced similar growth trajectories, and within China itself, inequality has increased. As a result, convergence across countries has been accompanied by rising inequality (Milanovic, *The Three Eras of Global Inequality*, 2023).

Relative vs. Absolute Inequality

An important idea is the difference between relative and absolute measures of inequality. Relative inequality focuses on proportional differences in income, which is depicted by measures such as the Gini coefficient. From this perspective, global inequality has declined in recent decades, as poorer countries have grown faster than richer ones (Milanovic, *The Three Eras of Global Inequality*, 2023).

On the other hand, absolute inequality looks at differences in real income levels. Even if poor countries grow at a faster rate, the actual income gap is still large. Because poor countries start from a lower base, even though they're growing, they're unable to catch up in terms of real income. This helps explain the paradox in global inequality trends. While relative measures suggest convergence, absolute measures show that disparities still exist. In simple terms, countries may be catching up relative to each other, but not in absolute dollar terms. The difference between relative and absolute inequality is crucial to interpreting global economic trends. It suggests that convergence is real but incomplete, and that structural differences across countries are still primary drivers of the distribution of income.

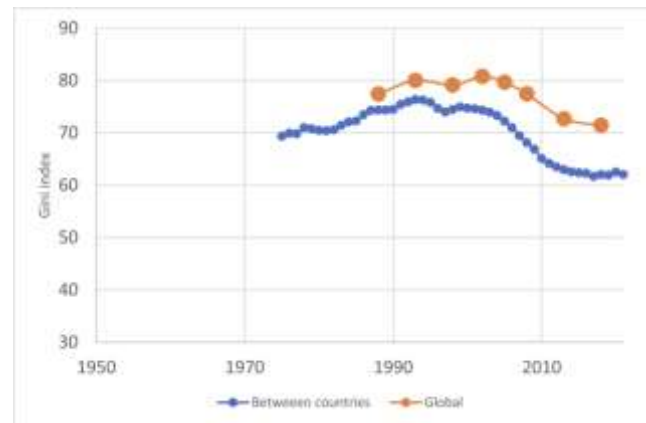


Figure 2. Absolute vs. Relative Inequality (Milanovic, *The Three Eras of Global Inequality*, 2023)

Data and Methodology

This analysis uses the Milanovic Global Gini Database (“All the Ginis”), assembled by Branko Milanovic and other collaborators. The dataset combines inequality estimates from numerous national household surveys and secondary sources (Milanovic, Global Gini Database, 2019). The database itself is designed to track inequality at the country level using the Gini coefficient, with data going back to the mid-twentieth century. Because consistent long-run data on inequality is hard to obtain, the dataset combines observations from various sources. Some of these are income-based, while others are consumption-based metrics. The approach of the assemblers is to prioritize breadth and comparability over perfect consistency. There are lots of blanks in the dataset; however, the goal is not to produce identical measurements across all countries but to capture broad patterns.

For the purposes of this paper, the Gini coefficient is used as the primary measure of relative inequality. The sample includes a wide range of economies (low and higher-income) from approximately 1980 to 2015. This helps reflect global trends rather than only country-specific dynamics.

Sample Construction and Data Selection

To address the research question, the sample is drawn from the Milanovic Global Gini Database to capture both global and country-specific inequality trends. The analysis relies on overall global inequality data as well as a subset of data points for specific countries.

The selection process begins by filtering the dataset to include only observations with valid Gini coefficients. Any entries with missing or inconsistent data are removed to ensure that the sample is accurate. The early data for most regions is quite uneven, so most of the analysis primarily consists of data from 1980 to 2015. From this filtered dataset, three charts were created.

The first is a global inequality sample. This was created using all the available data points for each country/region and year. The idea is for it to highlight trends in relative inequality over time. By being spread out across countries (advanced and emerging), the sample captures a broad view of global inequality in the long run. The second is a country-specific chart for China, which was constructed to examine how inequality has evolved within this major economy. Since China has also played a central role in global convergence, it is significant to examining overall inequality. The data is further broken down into another chart with the rural vs. urban inequality trends, which allows for a more nuanced view of internal distributional changes and how they might impact overall country dynamics. Lastly, the third chart is a sample for the US, which is included to provide a point of comparison with an advanced

economy. This allows the analysis to highlight differences in inequality between advanced and emerging markets.

These three samples are designed to reflect different dimensions of the research question: global trends, emerging market inequality, and comparison with rich countries.

There are various alternative ways the dataset could be sampled, but each presents limitations in the context of this research question. One option would be to restrict the sample to a smaller set of countries with consistent data across all years. While this would improve the accuracy of the comparison, it would significantly reduce the geographic scope of the analysis and weaken the ability to make global claims. Another approach would be to weigh countries by population when calculating global inequality. Although this would more closely represent inequality at the individual level, it would also introduce a heavy reliance on a few large countries. For these reasons, the chosen samples would be the best approach in order to depict a balance between comparability and relevance to the question.

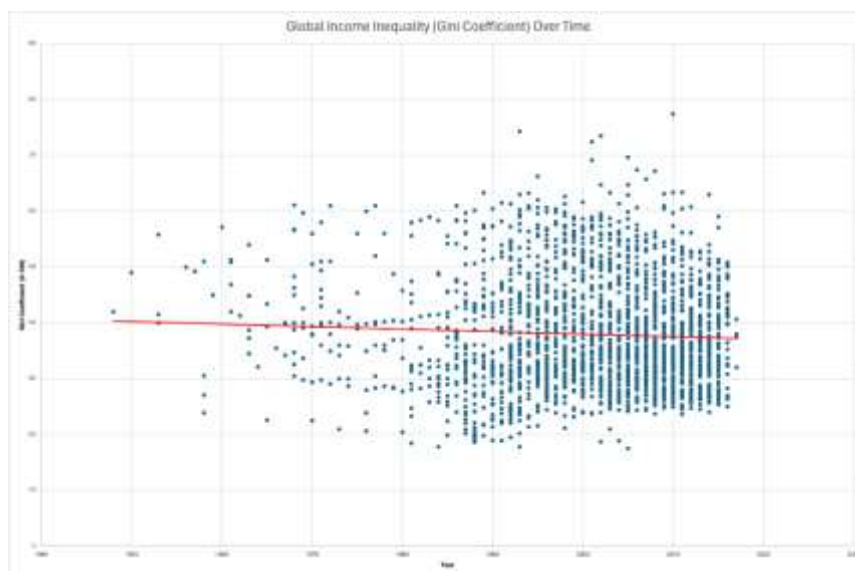


Figure 3. Global Income Inequality using Gini Coefficient



Figure 4 & 5. China vs. US Income Inequality Trends

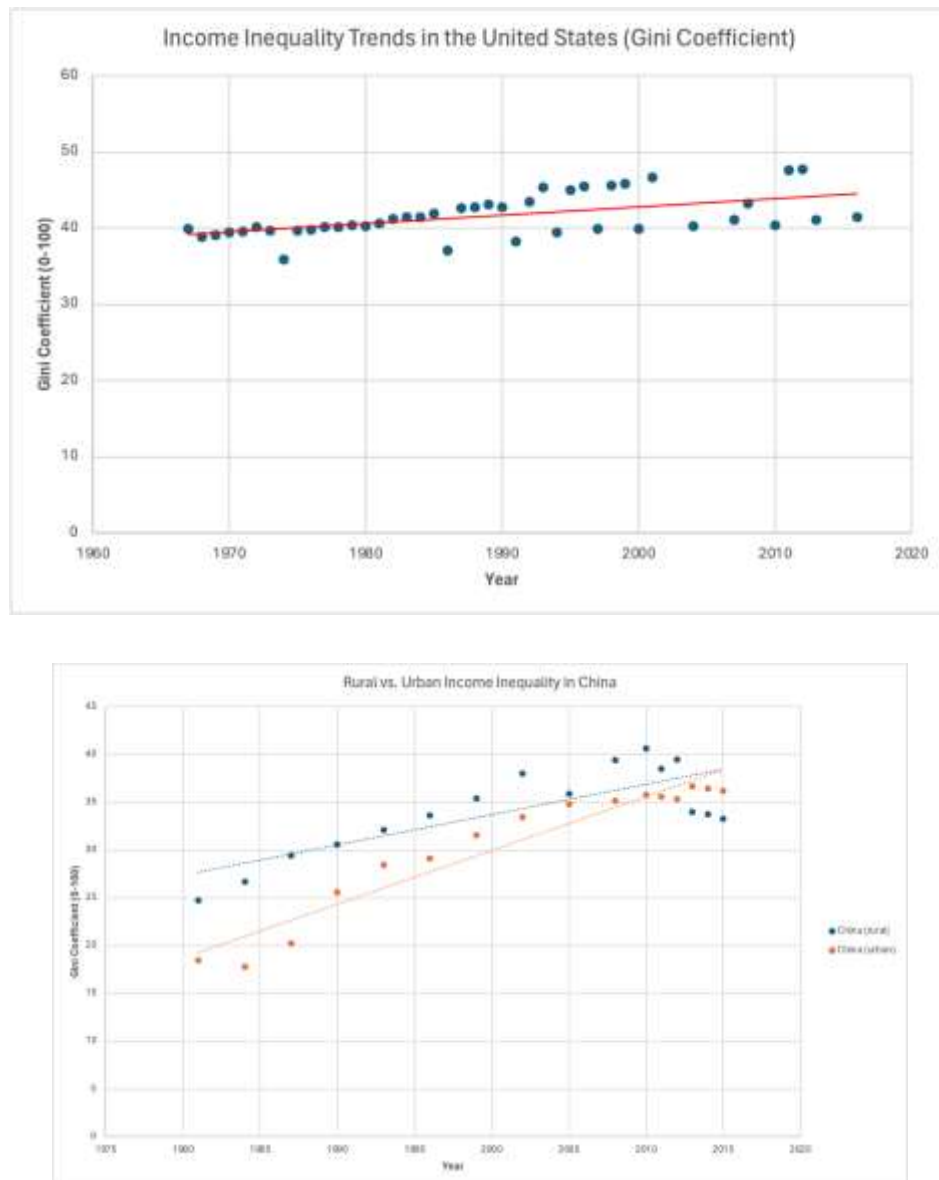


Figure 6. Rural vs. Urban Inequality Trends in China (Additional)

Data Analysis

The data reveals a pattern that is subtle at first glance but becomes more meaningful once the different pieces are considered together. Looking at Figure 3, the most immediate takeaway is that inequality has not moved dramatically; however, the trend line slopes downward. The change appears gradual, almost not present. This suggests that whatever forces are shaping global inequality are over the long-run. At the same time, the spread of the data is striking. Even in the most recent years, countries show a wide range of Gini values. Some cluster in the mid 20s to low-30s, while others remain well above 50. This dispersion never really disappears; rather, it reinforces the idea that global inequality is not a uniform trend.

Once the focus shifts to individual countries, the story becomes slightly clearer. China stands out (figure 4) as its Gini coefficient rises steadily over time. It moved from low levels in the early 1980s to significantly higher levels by the 2000s. The upward slope is consistent and very evident. Growth, in this

case, has not been evenly distributed. The rural versus urban breakdown makes this even more apparent. Both series increase, but they have different starting points. Urban inequality is generally lower, while rural inequality begins higher. However, in more recent years, the two have begun to come to similar values. The implication of this is that China's rapid development has lifted incomes overall, but has also introduced new forms of internal imbalance.

A similar, but less pronounced pattern is portrayed in the United States in Figure 5. Inequality trends upward over time. The increase is more gradual than in China, but the trend is consistent. There are small fluctuations, but there isn't a sustained period of decline. In both cases, the data suggests that within-country inequality is rising, regardless of whether it's an emerging market or not.

Together, these charts point to a significant point of tension. At the global level, inequality appears to be modestly declining. However, on a country-level, inequality is either rising or remaining high. These two trends are not contradictory, but instead reflect different underlying dynamics. When poorer countries grow faster than rich ones, the gap between countries narrows in relative terms². At the same time, the growth can create a larger gap internally, especially when it is uneven across regions or sectors.

This helps explain how relative inequality can decline even as absolute inequality persists. The global Gini captures proportional differences, not actual income levels. A country can grow rapidly and still remain far below the income levels of advanced economies. That gap does not disappear simply because growth rates are higher. In fact, depending on the starting point, it could remain large for decades. The data presented does not directly show income levels, but the divergence between global trends and country-specific patterns suggests that convergence is incomplete.

There are alternative ways to interpret these patterns. The downward trend in global inequality is small and it is possible that it is a result of other factors rather than an actual shift. The number of observations increases over time, which may influence the average as well. Additionally, large countries such as China and India carry disproportionate weight, due to their population. There are also some limitations in what the data can represent. The Gini Coefficient, while it's useful, only provides a partial view of inequality. It does not reflect differences in absolute income levels, nor does it account for wealth distribution. There's various economic and standard of living factors that are not included in the value,

² Relative convergence (Milanovic, *The Three Eras of Global Inequality*, 2023) There are,

especially when population sizes vary so widely. A small country is treated the same as a large one, which can distort the entire global picture.

Nonetheless, even with these limitations, the overall pattern is difficult to ignore. The data suggests that global inequality is becoming less pronounced in relative terms. But it also depicts that convergence is real. Growth is shifting toward emerging markets, and structural differences between countries continue to have an impact.

Interpretation & SWOT Analysis

The patterns observed in the data point to a global economy that is becoming more interconnected.

Strengths

One of the most notable strengths revealed by the data is the rise of emerging economies. Growth is no longer concentrated only in advanced markets. Countries such as China have experienced rapid income expansion over several decades, which is reshaping the global distribution of income. This shift creates

new hubs of economic activity and areas for investment and also suggests that convergence can continue to support global growth.

Weaknesses

Despite these shifts, absolute income differences are still quite high, which limits how meaningful convergence is in real terms. A country may be able to grow quickly and still remain far behind richer economies. Simultaneously, internal country inequality is rising both in developing and advanced economies. The upward trends observed in China and the United States highlight growing internal imbalances, and these dynamics can create economic and political strain.

Opportunities

The data points to a reallocation of growth across regions, which presents clear opportunities. As emerging markets expand, they offer new avenues for investment, particularly in sectors tied to consumption and infrastructure. This also leads to overall interconnectedness and equality of the global economic landscape.

Threats

Several risks also complicate this situation. A lot of the observed convergence is driven by a small number of large economies. If growth in these economies slows, the overall trend may not be as strong. Rising inequality within countries also introduces a level of uncertainty. The evidence suggests that global inequality is changing, but not disappearing. Relative convergence creates opportunities, yet persistent absolute differences continue to shape outcomes.

Consequences

The coexistence of declining relative inequality and persistent absolute inequality points to a shift in how global growth is distributed. Economic growth is no longer only in advanced economies; instead, a large part is coming from emerging markets. This has implications for overall growth patterns. Rapid growth in developing regions can support global output when advanced economies might slow down.

At the same time, rising inequality within countries may weigh on consumption and contribute to uneven labor markets. These internal imbalances can also create inflationary and political pressures. As a result of this, the global economy might experience stronger growth overall, but with more variation across countries.

These dynamics shape financial markets. Absolute inequality suggests that capital stays concentrated in wealthier economies. But faster growth in emerging economies points to the potential upside in equities and real assets, even if the risk is high. This creates a gap between where growth is occurring and where capital. This creates a gap between where growth is occurring and where capital is allocated. For investors, this may lead to opportunities in emerging markets; however, policymakers might face a challenge. They will need to address internal inequalities through redistribution and structural changes. Without these changes, convergence across countries will probably continue, but the underlying imbalance is likely to remain.

Conclusion

This paper is set out to examine a central tension in global inequality: why has it declined in relative terms while staying high in absolute terms? Using the Milanovic database, the analysis shows that both trends can exist at the same time. Countries are catching up, but the gap in real dollar value is still very much evident.

These findings help align competing views. The argument that inequality is falling is not wrong, but the

conclusion depends on how inequality is measured. At the same time, the persistence of absolute income gaps suggests that there is much more to the story. Growth has shifted toward emerging markets, but structural differences between countries continue to shape outcomes in meaningful ways.

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