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What is Inclusive growth?

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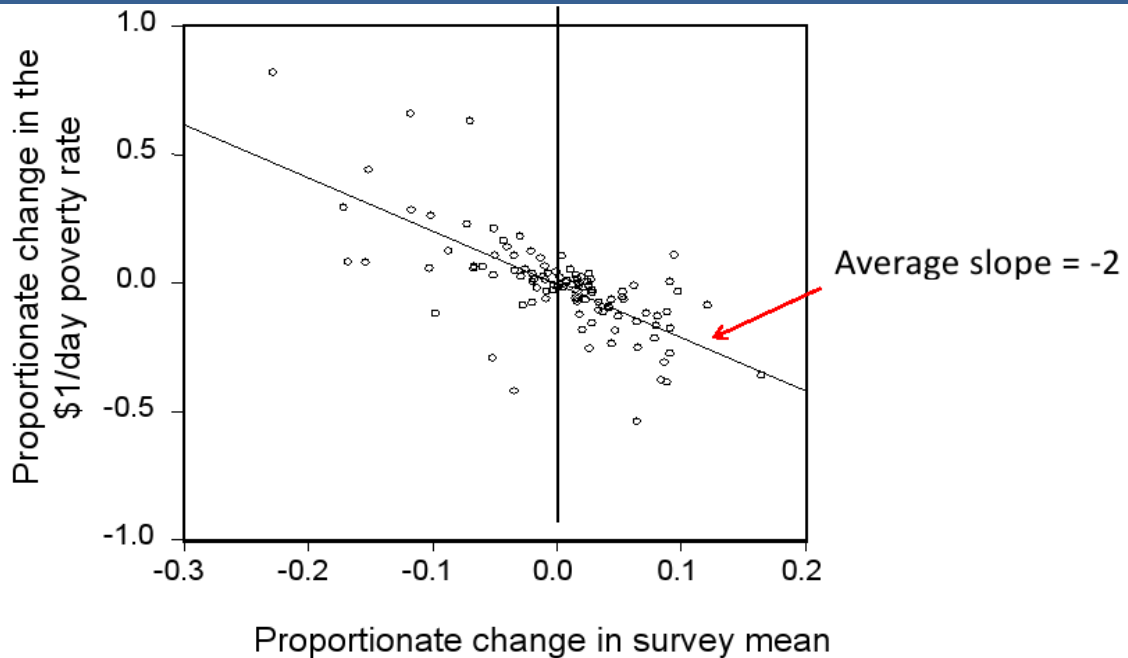
Why is economic growth important?

- Economic Growth – to deliver sustained poverty reduction (e.g. Bangladesh, Uganda – poverty down)
- BUT: chronic poverty can remain resilient even when growth is high (e.g. India) – discrimination by ethnicity, gender etc.
- Growth can reduce the poverty of a healthy young man able to work, but not a sick mother in subsistence farming
- AND: growth's environmental impact must be managed
- AND: growth does not necessarily reduce conflict (Pakistan)
- Foreign Aid has a robust impact on growth (but not at all times & in all places)
- Aid has helped Ethiopia, Ghana, Rwanda, Mozambique, Uganda, Tanzania pull themselves out of crisis

What do we mean by Inclusive growth?

- Ambiguous concept in the Economics literature –it lacks theoretical foundations and it is, to a large extent, country specific
- It refers to the notion of achieving material progress through economic growth while encompassing **equity, equal opportunity** to basic service provision; **access the key markets** (labour and credit), and **social protection** for the most vulnerable in society
- It is often linked to the concepts of ‘pro-poor growth’ and ‘growth with equity ‘
 - Are there differences between these concepts?
 - Is there anything new under the sun?

Economic growth is in general 'pro-poor'

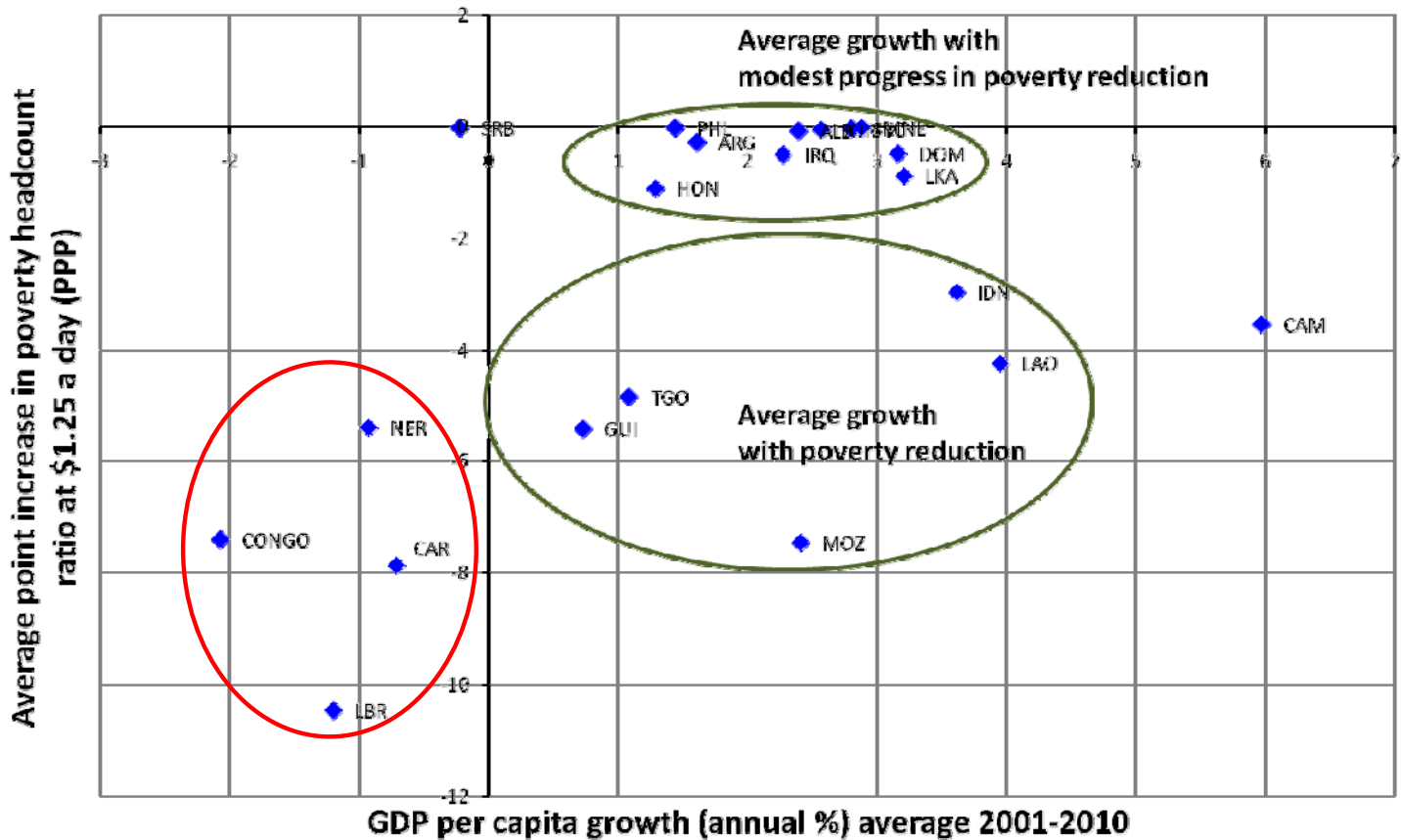


But: Sizeable variance in impact of growth on poverty: A **1%** rate of growth will bring anything from a modest drop in the poverty rate of **0.6%** to a more dramatic **3.5%** annual decline

From Ravallion 2011

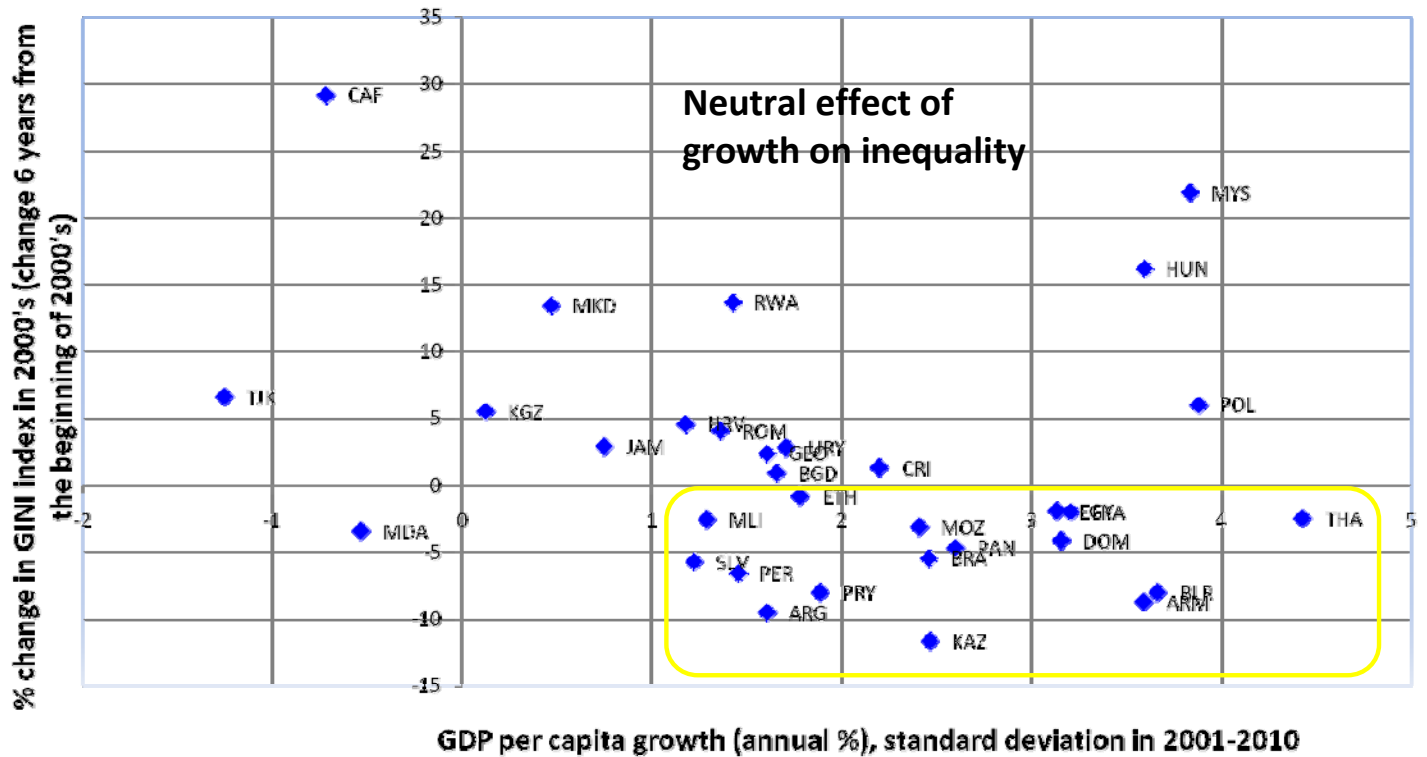
Growth and poverty reduction

Change in poverty headcount and GDP growth (2000s)



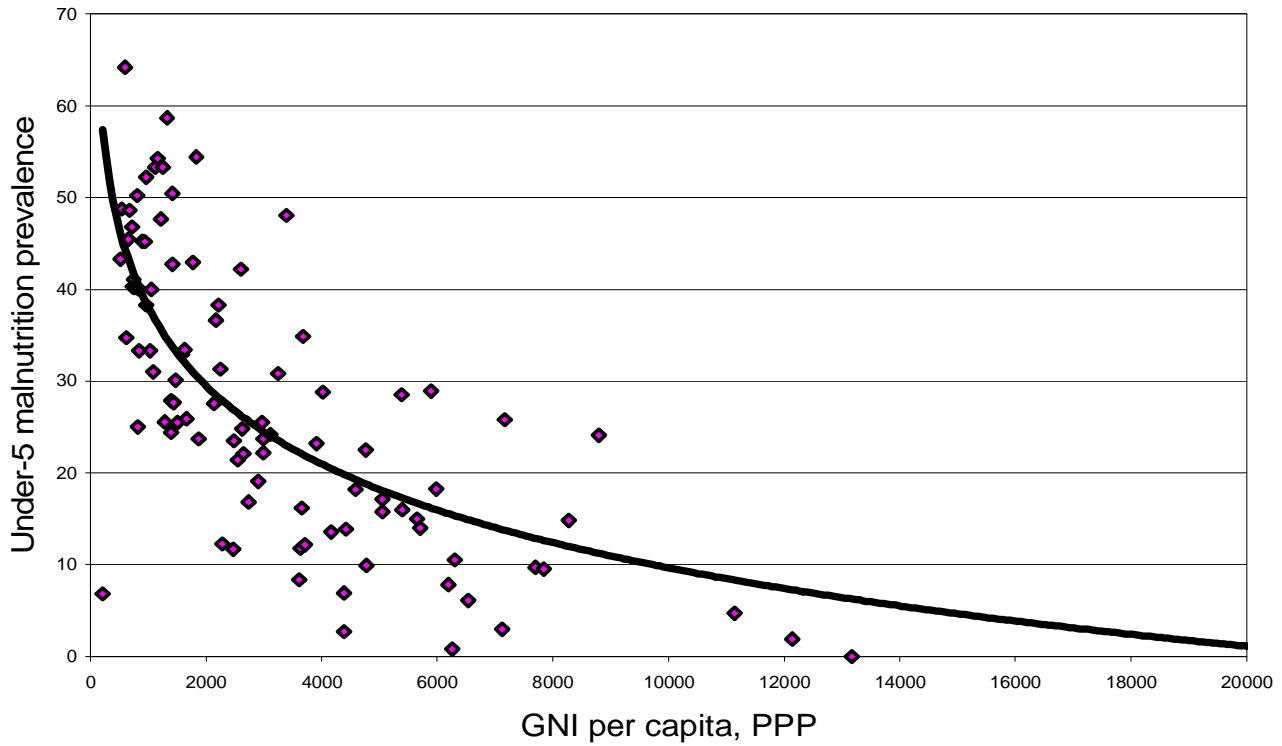
Growth and inequality

Changes in Gini's and GDP growth (2000s)

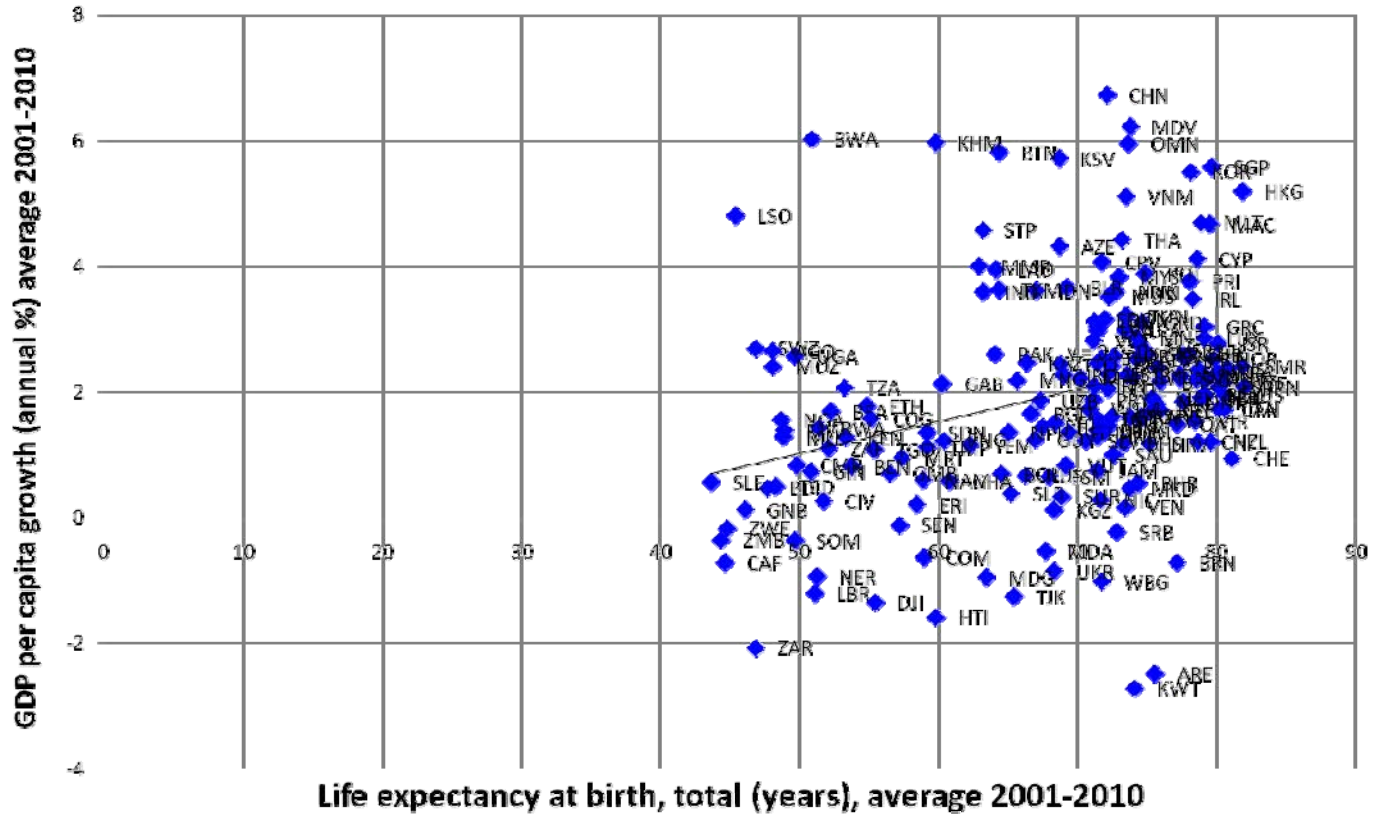


Growth and child malnutrition

Malnutrition and growth in cross-country evidence



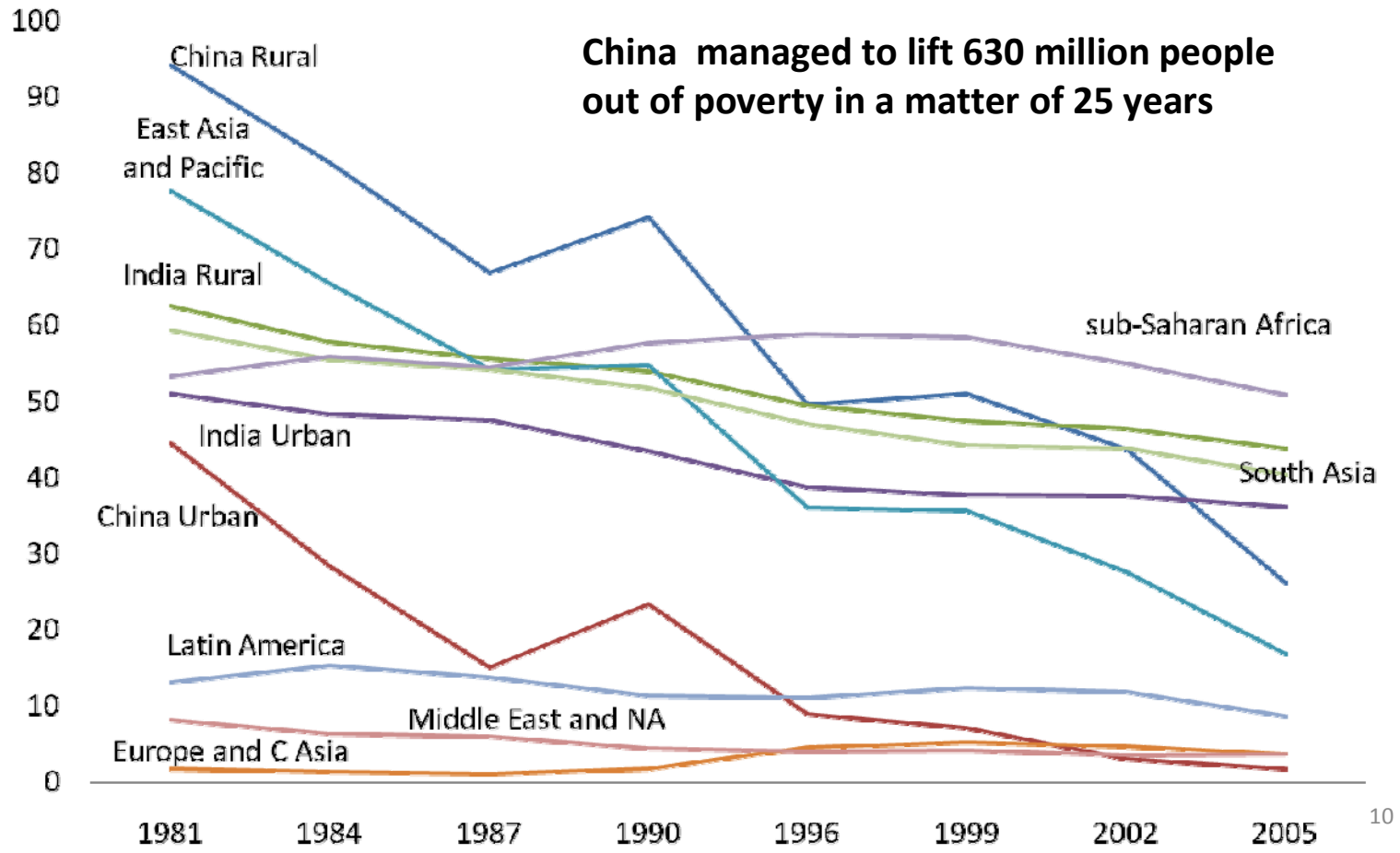
Growth and life expectancy



Pro-poor growth vs. Inclusive growth

- Growth is ‘pro-poor’; under two definitions:
 1. **If growth accompanies a reduction in the *absolute* aggregate headcount ratio** of an agreed poverty threshold –for example the World Bank US \$1.25 dollar a day poverty line
 2. **If growth accompanies a *pro-poor redistribution***, i.e. if poverty falls by more than the overall population holding distribution constant. In other words, if the incomes of the poor grow faster than the overall population
- The notion of inclusive growth may not necessary be aligned with ‘pro-poor’ growth...Why?

People living on less than \$1.25 per day



Inequality in China (1978-2006)



What do we mean by Inclusive growth?

- Inclusive growth deals with policies that allow people from different groups –gender, ethnicity, religion-, and across sectors – agriculture, manufacturing industry, services, to contribute to, and benefit from economic growth
 - It links macroeconomic fundamentals with microeconomic determinants of growth

Determinants of inclusive growth

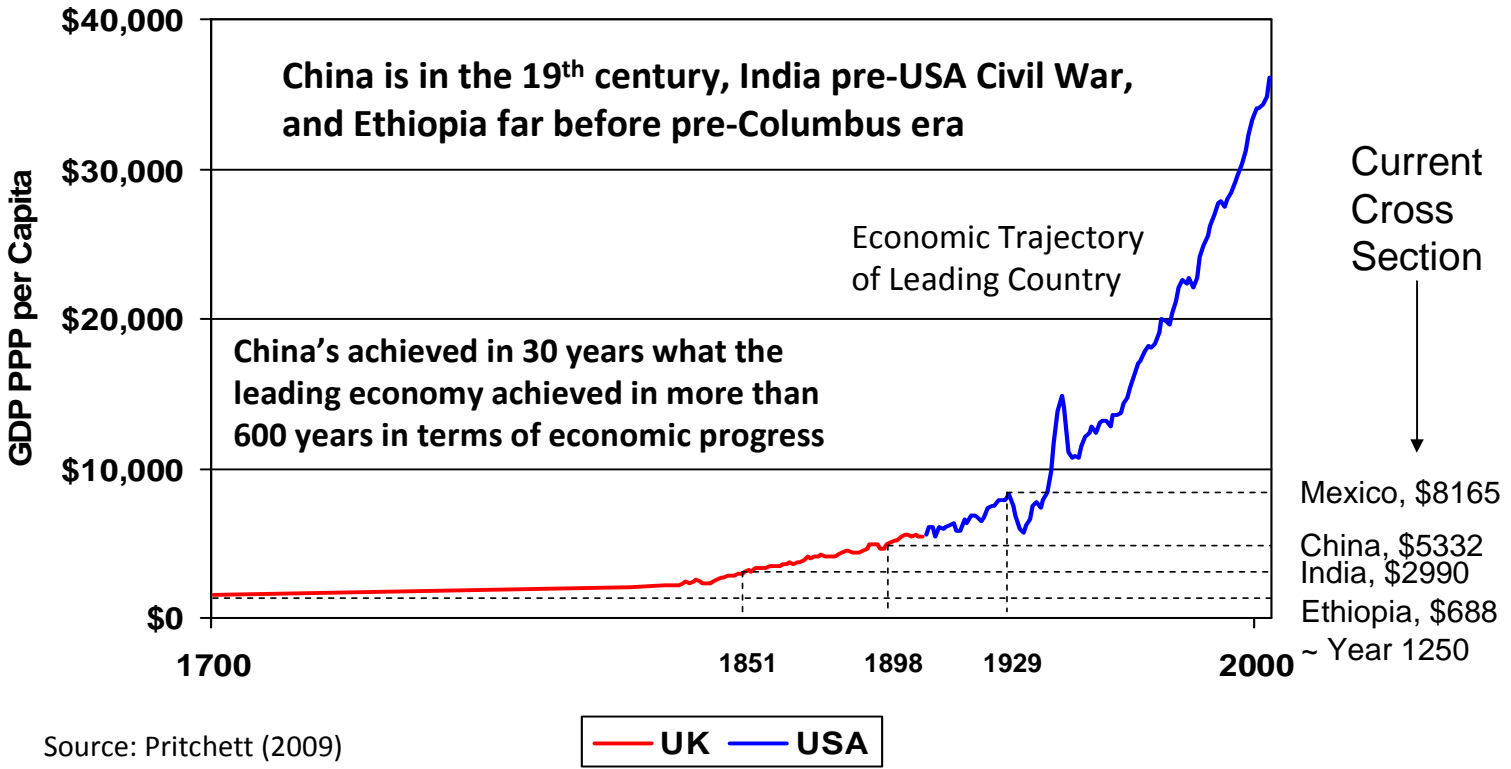
Macro fundamentals	Micro determinants	Elements of Inclusive growth
<p>Macroeconomic stability</p> <ul style="list-style-type: none"> •Moderate fiscal and current account deficits •Low debt to DGP ratio •Moderate inflation 	<p>Investment in human capital</p> <ul style="list-style-type: none"> •Health •Education •Water and Sanitation 	<p>High growth rates for several years</p> <ul style="list-style-type: none"> •Particularly relevant for LIC
<p>Political stability –democratic institutions</p>	<p>Investment in physical infrastructure</p>	<p>Sustained growth patterns</p> <ul style="list-style-type: none"> •Avoiding collapses/crisis/environmental degradation
<p>Progressive fiscal policies</p>	<p>Tackling horizontal inequalities in basic service provision</p> <ul style="list-style-type: none"> •Discrimination by gender, ethnicity, religion, etc. 	<p>Structural transformation –finding country's own competitive advantage</p> <ul style="list-style-type: none"> •Production specialisation •Export diversification •Good business environment
<p>Social Protection for vulnerable groups</p>		<ul style="list-style-type: none"> •Broad-based productive (and decent) employment opportunities
<p>Openness to trade</p>	<p>Facilitate access to finance</p> <ul style="list-style-type: none"> •Microfinance •SMEs finance •Capital markets 	<ul style="list-style-type: none"> •Equal opportunities for all, in terms of education and health
<p>Promotion of direct investment in key sectors (agriculture key for LIC)</p>		<ul style="list-style-type: none"> •Significant reduction of absolute poverty
<p>Vertical and horizontal industrial policies</p>	<p>Support broad-based skill development and employment</p>	<ul style="list-style-type: none"> •Reduction in vertical and horizontal inequalities
<p>Low population growth rate</p>		

Clues for inclusive growth

There is no rule of thumb for general inclusive growth policy, as it is a country-specific question, BUT there are some important empirical clues

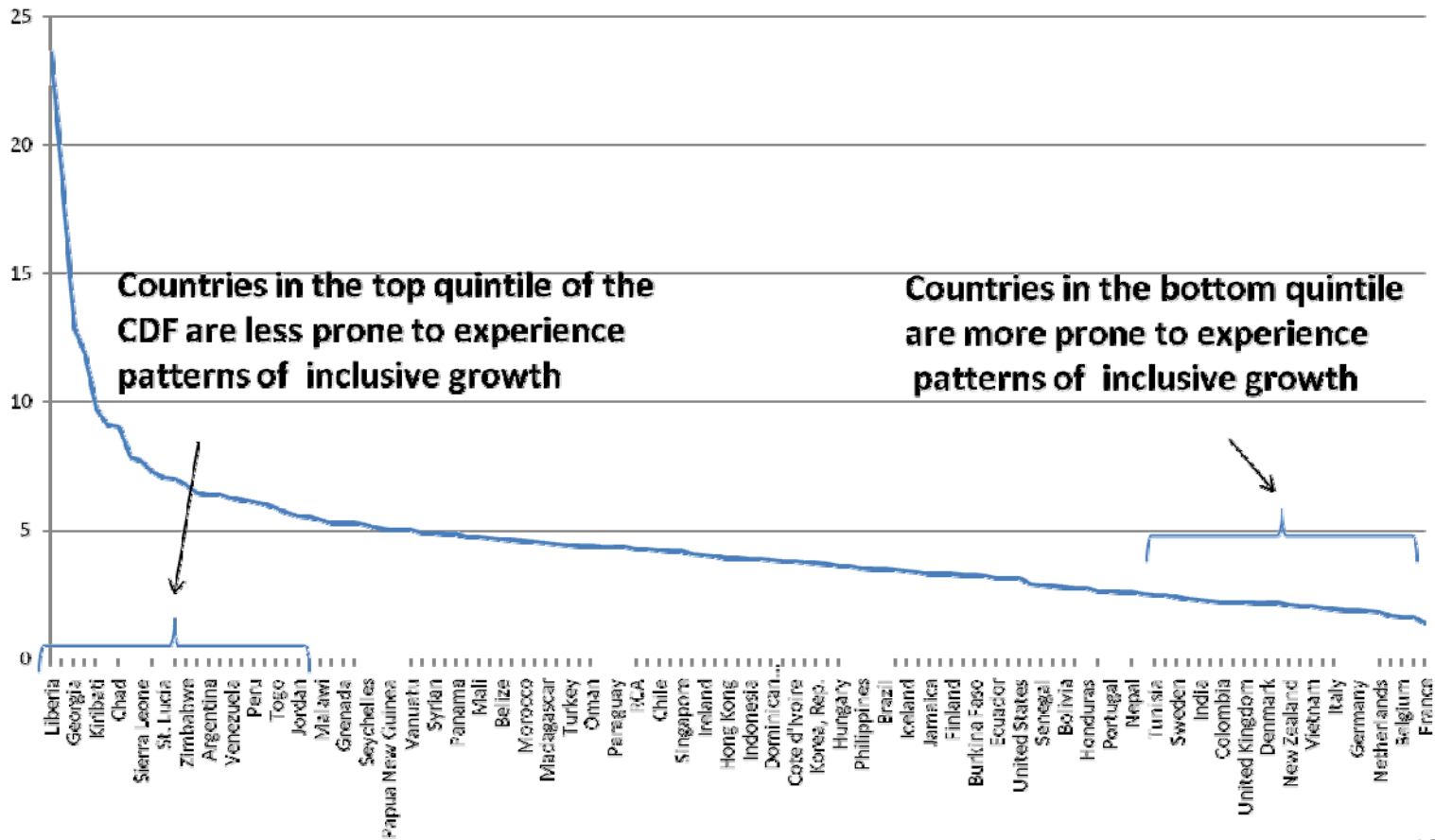
- **Structural transformation** is key – finding country's own competitive advantage
- **Growth determinants are dependent on initial conditions of growth**, such as levels of income, capital endowments and labour
- LIC require much higher AND steady growth rates than MIC to reduce poverty – *the poorer the country, the more relevant GDP growth is for poverty reduction*
- The **rate of growth matters**, BUT **especially a sustained and steady longer-term pattern of growth**
 - high growth rates for many years (how long?)
 - Sustained growth accelerators (investment)
 - Policies that provide **stability and avoid collapses**

Divergence, Big Time in current levels of output, mapped into history

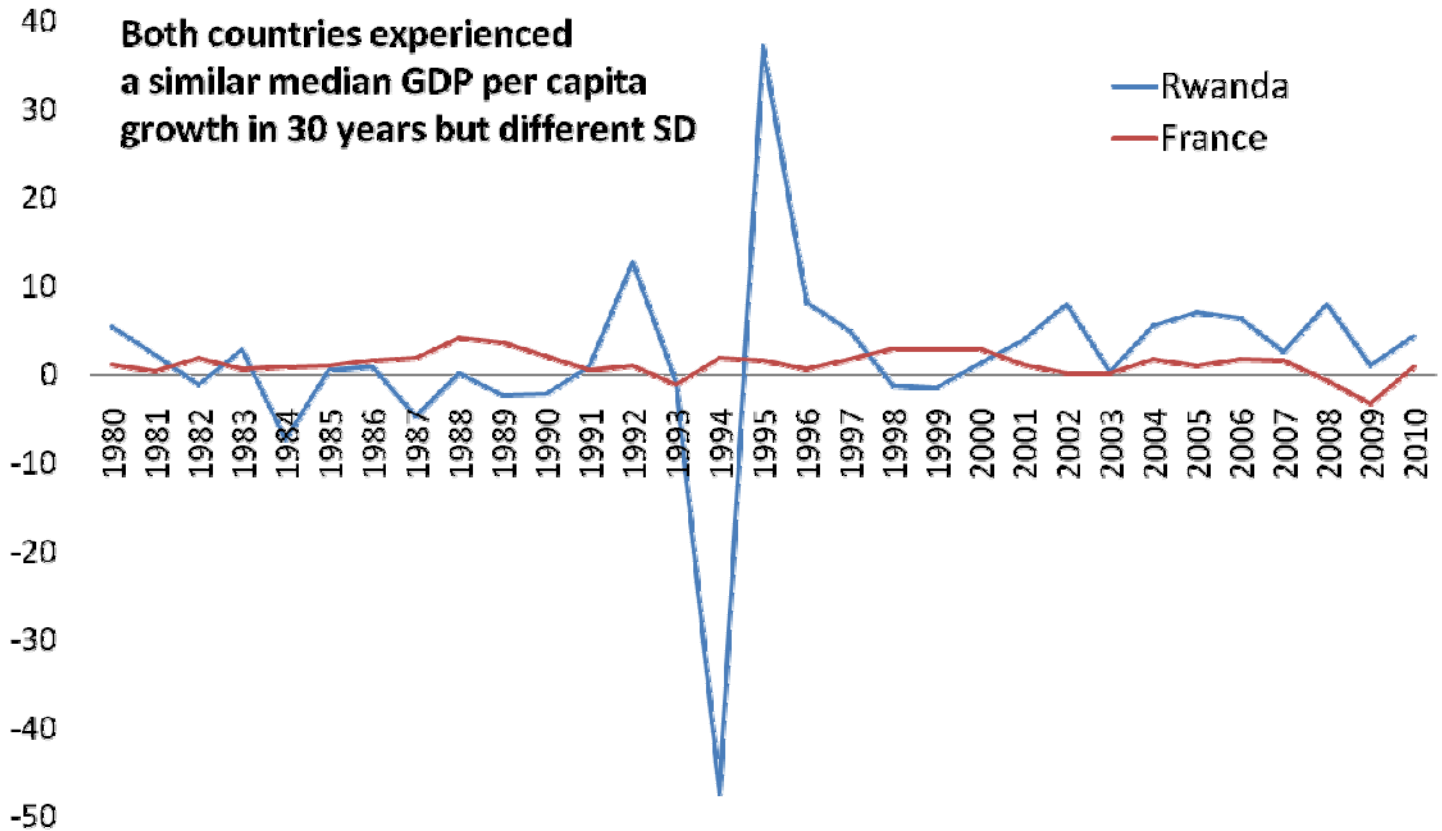


Source: Pritchett (2009)

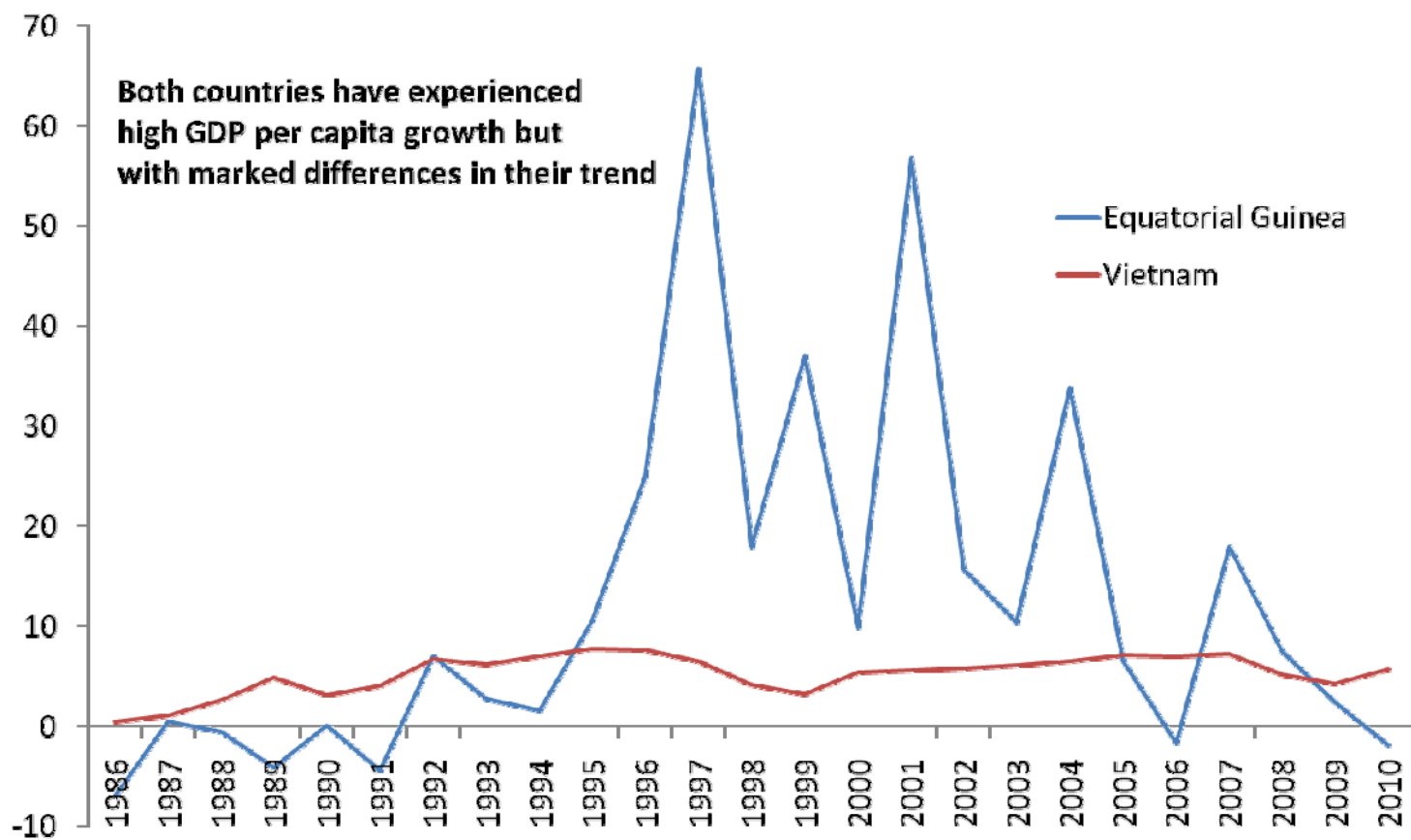
Standard Deviation of GDP per capita growth (1980-2010)



High or steady growth?



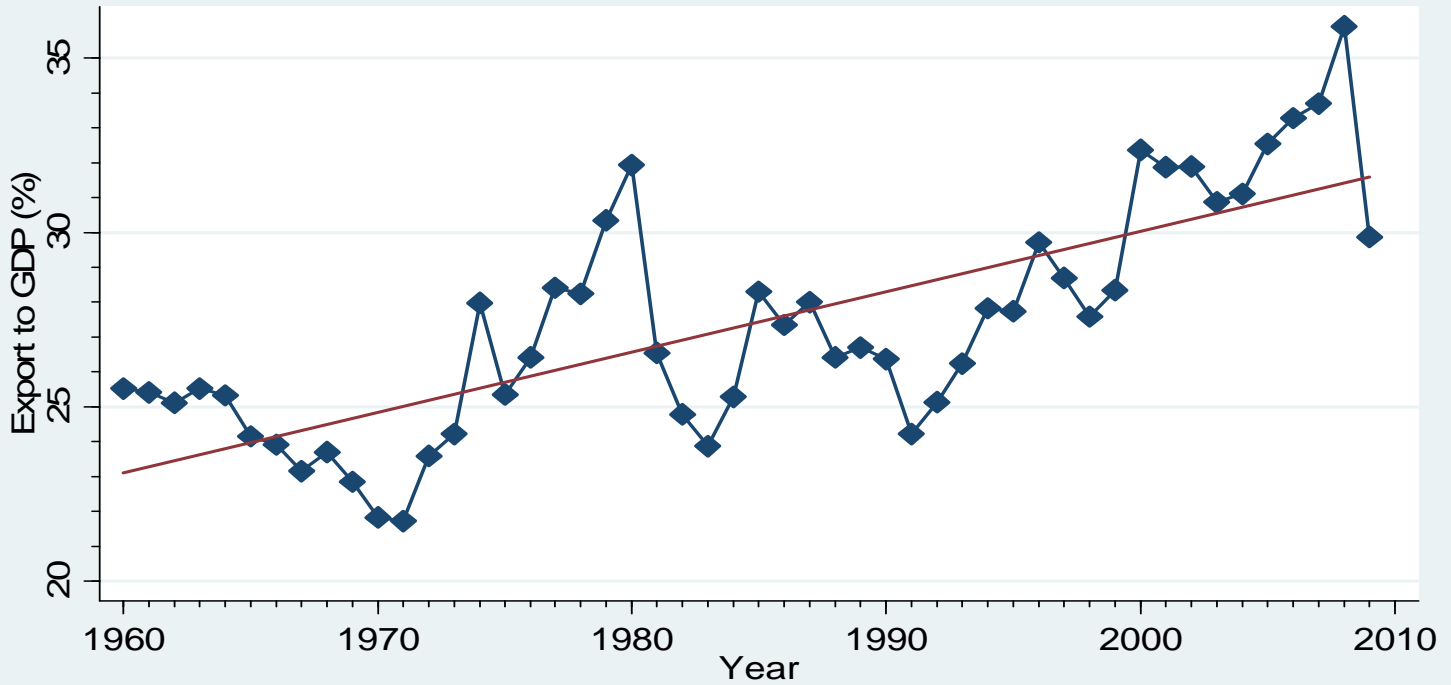
Steady growth, as relevant as a high GDP rate



Trend in SSA Export Performance

Export Performance of SSA (Percentage of GDP)

1960-2009



Exports of goods and services (% of GDP) Fitted values

The role of redistribution

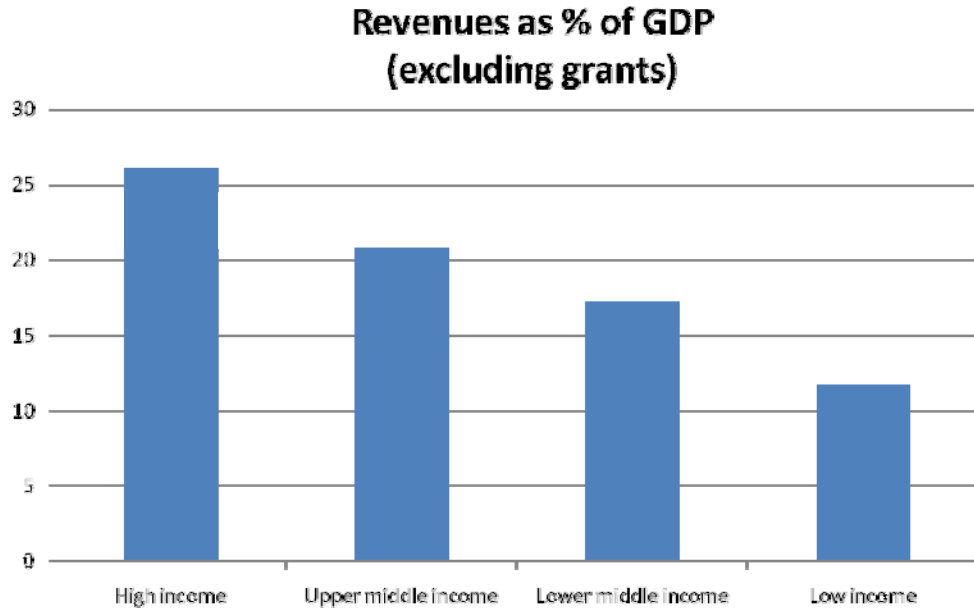
- Evidence shows that sustained economic growth can only be achieved when a broader-based labour force is *included* in the growth process
 - **Getting the balance right between winners and losers is a key challenge**
- Growth with **progressive distributional policies** are more inclusive and have greater poverty impacts than distribution-neutral policies
- In LIC, **asset equality has a greater effect on inclusive growth** than income redistribution alone
 - Land distribution, a challenge in SSA, India

The role of redistribution

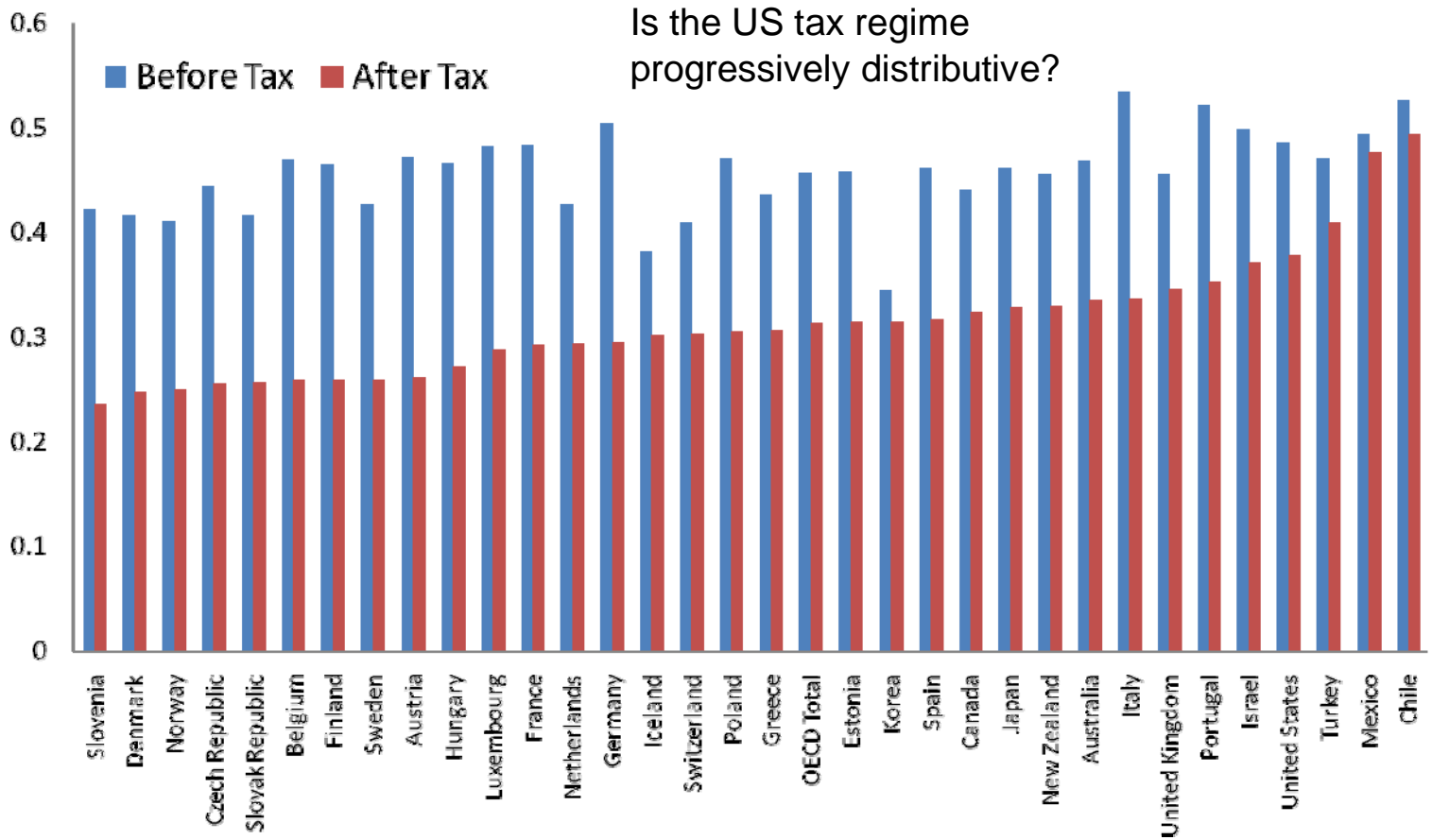
Tax revenues as % of GDP have grown modestly among low income countries, to about 11% in the end of 2000s

Constraints associated with:

- **The structure of the economy** – the rural subsistence economy and the informal sector are difficult to tax
- **Administrative capacity** of revenue authorities
- **Political economy factors**



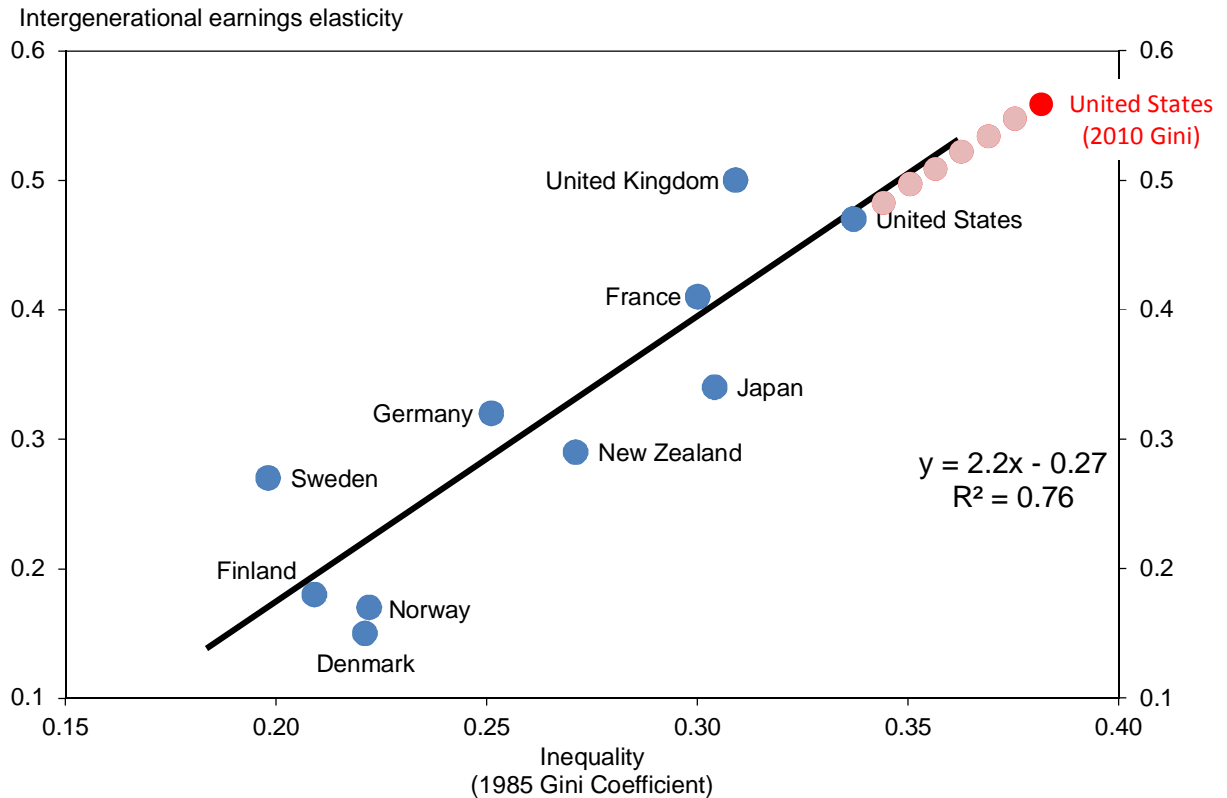
Gini coefficients before and after taxes and transfers (2010)



Source: OECD

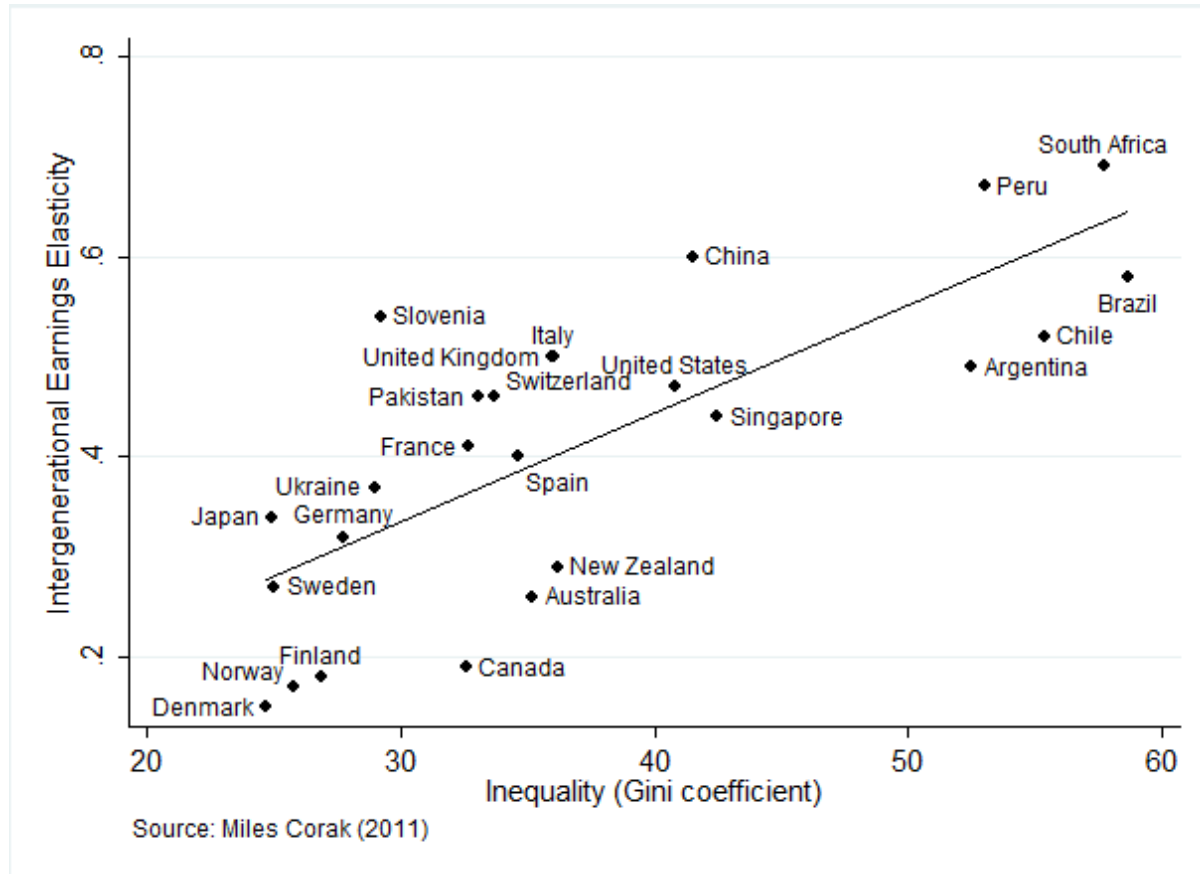
Higher income inequality associated with lower intergenerational mobility

The vertical axis shows how much a 1% rise in your parents' income improves your expected income – the higher the number, the lower expected social mobility



Source: Corak (2011), OECD, CEA estimates

Higher income inequality associated with lower intergenerational mobility

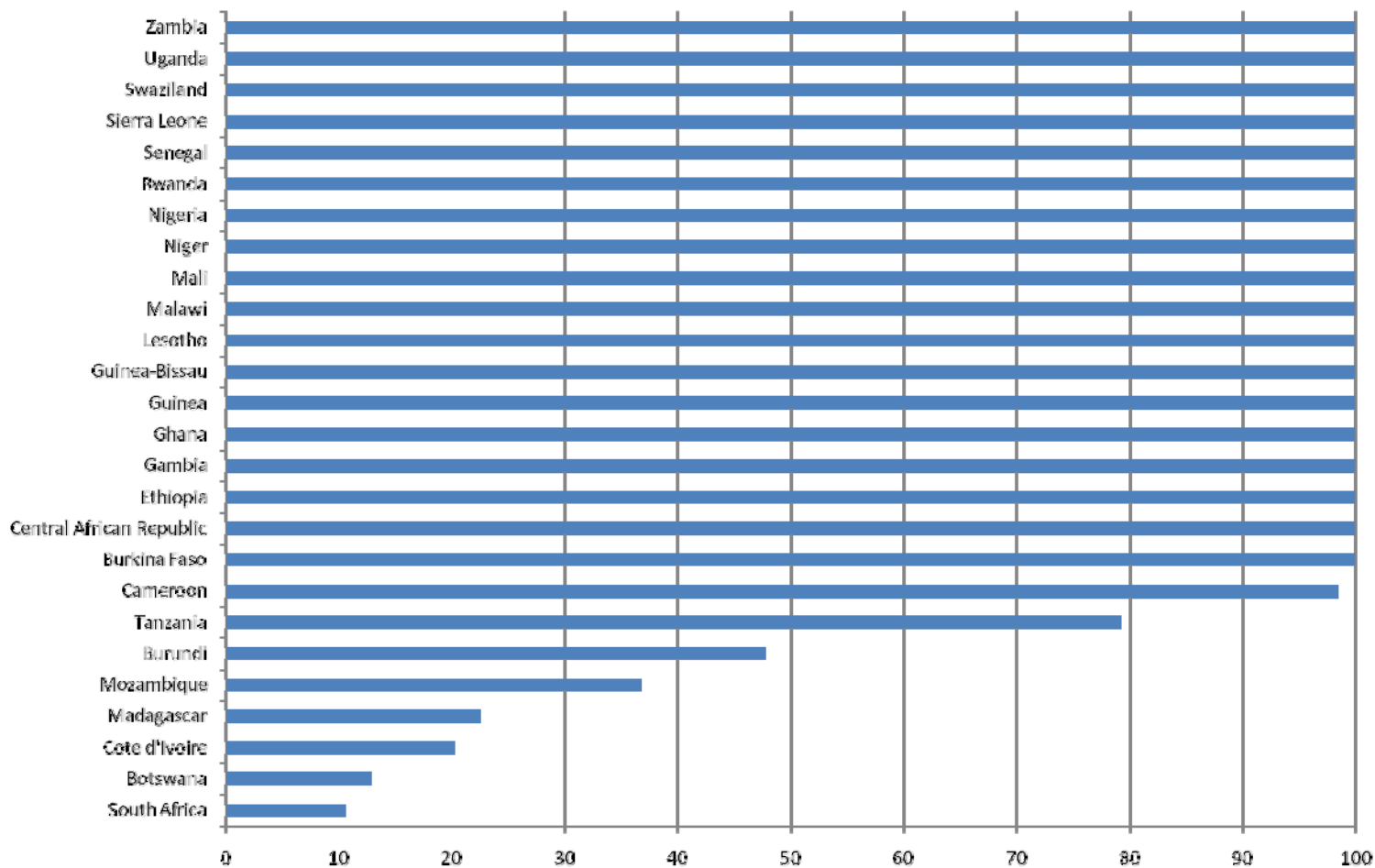


Inclusive growth is about policies that facilitate **intergenerational social mobility**

Sources for redistribution?

- **Revenues from Natural resources** in low income but resource rich countries – challenges:
 - Small labour force participation
 - Not well integrated to the rest of the economy
 - Governance and transparency issues
- **Medium-term fiscal policy objectives**
 - Rises in VAT earmarked for expenditures on the social sectors
 - Anti tax-evasion policies
- **Room for redistribution? What marginal tax rate on the ‘rich’ would be necessary to eliminate the normalised aggregate poverty gap?**
 - **MTR:** *proportion of tax paid for each additional income unit earned at the highest income threshold*

MTR needed to eliminate the poverty gap



Source: Niño-Zarazúa *et al* (2012)

What can donors do to support inclusive growth?

- Help countries to tighten the **link** between the **macro-economic framework & the longer-term development strategy** e.g. via National Plan (Botswana good example)
- Need to think harder about **structural transformations**– growth but not enough structural change (new industrial policy, or ‘learning to compete’)
- Support reforms to **improve business environment**
- Role for **aid in encouraging more private capital flows** (e.g. via reducing macroeconomic risks)
- Support technical cooperation to **boost productivity in labour intensive sectors** e.g. agriculture

What can donors do to support inclusive growth?

- Distorting impact of **resource rents** – much to worry about – often associated with institutional weakening (oil especially) whereas aid tries to improve institutions
- **Strengthen technical assistance & policy dialogue** to help countries **use growing resource revenues in transparent & effective way**
 - For example enhance policy toolkit for investing resource rents in social protection & high-value infrastructure & link to industrial policy ('learning to compete')
- **Retain budget support** to countries receiving larger resource revenues when it provides entry-point for dialogue on overall fiscal framework (taxing & spending)

What can donors do to support inclusive growth?

- In principle, plenty of **high return projects** that could pay back the funding – but be careful about excessive borrowing
- High-return **public investments (e.g. health, education)** still on the shelf – investments often financed by high-cost domestic borrowing rather than concessional aid
- So what is **optimal blend** of grant aid, concessional borrowing, commercial borrowing, FDI? Very country specific

What can donors do to support inclusive growth?

- Fragile countries where risk is high & stubborn & macro-framework weakest. Will aid become concentrated on these?
– **Country Fragility**
- (ii) International Monetary System – weakness – countries build large forex reserves to provide shock-insurance – reason why central banks like to use aid to add to reserves – **Global Fragility**
- Aid-Growth impact can't be maximized without action on:
 - (i) Conflict - 'peace-building is good economics
 - (ii) Reform of the international monetary system to raise stability & provide more global shock insurance (& movement on trade agreements)

More information?

- We have provided a taste of our thinking
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