Human Development and Wealth Distribution

by Dominique Strauss-Kahn, Managing Director, International Monetary Fund, Agadir, November 1, 2010

It is a great pleasure to be here today, to talk about this all-important topic of human welfare and economic stability.

This link is too often neglected, but it is an old idea. Adam Smith—one of the founders of modern economics—recognized clearly that a poor distribution of wealth could undermine the free market system, noting that: “The disposition to admire, and almost to worship, the rich and the powerful and…neglect persons of poor and mean condition…is the great and most universal cause of the corruption of our moral sentiments.”

This was over 250 years ago. In today’s world, these problems are magnified under the lens of globalization.

A new globalization

Globalization has certainly delivered a lot. It has helped hundreds of millions of people break the bonds of poverty. A spirit of openness has broken down walls all over the world, allowing for the sharing of information and technology across borders and between people on a scale never before seen in human history. New economic powers have arisen, forever shifting the balance of economic power.

But globalization also had a dark side. Lurking behind it was a large and growing chasm between rich and poor—especially within countries. An inequitable distribution of wealth can wear down the social fabric. More unequal countries have worse social indicators, a poorer human development record, and higher degrees of economic insecurity and anxiety. In too many countries, inequality increased and real wages stagnated—failing to keep up with productivity—over the past few decades. Ominously, inequality in the United States was back at its pre-Great Depression levels on the eve of the crisis.

Fundamentally, the growth model that co-existed with globalization was unbalanced and unsustainable. Growth was driven by too much borrowing in some countries, made possible by too much saving in others. For a while, this seemed to work. But the illusion of stability was forever shattered by the wild ride of the global financial crisis. A runaway financial sector took risk to new heights, making sure that the inevitable fall was especially hard.

Inequality may have actually stoked this unsustainable model. In countries like the United States, borrowing seemed to allow ordinary people to share in the rising prosperity. Like the Great Depression before it, the Great Recession was preceded by an increase in the income share of the rich, a growing financial sector, and a major rise in debt. Inequality could also be behind the Chinese export-oriented model, since solid domestic demand needs a healthy middle class, while a low exchange rate goes hand-in-hand with a low real wage. Of course, the unbalanced pattern of growth had a variety of causes, but we would be foolish to ignore the distribution of wealth.

Inequality goes against notions of fairness and solidarity, but it also threatens economic and social stability. This is especially true in poorer countries. Inequality can dampen economic opportunity, by preventing the poor from accessing the financing needed to pursue profitable investments. It can

divert people toward unproductive activities. It can make countries more prone to adverse shocks—with fewer people able to dip into savings during bad times, the decline in growth is larger.

In our globalized world, if the benefits of growth are not widely shared, we could see a backlash against openness and cooperation and a retreat to economic nationalism. Especially in poorer countries, it can lead to instability, a breakdown in democracy, and even war.

We stand on the threshold of a new era. We cannot turn our back on openness and globalization, but we need a new globalization for a new world—a globalization with a human face, where people come first, and where growth and equity always go together. We must rely on the market for growth, but the invisible hand must not become the invisible fist.

Policy agenda

What are the practical implications of this? They are many, but I will focus on a few.

First and foremost, we need to rebalance global growth. With savings in the United States and elsewhere unlikely to return to pre-crisis levels, the old model is dead. The surplus countries must shift from an external to an internal growth engine, relying more on domestic demand, and letting the middle classes come into their own. Stronger social safety nets and investment in infrastructure will support this rebalancing. This will give us new growth, and growth that is more stable and fair, marked by lower inequality.

On top of that, this is surely a ripe opportunity to invest in green technology. Policymakers must encourage the innovation needed to tap into the untouched reservoirs of productivity in this area.

Before we talk about a new growth model, we need to fix old problems, especially in the financial sector. The financial sector was at the epicenter of the crisis. There must be a shift away from the culture of risk and recklessness, to put the banks back in the service of the real economy. Substantial progress has been made, but there is still a lot of unfinished business.

An immediate task is to end the scourge of unemployment. The crisis threw over 30 million people out of work, and in the coming decade, more than 400 million young people will be looking for their first job. So clearly—growth is not enough, we need growth for jobs. And jobs are not enough, we need decent jobs—so that all can benefit from the rising tide.

We must not forget the human costs of joblessness. Unemployment leads to a loss of earnings that is both substantial and long lasting, especially among younger people. If you lose your job, you are more likely to suffer from health problems, or even die younger. If you lose your job, your children are likely to do worse in school. If you lose your job, you are less likely to have faith in public institutions and democracy. We face the very real prospect of a lost generation, distanced from the labor market, and marginalized from society.

Here, in North Africa, these challenges are clear. Given the demographic time bomb, young people need economic opportunities—urgently. More regional integration and openness would be a welcome step in the right direction.

We need labor market policies to focus on job creation. We need opportunities for *all* to prosper, through better education and training, as well as help for small businesses.

Tax and expenditure policies can support fairness and economic stability. Adequate social safety nets are essential, including decent unemployment benefits. And here, the IMF is working closely with the ILO on the concept of a social protection floor for people in poverty or vulnerable situations. In our lending programs, we always emphasize the protection of the poorest and most vulnerable though strong social safety nets. Progressive taxation can also promote equity through redistribution, and this should be encouraged.

We should also make sure that workers have adequate bargaining power, especially if this lies at the root of rising wage inequality. Collective bargaining is important. But we must avoid dual labor markets that create stark divisions between protected insiders and excluded outsiders.

When it comes to the low-income countries, we have a special responsibility. There are few goals more important today than the Millennium Development Goals. Because of the crisis, we have lost years of progress—with an estimated 70 million fewer people escaping poverty by 2020. We must redouble our efforts in the face of this immense human suffering. For this to happen, we need balanced, sustainable, global growth. Without this, we will be treading water against a rapidly advancing tide.

The richer countries must show solidarity with their poorer neighbors. They must keep their Gleneagles promises on aid, and find ways of channeling financial support to help low-income countries overcome the crippling challenges of climate change. They must tear down the barriers to trade that block exports from low-income countries, preventing them from lifting living standards. They should also redouble their efforts to help fragile states, which risk being left behind.

The low-income countries must also help themselves, in part by rebuilding policy buffers and mobilizing domestic revenue so they can be ready for the next crisis. This will also create room to invest in infrastructure and strengthen social safety nets—needed for pro-poor growth.

Conclusion

Let me conclude briefly. Before he died this summer, the British historian Tony Judt made a passionate plea for policymakers to pay far more attention to the damaging effects of inequality. "Inequality is corrosive" he wrote, "it rots societies from within…it illustrates and exacerbates the loss of social cohesion…the pathology of the age and the greatest threat to the health of any democracy."

The mandate of the IMF is economic and financial stability, the sure foundation of human development. We care about inequality not only on grounds of common decency, but because inequality threatens this stability.

The IMF was founded in the aftermath of the Great Depression and the Second World War to promote better relations among countries, to prevent a retreat to nationalism, and to avoid the economic roots of conflict. To achieve this goal, we need the openness delivered by globalization, but we also need global growth that is equitable and stable. We need a new globalization.

The last great period of globalization—in the decades leading up to the First World War—held a lot of promise, but it ultimately came crashing down with thirty years of brutal war and economic devastation. It happened once, and it can happen again. The recent crisis was a wake-up call. We avoided a second Great Depression, and we learned many lessons. But we still have a long way to go.