

## ECONOMICS



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# The Economics of Inclusion

CAMBRIDGE – Many people find economic growth to be a morally ambiguous goal – palatable, they would argue, only if it is broadly shared and environmentally sustainable. But, as my father likes to say, “Why make something difficult if you can make it impossible?” If we do not know how to make economies grow, it follows that we do not know how to make them grow in an inclusive and sustainable way.

Economists have struggled with the tradeoff between growth and equity for centuries. What is the nature of the tradeoff? How can it be minimized? Can growth be sustained if it leads to greater inequality? Does redistribution hamper growth?

I believe that both inequality and slow growth often result from a particular form of exclusion. Adam Smith famously argued that, “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.” So why would growth not include people out of self-interest, rather than requiring deliberate collective action?

It is well known that levels of income are dramatically different around the world. Thanks to more than two centuries of sustained growth, average *per capita* income in the OECD countries is just under \$40,000 – 3.3, 11.3, and 17.7 times more than in Latin America, South Asia, and Sub-Saharan Africa, respectively. Sustained growth has obviously not

included the majority of humanity.

What is less well known is that huge gaps exist within countries. For example, GDP per worker in the State of Nuevo León in Mexico is eight times that of Guerrero, while output per worker in the Department of Chocó in Colombia is less than one-fifth that of Bogotá. Why would capitalists extract so little value from workers if they could get so much more out of them?

The answer is surprisingly simple: fixed costs. Modern production is based on networks of networks. A modern firm is a network of people with different expertise: production, logistics, marketing, sales, accounting, human-resource management, and so on. But the firm itself must be connected to a web of other firms – its suppliers and customers – through multi-modal transportation and telecommunication networks.

To form part of the modern economy, firms and households need access to networks that deliver water and dispose of sewage and solid waste. They need access to the grids that distribute electricity, urban transportation, goods, education, health care, security, and finance. Lack of access to any of these networks causes enormous declines in productivity. Just think of how your life would change if you had to walk two hours each day to obtain drinking water or wood for fuel.

But connecting to these networks involves fixed costs. Before anyone can consume a kilowatt-hour, a liter of water, or a bus ride, somebody has to get a copper wire, a pipe, and a road to their house. These fixed costs need to be recouped through long periods of use.

If income is expected to be low (perhaps because of other missing networks), it does not pay to connect a firm or a household to the network, because the fixed costs will not be recouped. Growth is not inclusive because fixed costs deter markets from extending the networks that underpin it.

Changes in these fixed costs have outside effects on who is included. For example, the first telephone company started operations in 1878, while mobile phones are barely 25 years old. One might expect that the former would have diffused more than the latter, just because of the time advantage. Yet, in Afghanistan, there are 1,300 mobile phones for every landline. In India, there are 72 cellphone lines per 100 persons, but only 2.6 landlines.

In fact, many Indians with mobile phones must defecate in the open because the median Indian does not have piped water in his house. In Kenya, where there are 50 mobile phones

per 100 people, only 16% of the population has access to electricity. This reflects the fact that cellphone towers and handsets are much cheaper than pipes and copper wires, making it possible for the poor to pay the fixed costs.

It is the fixed costs that limit the diffusion of the networks. So, a strategy for inclusive growth has to focus on ways of either lowering or paying for the fixed costs that connect people to networks.

Technology can help. Clearly, cellphones have done wonders. Cheaper photovoltaic cells may enable remote villages to get electricity without the fixed costs of long transmission lines. Mobile banking may lower the fixed costs faced by traditional banks.

But in other areas, the issue involves public policy. From its beginning in 1775, the US Postal Service was based on the principle “that every person in the United States – no matter who, no matter where – has the right to equal access to secure, efficient, and affordable mail service.” A similar logic led to the expansion of the interstate highway system.

Obviously, all of this costs money, and it is here that priorities matter. Poor countries lack the money to connect every person to every network at once, which explains the huge regional differences in income. But too many resources are often allocated to palliative redistributive measures that address the consequences of exclusion rather than its causes. Countries such as Brazil, South Africa, Peru, Uganda, Guatemala, Pakistan, and Venezuela spend substantially more money on subsidies and transfers than on public investment to expand infrastructure networks, education, and health care.

A strategy for inclusive growth must empower people by including them in the networks that make them productive. Inclusiveness should not be seen as a restriction on growth to make it morally palatable. Viewed properly, inclusiveness is actually a strategy that *enhances* growth.

<https://www.project-syndicate.org/commentary/inclusiveness-key-strategy-for-growth-by-ricardo-hausmann-2014-11>