Global Poverty & Inequality Dynamics Research Network WWW.developersdilemma.org Researching structural change & inclusive growth

## **ESRC GPID Research Network Briefing Paper 5**

# THE GLOBAL ECONOMY AND THE CHALLENGE OF INCLUSIVE GROWTH

Author(s): Terry McKinley

Date: 10 November 2017

Affiliation(s): Centre for Development Policy and Research, SOAS, University of London

Email(s): tm9@soas.ac.uk



What are the prospects for Inclusive Growth under the projected GDP growth rates of the world economy? This brief argues that they are not promising. Without a dramatic structural change in both employment and productivity, a narrowing of the income gap in favour of the poor is unattainable. The brief advances a critique of the concept of Inclusive Growth and advocates for a more ambitious concept of Inclusive Development which encompasses an economic and political agenda of structural change.





### About the GPID research network:

The ESRC Global Poverty and Inequality Dynamics (GPID) research network is an international network of academics, civil society organisations, and policymakers. It was launched in 2017 and is funded by the ESRC's Global Challenges Research Fund.

The objective of the ESRC GPID Research Network is to build a new research programme that focuses on the relationship between structural change and inclusive growth.

See: www.gpidnetwork.org

#### THE DEVELOPER'S DILEMMA

The ESRC Global Poverty and Inequality Dynamics (GPID) research network is concerned with what we have called 'the developer's dilemma'.

This dilemma is a trade-off between two objectives that developing countries are pursuing. Specifically:

- 1. Economic development via structural transformation and productivity growth based on the intra- and inter-sectoral reallocation of economic activity.
- 2. Inclusive growth which is typically defined as broad-based economic growth benefiting the poorer in society in particular.

Structural transformation, the former has been thought to push up inequality. Whereas the latter, inclusive growth implies a need for steady or even falling inequality to spread the benefits of growth widely. The 'developer's dilemma' is thus a distribution tension at the heart of economic development.

### **Global Framework**

Global projections of GNP per capita (in 2005 \$PPP) in the recent report of the New Development Bank ('BRICS Bank') suggests that the world economy is projected to recover modestly from low economic growth over the coming five years (2018-2022) (New Development Bank 2017).

This trend is illustrated in *Table 1*, which partitions the global economy into six major blocs. These include 1) three Developed-Economy blocs: the USA, Europe and the remaining 'Other Developed Economies' and 2) three Emerging and Developing Economy blocs: the BRICS<sup>1</sup>, 'Other Emerging Economies' and lower-income 'Developing Economies'.

The table reports that the global growth rate of GNP per capita is projected to rise to 2.4% from 1.7% between 2018 and 2022. But this rise appears to be due mainly to the recovery in growth of GNP per capita among Developed Economies. However, their projected growth rates would remain relatively low, namely, 1.5% or less.

Over the period 2018-2022, the BRICS are expected to continue being the most important driver of global economic growth. But their combined growth rate of GNP per capita would slow to 4.7% from 5.4% during 2008-2017.

The growth of the world economy is expected to increase at a broadly comparable rate during 2023-2030, with global GNP per capita growing at 2.5% as compared with 2.4% in 2018-2022.

Growth across Developed Economies is projected to remain relatively slow. For

example, growth in the USA would dip slightly, from 1.4% during 2018-2022 to 1.3% during 2023-2030 and growth in Europe and 'Other Developed Economies' would rise only modestly.

The growth rate of the BRICS combined (and of China and India in particular) is projected to slow slightly, namely, to 4.5%. The per capita GNP growth rate in Other Emerging Economies would remain the same, at 2.8% over both 2018-2022 and 2023-2030.

| Table 1. Historical and Projected Annual Growth |
|---|
| Rates of GNP per capita (%) (2005 \$PPP)        |

|                           | 2008-<br>2017 | 2018-<br>2022 | 2023-<br>2030 |
|---------------------------|---------------|---------------|---------------|
| World                     | 1.7           | 2.4           | 2.5           |
| USA                       | 0.7           | 1.4           | 1.3           |
| Europe                    | 0.6           | 1.5           | 1.8           |
| Other Developed Economies | 0.8           | 1.2           | 1.4           |
| BRICS                     | 5.4           | 4.7           | 4.5           |
| Other Emerging Economies  | 1.1           | 2.8           | 2.8           |
| Developing Economies      | 2.6           | 2.5           | 2.9           |

Data Source: the World Databank of the Cambridge-Alphametrics Model

### Prospects for Inclusive Growth

So what are the prospects for **Inclusive Growth** under such projected economic conditions? They are not promising. And, in addition to such lack of promise, current analyses and discussions of Inclusive Growth are bedeviled by a mounting pile of inherently vacuous concepts.

This author spent many years in UNDP as a Policy Advisor, sponsoring country studies that sought to identify the macroeconomic policies most conducive to 'Pro-Poor Growth'. This effort involved finding ways of shifting

<sup>&</sup>lt;sup>1</sup> BRICS stands for Brazil, Russia, India, China and South Africa

the **'distributional bias'** in favor of the poor. However, without a dramatic structural change that would improve the poor's employment status, such a shift was inevitably going to be unattainable.

Decades ago, Kuznets recognized the importance of underlying **structural trends** (Kuznets 1955). But he posited the classic conundrum that during a meaningful process of structural change, inequality would, in fact, increase before it would eventually decline.

His explanations for how such an eventual decline would occur were not, however, well developed. He tended to focus on associated political developments, such as the rising political power of the working classes. Such new-found political influence would lead, he believed, to disproportionate economic advancement.

In contrast to such a structural analysis, the more 'modern' concept of Inclusive Growth (supposedly an intellectual advance on 'propoor growth') still tends to propagate abstract economic 'fairy tales', namely, that the congenitally 'excluded' poor (as well as the relatively disadvantaged in general) could be allowed to advance economically at least as rapidly as everyone else, and especially vis-àvis the rich. Namely, they would be 'included' thankfully in any economic advances.

Such an assumption would posit that the economically disadvantaged could see their income per person grow as fast as that of the rich in percentage terms. But even under such a benign scenario, the **absolute** gap between the income per person of the rich and that of the disadvantaged would still widen (see McKinley 2009 and McKinley 2008).

Let us take a simple mathematical example in order to illustrate such an outcome. Assume that the average income per person of the poorest 40% (those whom we assume for this example are the 'economically disadvantaged') were \$10 and that of the richest 10% were \$100 (so that the gap between the two were **\$90**). This is roughly the situation in countries such as Brazil and South Africa, for example.

Now let us do an exercise that could simulate a simple scenario of 'inclusive growth'. Namely, let us assume a 5% growth rate of income per person for each group. Unfortunately, such a benign scenario would lead to an increase in the absolute gap between the two to **\$94.50**. The income per person of the 'economically disadvantaged' would rise to \$10.50 while the income per person of the rich would reach \$105. In other words, inequality in absolute terms would worsen.

Hence, the economically disadvantaged would have to achieve, at least, a much faster relative rate of growth of their income per person than the rich in order to close the absolute gap between the two groups.

In this regard, it is interesting to note that the World Bank's originating definition of 'inclusive growth' (see Ianchovichina & Lundstrom 2009) relies on the notion that the poor or the disadvantaged would advance at the same rate as the rest of the population. In other words, they would be dutifully 'included'. Thus, there would be a seemingly 'egalitarian' outcome.

This stance implies, however, that in our simple example the World Bank would focus on the fact that both the poor and rich experienced a 5% increase in their income per person. In other words, they would ignore the fact that the poorest 40% experienced only an absolute 50-cent increase in their per capita income while the rich experienced a much larger \$5 per capita increase.

I suppose that we could argue that such an assumption is at least an improvement on Kuznets' projections. He assumed, in fact, that the poor would experience, at first, a relative deterioration in their income per capita as a result of structural change. For example, he posited that in its early stages, economic development would lead to a widening of income inequality—as farmers thrown off their land secured only very insecure and lowpaying industrial jobs.

Only later, he assumed, would these workers begin to close the income gap with the owners of industry and thus inequality across society would decline. But how exactly this later 'equalizing' historical trend would occur has remained a matter of much debate.

The chief problem with the current 'modern' widespread fascination with achieving 'inclusive growth' is that it can fundamentally distract us from focusing on the economic and political agenda needed precisely in order to narrow the gap, at the very least, between the disadvantaged and the rich. Achieving such an objective would necessarily depend, in fact, on significant structural changes in both employment and productivity.

However, any such 'narrowing of the gap' is looking more and more difficult to achieve under current and projected economic conditions. In developed economies, decentpaying industrial jobs are increasingly being automated and this trend is likely to catch up even with the low-paying industrial jobs that have been shipped out to developing economies.

At the same time, investment resources are being increasingly diverted to profitmaximizing financial adventures instead of supporting productive investment. On the basis of such trends, the absolute economic gap between the disadvantaged and the rich will most likely continue to widen substantially.

Hence, relying on a seemingly benign abstract analytical framework, such as that for Inclusive Growth, is not likely to reap any redistributive dividends. It would be better, for example, to adopt **'Inclusive Development'** a more expansive and meaningful term—as a starting-point.

Though admittedly more ambitious, such a broader approach would give us the latitude, at least, to focus on **structural changes** in the economy, at the national level and as a result of international trends.

### References

Ianchovichina, Elena and Susanna Lundstrom (2009). 'What Is Inclusive Growth?' World Bank Note, February 10.

Kuznets, Simon (1955). "Economic Growth and Income Inequality", *American Economic Review*, Vol. 45, No. 1, March, pp. 1-28.

McKinley, Terry (2009). 'Revisiting the Dynamics of Growth, Inequality and Poverty Reduction', Centre for Development Policy and Research Discussion Paper 25/09, August.

McKinley, Terry (2008). 'How Inclusive Is 'Inclusive Growth?' Centre for Development Policy and Research, Development Viewpoint No. 6, June.

The New Development Bank (2017). The Role of the BRICS in the World Economy & International Development. See the Chapter entitled 'The BRICS Role in the World Economy', contributed by Terry McKinley and Francis Cripps. Shanghai.