Inclusive Growth: The Evolution in IMF Thought and Practices

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The Evolution Toward Inclusive Growth

- In recent years, the IMF has put on its plate several issues that appear to go beyond its 'bread and butter' focus on fiscal and monetary policies. These issues include: employment & migration; gender; inequality; corruption; financial inclusion; climate change. Why has the institution done so? The answer is simple: they have become critical to the IMF's mission. These issues directly affect economic performance and stability in many countries, and thus fall under the IMF's mandate.

- Is there a unifying framework for all these new issues? There is and it can be summarized in two words: Inclusive Growth. Both words are important. We do want growth. Understanding the sources of productivity and long-run growth, and which structural policies will deliver them, thus remains an important part of the IMF's agenda. So when we talk about inclusive growth, we are not advocating as role models either the former Soviet Union or present day North Korea—those are examples of 'inclusive misery,' not inclusive growth.

- We want growth but we also want to make sure:

    - that people have **jobs** – this is the basis for people to feel included in society and to have a sense of dignity. (IMF Management set up a "**Jobs & Growth**" working group to emphasize the importance of this work.)

    - that women and men have equal opportunities to participate in the economy—hence our focus on **gender**;

    - that the poor and the middle class share in the prosperity of a country—hence the work on **inequality** and shared prosperity;

- that, as happens for instance when countries discover natural resources, wealth is not captured by a few—this is why we worry about **corruption and governance**;

- that there is **financial inclusion**—which makes a difference in investment, food security and health outcomes;

- that growth is shared just not among this generation but with future generations—hence our work on building resilience to **climate change and natural disasters**.

In short, a common thread through all our initiatives is that they seek to promote inclusion. What we are after is strong growth but one that is broadly shared, where major segments of society feel they have had an opportunity to make a better life for themselves.

- These are not just fancy words. We are putting these ideas into action in our work.

    - On gender: In Japan and in Saudi Arabia we have engaged the authorities in frank discussions on female labor force participation, or rather, on the lack of it. A paper by IMF staff called "Can Women Save Japan?" created quite a bit of a stir. We have a similar paper on India. Eliminating employment gender gaps could boost GDP by 9 percent in Japan and 27 percent in India.

    - On inequality: There are many examples.

        - In the Republic of Congo, staff are studying how to reduce inequality by providing access to transport infrastructure for those in rural areas;
        - In Bolivia, the authorities are worried that the collapse in commodity prices will raise inequality and we have been helping figure out how best to counter that;
        - In many countries, such as Colombia, Israel and Korea, we are trying to tackle what is called labor market 'duality'—that is the situation where some workers have well-paid protected jobs and others have poorly-paid jobs with little protection or benefits.

    - On corruption: We consider this a very serious issue, in some cases suspending our lending where there is clear evidence of corruption. Examples include the suspension of our program in Malawi in November 2013 and in Ukraine in February 2016.

    - On financial inclusion: Our Financial Access Survey, launched in 2009, is a key source of data on access to financial services around the world. There is hope and good news. There are 15 economies in Sub-Saharan Africa where the number of mobile money accounts exceeds the number of depositors in commercial banks. We have learnt that deposit accounts at commercial banks in India have grown by half a billion over the past five years, thanks to the government's efforts to make financial inclusion a priority.

- On climate change: There was great excitement in Paris, at the so-called COP21, at the agreement among nations to take steps to reduce global warming. COP22 at Marrakech focused on implementation of those steps. IMF staff has developed tools to calculate carbon prices needed for countries to their meet commitments, and to compare carbon pricing with other fiscal and regulatory mitigation instruments. We are also working intensively with small states to enhance resilience to climate change. (We are also looking into the links between emissions and GDP growth – I will be presenting this work at the MCC Center in Berlin on January 12.)

Globalization and Inclusion

- The IMF was set up to foster international cooperation. Hence, to us, inclusion refers not just to the sharing of prosperity within a country but to the sharing of prosperity among all the countries of the world. International trade, capital flows, and migration are the channels through which this can come about. And this why we stand firmly in favor of globalization, while recognizing that much more could be done to share the prosperity it generates.

- The pursuit of macroeconomic stability and globalization has commanded a consensus among policymakers for the last three decades. Over this period, the average person's income has risen four-fold, from $2,500 a year in 1980 to over $10,000 today; average life expectancy has increased by 8 years. The number of people in absolute poverty has fallen from over 40 percent of the world's population in 1980 to about 10 percent today. The Millennium Development Goal of cutting world poverty in half was met five years ahead of schedule.

- But while few people have lost out in absolute terms from these policies, many have not gained much. In the United States, for instance:

    - median family incomes only went up 20 percent over the past three decades (less than 1 percent a year); over the three decades before that (1950-80), the increase had been over 70 percent (over 2 percent a year);

    - only half the children born in the 1980s ended up earning more than their parents; for children born in 1940, the comparable figure was 92 percent; this drop in mobility was even steeper for those in the middle class (Chetty and others 2016);

- mortality increased for (white, non-Hispanic) middle-aged men and women between 1999 and 2013, reversing decades of progress. The physical and mental stress from slow growth in median earnings and widening income inequality may have triggered behaviors leading to increased mortality (Case and Deaton 2015).

- In many advanced countries, including the United States, there has been a hollowing-out of the middle class and polarization of incomes (Alichi 2016, Autor 2010).

Globalization's gains have also not been evenly shared.

- ***Losers from trade:*** In a broad range of countries, including emerging markets, workers displaced by import competition have suffered long-term wage losses and unemployment (Obstfeld 2016).

- ***Concerns about financial globalization:*** Foreign capital flows have made many economies more volatile, have not helped those without financial access, and have lowered labor's share of income, in part by giving capital the threat to move abroad (Furceri and Loungani 2016).

The recurrent protests against some policies reflect adverse socio-economic impacts.

- ***Backlash is not a recent phenomenon:*** Some of the recent backlash reflects deplorable sentiments such as racism or xenophobia. The recurrent and multi-faceted nature of the protests, however, suggests that many reflect serious socio-economic concerns about middle-class performance and prospects.

    - Politicians across the ideological spectrum have often expressed concern over the condition of the poor and middle class. In the United States, the Democratic candidate John Edwards ran in 2004 on a platform of bridging an "America Divided" into rich and poor; in 1992, Republican candidate Pat Buchanan expressed concerns about the effects of trade and immigration on unskilled workers.

    - In 1999, so-called anti-globalization protests erupted at the Seattle meetings of the World Trade Organization (WTO), reflecting a variety of concerns about the downsides of trade agreements, ranging from their impact on labor's share of income to the impact on the environment.

- ***Anger against the financial sector:*** Some protests seem motivated by perceptions of lack of fairness. "Abuses such as corruption, favoritism, and mismanaged governance" are "calling into question the legitimacy of the political and economic elite" (Lipton 2016). There is anger over the compensation enjoyed by those in the financial sector and their alleged capture of the political process. The Occupy Wall Street protest in 2011 reflected some of these sentiments.

- ***Immigration and social cohesion:*** In the case of migration, people may care about possible threats to social cohesion in their own communities as much as the economic benefits that accrue to society at large. Perceptions of fairness play a role here too: elites in gated communities do not bear the costs of asking those less fortunate to throw open their neighborhoods.

Higher growth will help calm some of the discontent but may not prove enough.

- ***Growth is essential:*** "A larger slice of the pie for everyone calls for a bigger pie" (Lipton 2016). In recent months, the IMF has embarked on an intensive research agenda to understand the causes of the slowdown in growth and productivity and what can be done to reverse it.

- ***Growth breeds tolerance:*** Higher growth should help address some of the discontent, as argued by Harvard economist Benjamin Friedman in his book, The Moral Consequences of Economic Growth. Friedman shows that, over the long sweep of history, strong growth by "the broad bulk" of a society's citizens is associated with greater tolerance in attitudes towards immigrants, better provision for the disadvantaged in society, and strengthening of democratic institutions.

Designing policies so they deliver inclusive growth will be a more durable response.

- ***Trampolines and safety nets:*** "More inclusive economic growth demands policies that address the needs of those who lose out … Otherwise our political problems will only deepen" (Lipton 2016). Trampoline policies such as job counseling and retraining allow workers to bounce back from job loss: they help people adjust faster when economic shocks occur, reduce long unemployment spells and hence keep the skills of workers from depreciating. While such programs which already exist in many advanced economies, they deserve further study so that all can benefit from best practice. Safety net programs have a role to play too. Governments can offer wage insurance for workers displaced into lower-paying jobs and offer employers wage subsidies for hiring displaced workers. Programs such as the U.S. earned income tax credit should be extended to further narrow income gaps while encouraging people to work (Obstfeld 2016).

- ***Broader sharing of the benefits of the financial sector and financial globalization:*** We need "a financial system that is both more ethical and oriented more to the needs of the real economy—a financial system that serves society and not the other way round" (Lagarde 2015). Policies that broaden access to finance for the poor and middle class are needed to help them garner the benefits of foreign flows of capital. Development of domestic financial institutions will help them better withstand the sudden ebbs and flows of foreign capital, as will more active use of capital flow management measures (Ostry and others 2011). Increased capital mobility across borders has also fueled international tax competition and deprived governments of revenues (a "race to the bottom leaves everyone at the bottom," Lagarde 2014). The lower revenue makes it harder for governments to finance trampoline policies and safety nets without inordinately high taxes on labor or regressive consumption taxes. Hence, we need international coordination against tax avoidance to prevent the bulk of globalization gains from accruing disproportionately to capital (Obstfeld 2016).

- ***'Pre-distribution' and redistribution:*** Over the long haul, polices that improve access to good education and health care for all classes of society are needed to provide better equality of opportunity. However, this is neither very easy nor an overnight fix. Hence, in the short run, should 'pre-distribution' policies need to be complemented by redistribution: "more progressive tax and transfer policies must play a role in spreading globalization's economic benefits more broadly" (Ostry and others 2016; Obstfeld 2016).

ANNEX

In this annex, I provide some details on two areas of work where I have been personally involved, the work on 'jobs and growth' and on 'inequality'.

'Jobs & Growth': the work on 'Jobs'

For five years, I co-chaired an internal IMF group on 'jobs and growth' set up by IMF management. On jobs, the immediate task was to remind people that sometimes unemployment is high because demand is low. Many often veer towards thinking of unemployment as largely a supply-side problem—people are lazy or we give them very generous unemployment benefits so they don't search for jobs or there are structural problems that keep unemployment high. At the onset of the Great Recession, the IMF's then-Chief Economist Olivier Blanchard and Deputy Managing Director Min Zhu—who had oversight over the group—were worried that the most obvious explanation for why unemployment had spiked up, namely that aggregate demand had fallen, would be underplayed in policy circles. Our mission was to keep the words "aggregate demand" alive within the IMF building and outside.

Did we succeed? In my biased opinion, yes. Let me give a couple of examples of our outside influence. Under Blanchard's supervision—he gave me a two-page outline and said "follow this"—Mai Dao and I wrote a 2010 paper which Paul Krugman praised: "A recovery in aggregate demand is the single best cure for unemployment. What a relief to hear the IMF say that!" Krugman's post was titled: "The IMF is not insane." This sentiment was echoed by many others over the ensuing years, including many in the trade union movement. Even on the other side of the political aisle, the Wall Street Journal noted that it's time to "stop worrying about the 'jobless recovery' [and] start worrying about the recovery-less recovery." Citing the work on Okun's Law done by our group, the *Journal* concluded that "it isn't unemployment benefits or other specific [structural] factors that are holding back hiring. It's the economy, stupid."

Within the IMF building, Larry Ball (of Johns Hopkins), Davide Furceri, Daniel Leigh and I kept up a drumbeat that the short-run relationship between output and unemployment—known as Okun's Law—had remained stable through the Great Recession. Our colleague Antonio Spilimbergo started calling us the "Okun police". I think it eventually started to rub off; one piece of evidence is a paper by our European department on the rise in youth unemployment, which provides an even-handed treatment of the respective roles of aggregate demand and supply factors.

Calibrating the pace of fiscal adjustment to growth conditions—and countering the effects of adjustment through other policies if possible—to minimize the drag on demand became an essential part of the IMF's advice to restore growth and lower unemployment. This was reflected in many actions and statements over this period: consider for instance the MD's 2013 statement on Spain where she welcomed the government's decision "to pursue a more gradual consolidation path" as a step to help the country in "securing a recovery and creating jobs."

When the Great Recession was followed by the Not-So-Great-Recovery, several suspects were lined up. In work done for the World Economic Outlook, Ayhan Kose, Marco Terrones and I noted that a key difference between the current global recovery and past global recoveries was that fiscal policy had not been able to provide the support this time that it did in the past—a point that has been picked by many observers including Paul Krugman (see Krugman's essay here).

Overall, our goal was to get to the point where demand and supply factors would both be considered in an even-handed manner. In a celebrated mid-1980s paper, Olivier Blanchard, along with Rudi Dornbusch and others, argued that tackling the high unemployment and low growth in Europe at that time would require a 'two-handed approach': a combination of demand-side and supply-side policies.

Hence it was not entirely coincidental that the IMF's advice to advanced economies reflected the return of the two-handed approach and did not neglect supply issues. In a recent Staff Discussion Note, Olivier Blanchard, Florence Jaumotte and I discuss many labor market reforms that have been advocated in IMF programs in Europe over the last few years. We argued that, by and large, these reforms can be expected to contribute to 'micro flexibility' (the ability of the economy to reallocate workers across jobs to boost productivity) and 'macro flexibility' (the ability of the economy to adjust to macroeconomic shocks). My more recent views on European unemployment are in a VoxEU blog.

'Jobs & Growth': the work on 'Growth'

On growth, the task was to, as Blanchard put it, "move beyond mantras". Both he and I had the view that the IMF goes to countries and says: "Here are 25 (structural) areas on which you are behind international standards. Improve on all them by next year and you will surely grow". So I started to look through the IMF's advice on growth and found that the characterization is unfair. Though you can still find examples of the kind I mentioned, the bulk of the IMF's advice on growth is actually quite 'granular'; that is, it digs down to see the specific problems the country is facing. I would point, as an example, to the great work that IMF staff have done in providing advice to small states on sustainable growth.

So, in a "Jobs & Growth" Board paper, we summarized the current 'do's and don'ts' on growth and then showed that IMF staff had been broadly following that advice. We also issued a guidance note for IMF staff on how to tackle growth issues. In this case too, as with jobs, we got some external recognition—in this case some back-handed praise from Dani Rodrik, who in the past has been critical of our advice on growth.

IMF Work on Inequality: A Primer

The IMF's recent research on inequality has attracted a lot of (mostly favorable) attention. My talk describes the main findings of this research.

Focusing on *within-country* inequality, I classify the work into three categories: causes, consequences, cures.

- On **causes**, the main finding is that—in addition to broad trends like trade, technology and demographics—inequality is driven by economic policies. This is not an earth-shattering research finding but it is an important one. The policies that turn out to drive inequality include fiscal policies, capital account liberalization (i.e. policies to foster mobility of capital across national boundaries) and labor market policies. Many of these are 'bread-and-butter' issues for the IMF, ones on which it routinely gives advice to its member countries.

- On **consequences**, there has been a novel research finding: inequality lowers the durability of growth spells. This result also puts inequality squarely with the remit of the IMF's work: fostering sustained growth, a goal of the IMF's advice, requires some attention to inequality.

- As it should, the work on **cures** follows from what has been learnt about the causes and consequences. To take an example: if fiscal policies are a cause of inequality, the IMF's advice on the design of these polices needs to account for this fact. This is both because the distributional consequences may be important in their own right to some governments and because—as noted—they can have an adverse effect on the sustainability of growth. One new research finding, which has implications for the design of many policies, is that redistribution, unless extreme, does *not* have an adverse impact on growth; hence redistribution need not be feared as a cure.