Book review

HOW TO ACHIEVE INCLUSIVE GROWTH


Type in the words “inclusive growth” into Google and the search engine will return more than 9 million hits. Everyone seems to be in favour of it, from official sector institutions like the Organisation for Economic Co-operation and Development (OECD) to private sector firms like McKinsey. The definition of the term from OECD is succinct: “Inclusive growth is economic growth that is distributed fairly across society and creates opportunities for all.” That does not seem too controversial, but it marks a departure from the standard practice in macroeconomists to focus on boosting growth rather than worrying about how it is distributed. Nobel Laureate Robert Lucas wrote that “of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution.”

The view that boosting aggregate output through structural reforms was of paramount importance was shared by policymakers and international institutions, and embodied for instance in the OECD’s famous Going for Growth reports, a series that started in 2005. By 2017, the series stressed the importance of “addressing the concerns of those bearing the costs of reforms, and ensuring that the gains are widely shared.”

A similar transformation appears underway at the International Monetary Fund (IMF). The Washington Consensus that has long guided IMF policy advice to countries does not refer to distributional concerns. Now, however, IMF has issued a hefty tome – approximately 900 pages – on how countries can achieve inclusive growth. In so doing, IMF cannot be accused of joining the bandwagon; it has to some extent led the band. Building on a decade-long effort at IMF, How to Achieve Inclusive Growth takes major steps forward in organizing IMF views and its broad policy advice to countries.

The book’s roots

In December 2010, a Tunisian fruit vendor set himself on fire, unleashing a movement for a more inclusive society that came to be known as the Arab Spring.
In September 2011, the Occupy Wall Street movement captured headlines, with its slogan “We are the 99 per cent” drawing attention to extreme inequalities of income and wealth. Rather than sticking to its knitting and ignoring these developments, IMF drew on past analytic work and argued that inequality could be inimical to sustained growth (Ostry and Berg, 2011). This was followed by work showing that many of the areas in which IMF provided policy advice were themselves the drivers of inequality. Chief among these were fiscal policy and capital account liberalization, both of which were shown to increase inequality (Ball and others, 2013; Furceri, Loungani and Ostry, 2019), thus setting up a trade-off between the goals of efficiency and equity. Revisiting its advice on labour market policies (Blanchard, Jaumotte and Loungani, 2014) IMF did extensive work on the need for financial inclusion. This body of work is summarized in Ostry, Loungani and Berg (2019).

How to Achieve Inclusive Growth goes beyond documenting the interactions of growth and inequality and the impacts of policies on inequality to providing an extensive discussion of how policies can be designed to achieve inclusive growth. One distinctive feature of the book is the extensive use of outside experts. Three IMF economists and noted academic Barry Eichengreen edited the book, and two thirds of the 22 individual chapters of the book are co-authored by eminent experts—Richard Rogerson on labour markets, Giovanni Peri on migration, Nora Lustig on public expenditure and Raquel Fernandez on gender equality, to name a few. Superstar economists like Joseph Stiglitz and Nick Stern also co-author respective chapters on the distributional aspects of technological progress and climate change (with a foreword by Jeff Sachs). This lends considerable credibility to the endeavour. Another welcome feature is the inclusion of authors from other institutions, not just the World Bank but also the International Labour Organization and the World Trade Organization.

Seeing the forest

Though inclusive growth is becoming more accepted within macroeconomics, so far there is no canonical model that defines the term and sets out the key parameters that drive it—there is no equivalent of the Solow model (or an endogenous growth model) for inclusive growth. In the absence of a model, chapter 1 makes a valiant attempt to give the book a common structure. It lays out an inclusive growth framework in the form on a flow chart

The top part of the chart illustrates the production of incomes by the private sector using inputs of labour, capital and technology. These inputs come from domestic sources as well as through global sources, that is through migration, capital flows, and trade and technology transfers across borders. Goods and services are produced and sold in markets, and inclusive growth “requires fair and competitive
marketplaces”. Government inputs are shown at the bottom part of the chart. The Government “contributes inputs and establishes the right conditions for growth and for inclusion”, including an overall governance framework, a political system, macroeconomic stability and public services (for which it raises taxes).

Government policies and provision of public services, for instance those that increase access to health, education and finance, affect the ‘pre-distribution’ phase of production – labelled as ‘pre-fiscal outcomes’ in the middle of the chart. In the production phase, as correctly noted in the chapter, “governments shape the functioning of the market and the incentives firms and individuals face in their employment, investment and innovation decisions”. After production and the distribution of market income, the government can use tax and spending instruments to redistribute income “to increase the welfare of the very poorest and reduce income disparities according to the weights that the society places on equality” – labelled as ‘post-fiscal outcomes’ in the chart.

Beyond aggregate measures of inequality, the sharing of economic benefits – either though pre-distribution or redistribution policies – can be analysed along other dimensions. These are shown along the right-hand side of the chart, including race and gender, region and generation (including generations yet to come). The final element of the framework is a “feedback loop” from the distribution of outcomes to future production through labour supply, savings and entrepreneurship, including through its impact on the next generation.

A look at some trees

In addition to providing an illustration of the inclusive growth framework, the chart contains a list of the book chapters. Each item in the chart is discussed in a chapter of the book (and, in a few cases, more than one chapter). Specifically, following a chapter on the interlinkages between measures of growth and measures of inclusion, chapters 3–5 are on contributions to growth and inclusion associated with each of the main factors of production, chapters 7–9 are on the integration of factor and goods markets across national boundaries, chapters 10–15 are on the role of government in fostering inclusive growth, and chapters 16–20 are on inequalities in outcomes across genders, regions and generations. Chapter 21 includes case studies of countries or regions that improved inclusive growth through a holistic set of policies. While Nordic countries epitomize some of the best practices in inclusive growth policies, some developing countries have achieved some success. The concluding chapter contains a useful recap of the book. Every chapter of the book makes for rewarding reading. Each provides a good overview of the literature and, as the title of the book promises, a comprehensive discussion of the policies needed to achieve inclusive growth.
The chapters on the design of fiscal policies, not surprisingly, are very strong as IMF is on its home turf. But they perhaps do not give sufficient voice to the criticisms of civil society on the regressive aspects of some IMF advice (e.g. advice on VAT) or that IMF corporate guidance on fiscal policies is not reflected in its country-level policy advice, particularly when countries are in IMF programmes. A review by the Independent Evaluation Office concluded that IMF needed to be more sensitive to social and distributional consequences in its policy advice to countries in IMF programmes (IEO, 2021).

Other areas show how far IMF has come in its policy stance. As noted earlier, IMF reworked its labour market advice to countries at the onset of the Great Recession to achieve a better balance between equity and efficiency (Duval and Loungani, 2021). The evolution continues in this book, in which IMF notes that for the vast majority of individuals, payment from selling their labour services in the labour market is the single most important source of income and “for this reason, the labour market has a key role to play in achieving inclusive growth.” Encouragingly, the authors suggest that “there are important areas where achieving inclusivity is a win-win proposition: that is, where making labour markets more inclusive also enhances economic efficiency and growth. Discrimination is an important such area.” This is consistent with the striking findings of Hsieh and others (2019), who found that the lowering of barriers to entry for women and African Americans accounted for a quarter of the growth of per capita income in the United States of America since 1960. Other policies to provide protection to workers will often face important trade-offs between equity and efficiency. For example, employment protection legislation may provide protection for currently employed workers while diminishing access for young workers entering the labour market. Likewise, collective bargaining may reduce narrow wage differentials among union members but widen disparities between unionized and non-unionized workers (Betcherman, 2012).

The chapter on the equity and efficiency effects of financial globalization is another example of how far IMF and the profession have come over the past decade. While theory “suggests that trade flows and capital flows have the same distributional effects ... this does not appear to be the case in practice”. Recent studies suggest that inequality has risen with financial globalization in both advanced and developing countries. At the same time, the efficiency effects to financial globalization are not guaranteed; it promotes growth in countries only when there are strong institutions and effective policy and regulatory frameworks. The chapter concludes that financial globalization should be carefully sequenced and coupled with other social and economic policies that help to level the distributional playing field.

It seems churlish to point out that this long book could have been made longer yet by the inclusion of a chapter on monetary and macroprudential policies and
inequality. Both have been shown to generate substantive distributional effects (Furceri, Loungani and Zdzienicka, 2018; Koedijk, Loungani and Monnin, 2018). The latest ESCAP report stresses that amid shrinking fiscal space, central banks may need to step up and consider “the distributional impacts of monetary policy, managing reserves with social gains in mind, and exploring central bank digital currency for financial inclusion.”

Overall, this is a remarkable attempt by IMF to provide in one comprehensive book – and made available freely in electronic format – what is known about the linkages between growth and distribution, and how countries that want to go for not only growth but inclusive growth can try to achieve their goal.

NOTE ON CONTRIBUTORS


REFERENCES


Berg, Andrew G., and Jonathan D. Ostry. Inequality and unsustainable growth: two sides of the same coin. International Monetary Fund.


