Toward Inclusive Growth

Emerging markets should share the fruits of their growth more equitably

Tao Zhang

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GROWTH rates in emerging market countries have significantly outpaced those of more developed economies in recent years. Poverty has fallen; standards of living have improved. But with this rapid expansion comes the danger that the gap between the rich and the poor in those countries will widen. Pew Research polls show that most people are optimistic about the future in emerging markets such as India, Nigeria, and other countries that are progressing toward advanced economy status. But we must ensure that growth remains inclusive in these economies so that this optimism is justified.

By inclusive growth, I mean a more equitable sharing of the benefits of increased prosperity, decent-paying jobs, equal employment and education opportunities, and improved access to and provision of health care and financial services. In comparison to advanced economies, emerging markets experience greater income disparity and higher poverty, and lag behind in access to key social services like health care and finance.

We need to make growth inclusive not only because it is the morally right thing to do, but also because it is critical for achieving sustainable strong growth. Research inside and outside the IMF has shown that high levels of inequality tend to reduce the pace and durability of growth and that policymakers should not be afraid to adopt measures that ensure shared prosperity, including ones that redistribute wealth.

So it will be important for policymakers to ensure that growth's benefits are shared equitably. Failure to do so risks increasing political and social instability, stifling investment in human and physical capital, and eroding support for structural reforms—which would impede the sustained growth that emerging markets need to achieve high-income status. Addressing these issues today is all the more important in light of the prospect of less favorable global economic conditions.

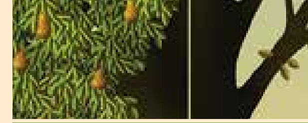
More progress needed

Over the past few years, emerging markets have made progress in fostering inclusive growth—thanks, in part, to favorable global conditions, such as low interest rates and rebounding international trade. Growth in these countries has averaged about 4 percent a year since the early 2000s, accounting for over half of global growth. And income inequality has declined, with the Gini coefficient—the most common indicator of inequality—falling to about .40 from .45. (The Gini coefficient ranges from zero, when everyone has the same income, to 1, when a single individual receives all the income.) Poverty has also fallen, employment has risen, education levels have gone up, and access to financial services and health care has improved.

But sustaining this progress can be challenging. To begin with, we cannot be complacent. In many emerging markets, income inequality remains high and too many people still live in absolute poverty. More important, these countries are facing a new global economic landscape, with increasing uncertainties. As emerging markets strive to attain the same level of development as advanced economies—a process that entails accumulating capital and raising productivity—these challenges will tend to worsen.

I see five priority areas where IMF policy advice can support country authorities in addressing these challenges.

Productivity: A rising tide lifts all boats, the saying goes. Raising productivity (output per hour worked) will help create the



widespread increase in income and wealth needed to reduce inequality and poverty. Achieving this goal won't be easy. Countries will have to promote competition in product markets and trade, encourage foreign direct investment, finance infrastructure projects, and improve business environments. These reforms are high on policymakers' agendas in such countries as Brazil, China, India, and South Africa.

Education and health care: Improving the quality of education and health care will enhance workers' employability and help break the vicious cycle of poverty and lack of education. In some cases, increased spending will be needed—think of programs like Brazil's Bolsa Familia, which provides cash transfers to low-income families to encourage attendance at primary schools, or Mexico's Opportunidades, which provides subsidies to enhance schools' performance and better align curricula with the job market.

Access to employment opportunities: Ensuring that women and men have equal opportunities would help boost growth and reduce inequality. In many countries, getting a job is more difficult for women. For example, only about a quarter of women in Egypt, Jordan, and Morocco are employed. Reasons include rigid labor regulations and large disparities in educational attainment. It is critical, then, for governments to reduce barriers to hiring while still protecting workers, remove restrictions on labor mobility, and eliminate tax provisions that discriminate against second earners in a family.

Financial inclusion: Greater access to financial services will help improve livelihoods, reduce poverty, and promote growth. This could be achieved, for example, by easing access to ATMs, promoting access to banking services, especially among low-income households, putting in place financial literacy programs, and promoting mobile banking (see "A Broader Reach" in this issue of *F&D*). Such measures are used extensively in India and Peru. Still, financial inclusion efforts should be accompanied by strengthened supervision and regulation to avoid the financial instability that might result from an expansion of credit.

Safety nets and redistribution policies: With rapid growth and improved productivity, inevitably there are winners and losers, as less competitive firms shut down and workers lose their jobs. It will be important for governments to adopt measures to ease that transition, including skills upgrading, training programs, and well-targeted social safety nets. More generally, better redistribution policies can promote equity without undermining efficiency. Examples of such policies include replacing general price subsidies with cash transfers to the poor, reducing tax loopholes that benefit the rich, making tax systems more progressive (including in some cases expanding the personal income tax base), and combating tax evasion.

Stepped-up engagement

We have recently stepped up our work in many of these areas—in large part because it is critical to the IMF's mission of promoting economic stability. Below are a few examples.

• On ***productivity,*** we are devoting more resources to understanding the sources of productivity and long-run growth and fully integrating structural reform analysis into our dialogue with member countries (see "Stuck in a Rut," in this issue of *F&D*). This means not only understanding which reforms enhance growth but also being aware of the short-term economic and social costs of those reforms.

• On ***inequality,*** there are several examples. In Bolivia, we have been working with the government to figure out how best to counter the rise in inequality that will likely result from the collapse in commodity prices. In countries such as Colombia, we are trying to tackle what economists call labor market "duality"—that is, a situation in which some workers have well-paying protected jobs and others have poorly paying jobs with little protection and few benefits.

Better redistribution policies can promote equity without undermining efficiency.

• On ***promoting equal access to employment opportunities,*** we have engaged the authorities in Japan and Saudi Arabia in frank discussions on female labor force participation. In particular, our analysis of labor market disparities in Saudi Arabia highlighted possible measures to address the gender balance through more widespread remote work practices and encouraging female employment in retail settings that target female customers.

• On ***financial inclusion,*** our **Financial Access Survey**, launched in 2009, is a key source of data on access to financial services around the world. This helped us learn, for example, 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 ***safety nets and redistribution policies,*** we continue to protect social spending when designing IMF-supported programs because the poor typically feel the effects of economic and financial crises more acutely. For example, over the course of Pakistan's economic program under the Extended Fund Facility—which helps countries facing serious balance of payments problems—more than 1½ million recipients were added to the Benazir Income Support Program, a well-established cash transfer program, and stipends were raised by more than 50 percent. We also help countries adopt tax systems that improve the balance between equity and efficiency.

In addition, we are working hard to strengthen the global financial safety net, which would allow countries to put their limited resources toward achieving better economic and social outcomes.

Putting it all together, I would say the time is ripe for emerging markets to make inclusive growth a centerpiece of their development strategies. This will not only enable the sustainable strong growth these countries need to achieve higher living standards, it will also help put the global economy on a stronger footing. ■