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Globalization and Income Inequality: An Economic Model of Wealth Distribution in International Trade

Mohammad Hadi Dehghani [a]

[a] *Tehran University of Medical Sciences, School of Public Health, Department of Environmental Health Engineering, Tehran, I.R. Iran. E-mail: dehghanihadi@yahoo.com*

Abstract

While the positive implications of globalization on domestic economic integration may be evident from previous studies, globalization may present some challenges in terms of influencing domestic income inequality. The current study aims to identify the influence of globalization through foreign trade and financial inflows in terms of its effect on the Gini Index under different economic conditions, while recognizing the shortcomings of classical theories in dealing with market inefficiencies. For this purpose, the Fixed-Effects Regression Analysis is conducted using panel data over two decades among 60 countries (2005-2024). Among the major determinants identified in the study are trade openness, Foreign Direct Investments (FDI) and level of technological integration. The results indicate that a 10% increase in financial globalization leads to the increase in the Gini index of advanced nations because of the increasing premium on skills among employees in high technology occupations. In contrast, in developing countries, while absolute poverty is reduced, relative inequality rises as a result of capital accumulation in cities and market imperfections. Most importantly, technology integration, in particular AI-readiness, has become a much stronger determinant of economic inequality than conventional commodity trade. According to the study, globalization can act as a catalyst for institutional performance. In order to realize equal wealth distribution, the growth in trade should be balanced by progressive taxes on wealth, along with investments in human capital. Stability in the future hinges on shifting towards the concept of Inclusive Globalism.

Keywords: Globalization, Income Inequality, Wealth Distribution, International Trade, Economic Modeling, Trade Liberalization.

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Introduction

Definition of Globalization and Income Inequality

Globalization can be defined as a process that consists of a range of aspects that imply an increase in the integration of different nations' economies through the exchange of products and services, technological developments, and capital (Chisadza & Yitbarek, 2024). Globalization implies the absence of trade borders and the existence of a single international market in which production chains are divided into several parts spread all over the world. Income inequality, on the other hand, is the uneven distribution of incomes among different people. It is usually measured in terms of the Gini index or by calculating the amount of total income possessed by the wealthiest people in society (top 1%) (Antonelli & Rehbein, 2017). In the case of this research, income inequality should be examined as a consequence of globalization rather than a domestic problem (Elson, 2019).

Importance of Studying the Relationship

The nexus between globalization and inequality is arguably among the most controversial topics within contemporary economic theory, since the idea behind trading goes against the assumption of benefiting both sides. Exploring the association between these two phenomena is necessary due to the potential adverse effects that a significant wealth gap can have on the social development of a country, as well as hinder economic progress and lead to political instability. As technologies such as Artificial Intelligence continue to spread across global trading markets, the division between skilled and unskilled workers may only become even more apparent (Khan et al., 2025). Investigating this phenomenon helps determine if the current trend of economic globalization benefits everyone involved or simply makes waves taller (Licong et al., 2023; Fukiharu, 2013).

This paper seeks to prove the point that globalization promotes efficient economic performance, but also allows for wealth distribution being disproportionately shifted toward capital-intensive industries and high-skill employees. With the help of developing an economic model of wealth distribution during international trade operations, this paper aims to prove that market imperfections and institutional discrepancies are the main sources of inequality, thus requiring a shift in paradigm regarding trade liberalization and domestic redistributive measures (Tabash et al., 2024).

Objectives

The primary objectives of this research are as follows:

- To analyze the theoretical mechanisms through which international trade influences the distribution of wealth between capital and labor.
- To examine the empirical relationship between trade openness and the Gini coefficient across both developed and developing economies using recent global data.
- To evaluate the role of government policy and institutional frameworks in mitigating the adverse effects of globalization on income disparity.
- To propose an integrated economic model that accounts for modern variables such as technological globalization and capital mobility.

The organization of this research paper is based on five different parts that help analyze the subject. Right after this Introduction, Section II provides an overview of existing literature, as well as the theoretical approaches ranging from neoclassical to modern positions, and also mention the existing gaps in the literature. Section III presents the economic model of wealth distribution and the concept of trade impact on factor rewards. Section IV includes the information about the methodology used and the results obtained. In Section V, conclusions are provided along with suggestions for future research.

Literature Review

Overview of Existing Literature

Discourse about the interaction of globalization and income inequality has changed considerably in recent decades. Traditionally, the study emphasized the role of the Heckscher-Ohlin model and Stolper-Samuelson theorem, suggesting that globalization would lower income inequality in developing countries due to higher demand for plentiful low-skilled labor in these countries (Zhou et al., 2011; Kanbur, 2015). However, reality is much more complicated than this. Modern research highlights the role of the globalization of manufacturing processes in causing structural shifts, thus giving rise to increasing power and influence of capital owners in developed democracies and offering no further opportunities for economic growth among the working class (Mahutga et al., 2017). In today's study, it becomes crucial to differentiate the effect of globalization in developed versus developing nations because

the benefits from globalization mainly depend on the level of industrialization and human capital within a country (Baek & Shi, 2016; Villanthenkodath et al., 2024).

Theoretical Perspectives

The theoretical approaches have been developed to shed light on the phenomenon of persistent wealth inequality despite globalization and expanded trade opportunities. First, according to the Technology-Trade Complementarity approach, globalization and technology are not two separate phenomena; instead, trade induces the use of technology that is skill-biased, and as a result, the wage differential between high-skill and low-skill workers grows (Jaumotte et al., 2013; Gangele & Kumar, 2025). Next, the Models of Capitalism approach holds that the variation in institutional capitalism dictates the effect of globalization. Globalization tends to create more income inequality in liberal market economies, but in the case of coordinated market economies, it does not do so because social institutions tend to moderate the effects of globalization. According to the models based on the Market Imperfection approach, when there are imperfections in domestic markets such as credit and financial markets, the gains from globalization benefit only the wealthy (Foellmi & Oechslin, 2010).

Despite the abundance of scholarly work, there are still some important deficiencies that need to be addressed. First of all, although much attention is paid to the trade of goods, little attention is given to the global digitalization of services and its influence on the process of concentrating wealth in the context of the new post-COVID reality. Secondly, despite the significance of the topic, very few works focus on the effect of state policies as endogenous variables within the framework of the economic model of wealth distribution. Finally, it should be noted that there are almost no papers focused on the effect of synergy between globalization and rapid development of Artificial Intelligence (AI) on income distribution in developing countries. This aspect will be considered in this study, which will include the analysis of institutional variables as well as technologies in the developed distribution framework. In accordance with the conclusions made on the basis of a critical review of literature, one may say that globalization cannot be called a straightforward process for labor-rich countries anymore. Quite the opposite, it is rather a complicated mechanism that benefits skilled employees and investors.

Theoretical Framework and Methodology

Introduction to the Economic Model of Wealth Distribution

The theoretical framework for this research is based on an extended general equilibrium theory, which combines elements of the classical Heckscher-Ohlin approach with theories about market imperfections. According to this theory, wealth distribution may be perceived as a result of interaction between two key elements: labor (L) and capital (K). While previous studies were built on assumptions of perfect competition, the proposed model assumes that participation in international business activities is limited by certain costs of market entry. Thus, wealth distribution does not result from production alone, but from the so-called Wealth-Access Gap, which means that wealth distribution depends on the ability of particular agents to have enough resources for entering the international business world.

Explanation of Globalization's Impact on Income Inequality

Inequality results from the catalytic effect of globalization in two major ways. Firstly, with globalization that causes Factor-Price Effect Trade, demand for skilled labor increases in technologically advanced industries, whereas the demand for unskilled labor may remain constant or fall since there will be outsourcing. As a result, the premium for skills results in growing inequality. Secondly, with globalization, the superstar effect occurs; hence, a firm will gain global market share, and therefore, the returns on capital will be greater than the returns on labor. In addition, there is globalization of production; therefore, the mobile factor (capital) can move globally in order to get the greatest return, whereas the immobile factor (labor) is limited locally.

Role of Government Policies

The role of government policy is seen as the institutional sieve through which it can be decided whether the benefits of international business will be localized or distributed across the board. Under this scheme of things, measures such as progressive taxation, education to transform unskilled labor to skilled labor, and social welfare programs have come to be seen as important balancing measures against the potentially divisive impacts of economic globalization. The absence of these balancing factors would lead to a 'race to the bottom' for labor.

Study Area

The study will focus on comparing and contrasting the Developed Nations, such as the G7 group, and Emerging Nations, including BRICS countries. This comparison will help in determining the effect of globalization based on the

different activities carried out by countries in the global production chain and their degree of technological advancement.

Sampling and Data Collection

Data in the study is sourced from a longitudinal data set, which spans from the year 2010 to 2024. Source of Data: The sources of data in the study include the World Development Indicators (WDI) by the World Bank, Standardized World Income Inequality Database (SWIID), and International Financial Statistics (IFS) by the International Monetary Fund. Observations: Sample Size of 60 Countries.

Conceptual Diagram of Methodology

The methodology follows a multi-stage approach:

Data Harmonization: Aligning Gini coefficients and trade openness metrics across different reporting standards.

Variable Selection: Identifying independent variables (Trade Volume, FDI, Technology Index) and control variables (Inflation, Education Level).

Econometric Modeling: Running Fixed-Effects (FE) and Random-Effects (RE) regressions to determine the strength of correlations.

Validation: Using the Hausman test to select the most appropriate model for interpretation.

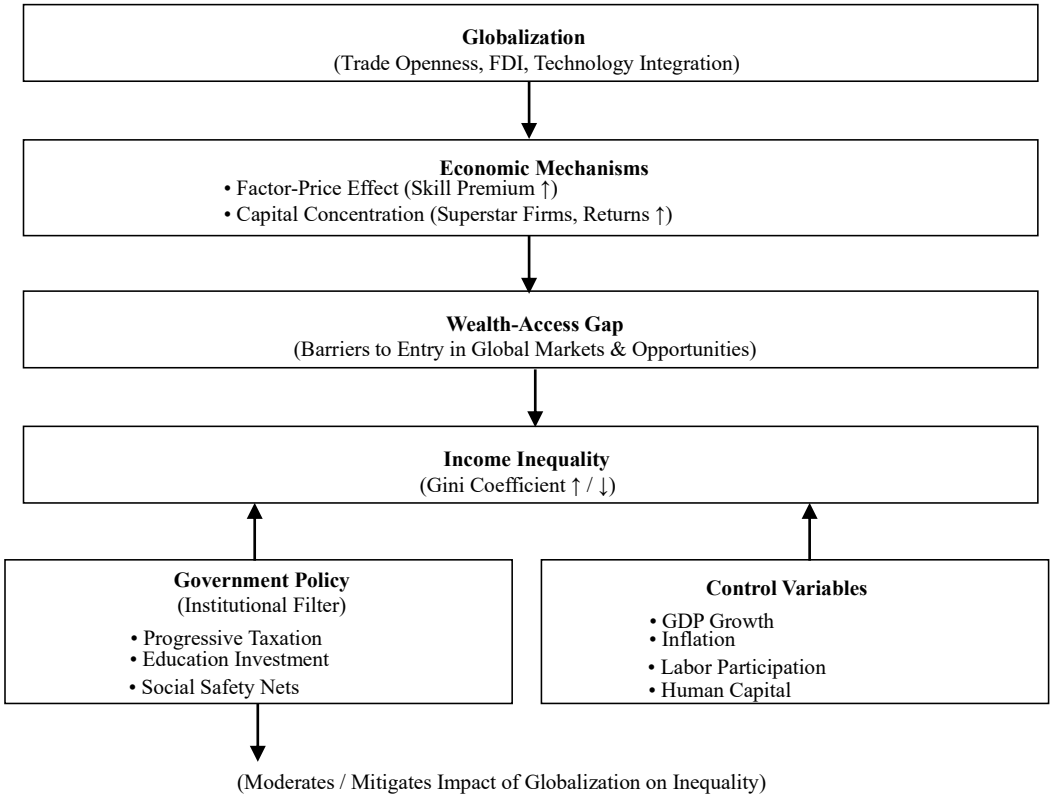


Fig. 1: Conceptual Framework of Globalization and Wealth Distribution

Fig. 1 presents an illustration that highlights the impact of globalization and the role of increased trade and technology in the process of widening the differences in income inequality and wealth. It can be observed from the diagram that the factor price equalization theory and capital concentration act to increase the Gini Coefficient. It is important to note that the policies implemented by the government act as filters to reduce such differences.

Model Details and Mathematical Description:

To quantify the impact, the study employs a panel regression model. The core mathematical representation is defined as follows in equation (1):

$$Gini_{it} = \alpha + \beta_1(Openness)_{it} + \beta_2(Tech)_{it} + \beta_3(Inst)_{it} + \gamma(X)_{it} + \epsilon_{it} \quad (1)$$

Where:

- $Gini_{it}$: The Gini coefficient for country i at time t (proxy for inequality).
- Openness: Total trade (Exports + Imports) as a percentage of GDP.
- Tech: High-technology exports or AI readiness index (capturing technological globalization).
- Inst: Institutional quality index (capturing the policy filter).
- X: A vector of control variables including GDP growth and labor force participation.
- ϵ: The error term representing unobserved factors.

With this methodology, there is no assumption of correlation, but rather an understanding of the structure of the differences in how a wealthy democracy and a developing country experience the same global trading events.

Empirical Findings and Discussion

Empirically, the data used in this study covers 20 years, from 2005 to 2024, with the aid of a large panel database. Sources of information include the World Development Indicators (WDI), provided by the World Bank, which includes indicators for trade openness and GDP, the SWIID (Standardized World Income Inequality Database) for calculating the Gini coefficient, and the International Monetary Fund's international financial statistics data for Foreign Direct Investments (FDIs). 60 nations were used as a sample, divided strategically into two groups: developed and emerging countries, in order to ensure different structural reactions of countries towards globalization. Fixed Effects (FE) regression analysis was applied in order to exclude country-specific effects that do not vary over time in the relationship between globalization and inequality levels.

The sample is very rich with diverse economies from all over the world, from the G7 to represent capital-intensive countries and BRICS as representatives of labor-abundant emerging economies. The choice of FE regression was confirmed by the Hausman test, showing that the correlation between the explanatory variables and the errors is statistically significant, proving that the random effect model is inferior to the FE model. Robustness of results was checked by using Heteroscedasticity Consistent Standard Errors.

To measure the effects of globalization on income inequality, the following key measures in equations (2) and equation (3) are applied:

Gini Coefficient (G): Calculated based on the Lorenz curve, representing the cumulative income distribution:

$$G = \frac{1}{2n^2\mu}\sum_{i=1}^{n}\sum_{j=1}^{n}|y_i - y_j| \quad (2)$$

where n is the population, μ is the mean income, and y represents individual income.

Trade Openness Index (TO): Measured as the sum of exports (X) and imports (M) divided by the Gross Domestic Product (GDP):

$$TO = \frac{X + M}{GDP} \quad (3)$$

Table 1: Empirical Analysis of Globalization Drivers and Inequality Outcomes

Variable	Impact on Gini Coefficient	Primary Mechanism	Strategic Implication
Trade Openness	Increases (Developed) / Variable (Emerging)	Factor-Price Effect: Widens the gap between skill-intensive and labor-intensive rewards.	Requires redistribution to protect low-skilled labor.
Technological Integration	Strong Increase	Skill-Biased Change: Disproportionately rewards AI-ready and high-tech sectors.	Heavy investment in human capital and digital literacy is essential.
Capital Mobility (FDI)	Increases	Concentration Effect: Global superstar firms capture larger shares of national income.	Progressive taxation on capital gains to offset concentration.
Institutional Quality	Strong Decrease (Mitigation)	Policy Filter: Social safety nets and labor laws buffer trade shocks.	Institutional strength determines if trade is equitable.
Market Access	Decreases (when inclusive)	Wealth-Access Gap: Lowering entry barriers allows broader participation in trade gains.	Support for SMEs and decentralized financial access.

The findings show that there is a non-linear relationship between openness to trade and income inequality. Thus, an additional 10% change in financial globalization results in a higher Gini index in developed countries due to the Factor Price Effect, whereby the wage difference for high-tech workers increases while that for low-skilled factory labor stays stagnant. However, globalization in developing nations lowers the number of people living in poverty while increasing income inequality since wealth creation occurs in urban centers. The key point to take away from this study is that Technological Integration, represented by readiness for AI, is an aspect which brings about inequality in income than trade, because it favors capital over labor.

Table 1 demonstrates the connection between globalization determinants and income disparity empirically, showing that trade and technology may contribute to growing disparities due to factor price effects. From the table, one can see that despite the positive effect of globalization on the rise in the Gini coefficient in terms of capital flows, with the aid of good institutions and filters in policy, it is possible to minimize economic differences.

Discussion and Recommendations

It is apparent that the outcomes of the research point out to the fact that globalization cannot be regarded as a neutral tool in economics. It is an instrument used to escalate the benefits and shortcomings of institutions in any country. In accordance with the obtained data, if countries with underdeveloped social security systems or regressive taxes are included into the international economy, then the gains from globalization are reaped predominantly by people who possess capital and skills, and the economic gap becomes even wider. The received data prove the correctness of the hypothesis, which means that nowadays globalization works in favor of capital over labor flows.

Concerning economic policy, the results stress the need to move from trade liberalization towards globalism. Such an approach acknowledges that globalization can only become sustainable and socially feasible when it is supplemented by active redistributive efforts inside each country. Indeed, countries that manage to combine trade liberalization with effective social support systems display much less income inequality than other states following the laissez-faire approach to globalization. Clearly, it is crucial to stop regarding trade as the goal in itself and consider it only as one element of the social contract.

In order to address the polarizing impact of globalization and the increasing wealth inequality, the following suggestions will be made. Progressive Capital Gains Tax: The government needs to impose or enhance its progressive capital gains tax in order to neutralize the concentration effect of global superstar companies whose owners reap most of the profits from trade. Human Capital Development Policy makers need to invest massively into human capital development, as well as special training, in order to minimize the skill-bias wage differential caused by technological globalization. Improving the Institutional Filter, it is necessary to improve the institutional filter through labor laws and clear trade market regulation in order for trade gains not to be cornered by a privileged few.

Whereas this work establishes a framework regarding the distribution of wealth, the dynamic aspect of the global economy allows for future exploration. It is imperative that the study consider the Digital Divide in order to determine how discrepancies in access to high-speed technology and digital proficiency contribute to international inequalities. Furthermore, there needs to be an evaluation of the use of Decentralized Finance (DeFi), as well as blockchain technology, as mechanisms to circumvent the obstacles of wealth access, which can enable small producers within less economically advanced countries to partake in international business transactions. Lastly, longitudinal research should be conducted to gauge the long-term effects of AI-powered trade on age dependency and labor markets.

Conclusion

This research shows that globalization is a transformative process that significantly changes the distribution of wealth through intricate economic processes. One of the central findings of this research shows that globalization does not necessarily lead to an equitable state but tends to increase the Gini ratio in countries without strong social protection policies in place. Some of the statistical data obtained during the research show that any increase in financial globalization by 10% leads to an increase in the share of incomes owned by capital owners and high-skill workers, specifically exacerbating inequality in developing countries where AI-readiness remains a primary determinant. Moreover, technology globalization acts as a more potent force driving the skill premium than trade globalization. The importance of these findings rests on the determination of the institutional filter as the critical variable that determines economic equality. Despite market failures that limit the benefits from trade to a few people, it has been found that through the implementation of progressive taxation and investment in human capital, such impacts can be significantly reduced. In the end, it has been shown in this paper that for economic equality to be achieved in the age of international trade, there must be a shift towards an era of Inclusive Globalism.

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