

# General Discussion: Balancing Growth with Equity: The View from Development

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*Chair: Marek Belka*

**Mr. Lin:** My comment is related to the previous paper presented by Dani Rodrik, and also the last comment by Kevin Murphy. Poor people earn their income from their employment in the labor market. Rich people earn more income from their capital. If we can promote structural policies that can facilitate the growth, something like Dani Rodrik mentioned in the manufacturing sectors, which create a huge demand for the labor force, then they will push up the wage rate much faster than the return to capital. In this process, the poor people will benefit from the growth because they are employed and their wage rate may increase much faster than the return to capital. Then we can enjoy growth with equity. This seems to be the experiences in East Asian economies including Japan, Korea, Taiwan and Singapore. In a growth process, we observe the equity with the growth. Those kinds of policies seem to be more related to the structural policy that has been indicated by Dani Rodrik.

My comment to Kevin is similar. The paper had a very good review of the micro levels—how to help the poor—but negates those kinds of structural policies to promote the growth of the sectors which would help the poor.

**Mr. Levine:** I had a question about Esther's comment that we know nothing about growth. We don't know anything about which policies promote growth. I wanted to ask you to define some of the

terms that we don't know anything and policies.

For example, I would go back to the comments made earlier. We know the ability to make contracts, the ability to defend property rights, there is quite a bit of cross-country evidence—if you don't like cross-country evidence, there is microeconomic evidence—which suggests this promotes economic activity. We might not be able to right here, right now write down a list of the specific types of contractual arrangements and laws that should hold in every single country represented in this room. In terms of having some notion of, if we go to a country, and we are looking at what impedes the efficient allocation of resources, this evidence would give us guidance in terms of policies. Similarly, in terms of knowing, my guess is many of the people in this room make monumental decisions without knowing in the sense of having no uncertainty. That might come from particular types of experimental designs. People make decisions about policies, using a variety of pieces of evidence that sum up to a strategy. I wanted to know more why you made such a strong statement, given the wide array of pieces of evidence in micro time series historically.

*Mr. Gurria:* Again to make the point about the question of the labor market consideration in this discussion, we find in our work when looking at inequality that is where the big secrets are. That is where the big solutions are, also. That is where the greater causes of inequality and more hope are, in terms of getting it right in the policies—the dispersion of hourly wages, the earnings inequality among the households, and the disposable income inequality. That also includes taxes.

By the way, on taxes there is a broader issue, just not applied to labor markets. When you are dealing with inequality, the genius of some of the developing country areas like Latin America, Africa, and Asia—certainly Latin America—you reduce the inequalities about 20 points when you apply taxes and Social Security contributions in the United States or in Europe. After taxes and social security contributions in Latin America, it is like Johnny Walker, it just keeps on walking and there is no change at all. It reduces inequality by about 2 points. That is a very dramatic and very serious policy issue that has to be addressed. It comes from the combination of the labor market

and the tax policies.

Also, globalization is producing very serious impacts in inequality, and even trade, which is good. Globalization and trade are good things. In this kind of world, where globalization is favoring or paying or pricing higher skills, the difference between the skilled and the unskilled will increase and therefore inequalities will grow.

Inequalities were growing even in the richest countries among the OECD. In 24 of the 30 OECD countries before the crisis, we registered and measured increases in inequality. Therefore, after the crisis (we are coming out with something in October perhaps), we expect these inequalities to have obviously grown, because of the crisis. Therefore, this is a very, very important policy issue we should be focusing on. Certainly it is important to look at the credit on the financial side, but our impression is that perhaps the greatest source of secrets, challenges, and solutions lies elsewhere.

**Mr. Poterba:** I thought Kevin's focus on the role of labor markets was very important. There is, of course, a place where the labor and capital markets come together and that is the acquisition of human capital, and, in particular, education. The question I had was whether there is a significant role for education policies in these countries in preparing the current bottom end of the distribution to participate in the takeoff, whether it is driven by structural shifts or other sources of development we have heard about earlier.

My question for Esther is: Do we know much about whether the current educational levels at the bottom of the distribution in some of these countries preclude the workforce from taking advantage of globalization? Is there an important role for the state in providing formal education?

**Ms. Duflo:** Thank you very much for the comments and questions. I guess I am in a weird position, where I think I agree with most of the comments, but I don't agree they apply to my paper.

First, I agree that poverty reduction is more interesting than inequality, but I played the cards I was dealt. I must point out I pushed it as much as I could to focus on poverty reduction rather than the rich—

which can stay as rich as they can, as far as I am concerned—and really started talking about what do we do about the poor. Second, I agree labor markets are important. I don't agree that I don't talk about it, because I keep talking about it the entire time, and about human capital, which covers both the allocation, of course, at static point—who works where—and the education issue. Both are fundamental.

What is important to say, and it goes back maybe to Dani's point, is that we know where we want to be—where everybody who is very talented can go and work exactly where their talents are most required. But how do we get there? Labor markets don't work very well in developing countries, sometimes because they are heavily regulated but sometimes despite not being regulated at all. In fact, a large part of the economies is informal, so there is no regulation in those sectors.

There are other issues that prevent the labor market from working well and some of these issues have to do with money. For example, migration is much, much lower, particularly it is not what people have in mind. Permanent migration to cities is much lower than it should be. Transitory migration is very high, but people keep going back and forth, back and forth, and back and forth, which is extremely inefficient. It puts a lot of pressure on the cities' ecosystem and prevents people from accumulating any skill that would make them succeed in the city. The reason why they do that has something to do with the lack of insurance should they go—what happens if they become sick—with maybe the lack of money to justify the move and maybe with the lack of infrastructure both from transportation and in the city.

Going back to Jim's point, it also has a route to education. I unfortunately ran out of time to talk about education. I talked about it in the paper. There is a very big, big problem with the education system in developing countries. The education system produces the current social structure. The children of the poor go to schools—they now all go to schools—so it is not their parents who are not sensitive to returns to education.

Everybody has bought into the agenda and happily sends kids

to school. The child goes to school, however, and doesn't learn anything. In Kenya, to take one example, a quarter of children in grade 5 cannot recognize a grade 1 sentence. That is just Kenya, but you have the same thing in India and Uganda. The model is not improving, despite the fact that more and more children are going to school and the countries are growing.

That is a real issue and it's an interesting one, because it is one where we have some ideas about what could be done. But countries seem to not put them in place. I don't exactly know why, but the education establishment seems to have a view on what the education should be, which is there should be a few people who are able to go to college. They completely forget a lot of people need to learn to read and write and have the basic skills to have the option to go to college or at least to be effective in the labor market.

One example of going in the wrong direction was current reform in India by the Right to Education Act. It was a very nice idea. Everybody should have a right to education, but it sets a restriction on what the school must be. If it is applied, it is going to shut down all informal private schools that actually do educate the poor, which is a bit of a problem. So it shows both the potential there and the difficulties.

Giving money to the poor to start their own businesses might not be the solution. Actually, I agree. Finding a way for them to work in larger firms is the way for both themselves and their children to grow. How is that going to happen? Partly it might be with reform in the labor market, partly it might be improvement in intermediation, and partly we just don't know. That might have to do with improving credit markets for larger firms and we don't know how to do that.

On the growth issue, I may hide behind Dani, who is more of a macroeconomist than me. I was not referring to experiments or whatever. I am going by, say, Caselli's paper on growth accounting, showing how much we explain in growth accounting is pretty low. Looking at what we know about the links of some things to growth, we know very little. I agree with you that we have micro evidence that property rights are a good thing. In fact, there is some of that in the paper. How they are related to something is something we need

to think about. And how we get to good property rights is another interesting question, which will be there for some other time.

**Mr. Murphy:** I have a couple things. First of all, I agree with Jim. Investments in education are important. And Esther is right that policies seem to have a hard time. Parents really do respond to incentives in both market incentives and incentives that are given to them to send their children to school. I don't think it is a bad idea to rely on parents to look after the interests of their children. They are not perfect, but they do a pretty good job. They are the best mechanism we have. The problem a lot of times is parents—and this is true within the developed world as well—just don't have good options and that's important.

One thing I would point out, though. You can help everybody, even if some people have better access. One thing we know about labor markets is supply and demand matter. If we educate some people, move them out of the market, and reduce the supply of less-educated people, that will benefit even those who don't get more educated. You don't have to help everybody in order to benefit the last person. Improving education for a segment of the population can help everyone.

The bad news, and this was pointed out earlier, is education is a slow gain. It takes a long time. Human capital is probably the most durable asset we have. People work in a labor market for 40 years. It takes us 15 to 20 years to produce them, so even if you fix the world tomorrow, it might be 30 years or so before you have half the labor market fixed. That's a long time and that is with instantaneous repairs. That is not to say you shouldn't do it. Again, for an economy as a whole but for poor people in particular, human capital is a key part.

One thing I didn't talk about that ties in, and Esther and somebody else brought this up, is trade. Trade is a big part of it. One of the things trade is good at is you don't have to do everything. You can focus on things you are good at and not do things you are not so good at.

Allowing people to more fully trade allows you to overcome some

of these bad technologies you have. If you have a technology that is really bad for intermediating certain types of activities, well you won't do those activities any longer and import those products. That is an important piece to keep in mind. It prevents your weak link from dragging you down. One area where that happens is in agriculture, where you can move people out of agriculture and they can get agricultural products far less expensive maybe from someone else.

In terms of inequality, I agree. Inequality has been growing in the United States and around the world, and it does have a lot to do with technology and progress in prices of capital and things like that. I would say, if I am interested in the welfare of the poor (I'll go back to the same thing I said before), I'd be interested in general in the growth of the economy as a whole, which, if facilitated by the things we've talked about, is probably the best way to alleviate poverty.

I'm interested in, and I'll ask Esther as she has done more work in this area than anybody, What policies or what things you can do for the poor that tethers them most closely to the economy? If we hit the magic bullet and the economy takes off, what ensures that the poor are tethered? My guess would be human capital, obviously, and things like that, but beyond that, are there specific things that tether people? To me, that's the link that needs to be strengthened if we are interested in growth translating into poverty alleviation.

