**Session 2: The Theoretical Roots of Growth-Inequality Linkages/Les liens inégalité-croissance: les bases théoriques**

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**"Economic Growth and Income Inequality: Implications of a Behavioral Model of Economic Growth for Public Policy"**

Thanks very much Andrew. And thanks everybody for waiting around this long. It is getting late and I can feel Andrew is getting very nervous, so I promise to be as efficient as I can with my . . . oh . . . 35 minutes or so.

I'm a micro-economist. I've forgotten all the macro growth theory I ever knew and of course it would all be obsolete now anyway. So let me just start by saying that I support very much the microeconomic approach that Morris takes, which emphasizes the role of worker involvement in the process of technical change. This idea has been part of my own work and I think it is very important.

My overall view of growth is that you start off with education, which is an an input into something like growth potential, and which then has to get transferred into outcomes in the marketplace. The key for a fast growing economy is to design incentives so that all of these transfers take place. You've got to give people the incentive to become educated in the proper skills. Once someone has a good idea, or the choice to support an idea that comes from somewhere else, we have to make sure it is in their interest to see this idea implemented.

The truly difficult factor is that growth creates losers. Entrepreneurs with newly obsolete products are certainly one example, but from the standpoint of inequality it is probably more important to look at workers. In the English language the word "Luddite" has come to mean someone who is blind to the benefits of change. But the history is quite different. The Luddites were people who were being displaced by new technology in a world where there were very few social programs. They knew exactly what was going on and there is no doubt they were being made worse off. So in order for growth to occur we need to do one of two things. One would be to make sure that the people who are being displaced are somehow allowed to share in the benefits from change, so that they actually support it. The other, which is the the decision we made many years ago, is just to make sure they don't have the power to stop it.

Now let's be clear - we are all vastly better off that the industrial revolution occurred. But it's also clear at the time that there were losers. So the first obvious point is that redistributive social policies - to the extent that they help out workers who are displaced by technical change, and to the extent that those workers have the ability to slow down technical change - are bound to be good things. They will reduce inequality and increase growth. I'll come back to this point in a minute though.

There's also the issue that inventiveness can be used in different ways. Broadly speaking, there are two basic ways to get rich. You can create something of value and sell it to somebody else. At that point you've got the money and they've got whatever it is you've created, and we're all better off. But you could also just find a pot of money that is already there and figure out a way to appropriate more of it to yourself. I'll spare you all a long digression about lawyers. But it is interesting that a few years ago when the U.S. was experiencing weak productivity growth while Japan and the other Asian countries were doing extremely well, this idea was fairly popular. We would go to conferences like this one and see diagrams on the board that would put growth rates on one axis and on the other they'd put lawyers per capita or lawyers per engineer. Everyone could see a negative and very satisfying correlation. Now nobody's doing that since the last few years Japan has not been doing so well and the U.S. has taken off.

The basic difficulty this view of innovation creates for explanations for the relationship between inequality and growth is that incentives are always at the margin. The key to growth is that the people who are in a position to make things happen, or prevent them from happening, must be made better off if growth occurs. But this is a statement about changes in welfare. There is just no necessary relationship to levels. To go back to the example of the Luddites, you will certainly get their cooperation if you let them share in the gains from change, but you could also just throw them all in jail. Now we wouldn't do that, you might say, but the sort of empirical facts that we're trying to explain here are cross-country comparisons and there certainly are countries where this kind of thing might go on. Indeed some might argue we need look only to the immediate South to find a country that has been growing very fast and at the same time has one of the highest incarceration rates in the world.

Now to get back to Morris' paper, he suggests that workers are an important source of growth and that if we pay them more we'll get more. And also that high wages force the firm to focus. This is a little bit like the strong currency argument that you sometimes hear. Canada is in trouble, supposedly, because we have this weak currency and all our entrepreneurs are getting lazy. They are not innovating because it's just too easy to compete with cheap labour.

One thing that I think this paper needs is a really good example, and the experience of Japan up until the mid 1990's seems to be a natural one. The Japanese, at least in the larger exporting firms, have a system with a lot of blue-collar worker participation. There is a high level of employment security and a lot of multi-skilling. This leads to a focus on process innovation where workers get involved in quality improvement and cost reduction in a way that North American workers do not. If a North American welder discovers a way to reduce the number of welds that are needed to make a car then by revealing this idea to the firm he is putting himself out of work. This is something that just doesn't happen in Japan. The worker is skilled in many other tasks of value to the firm, and he has employment security. Japan also had a strong currency over this time period. One gets this image of a firm that is committed to a workforce that keeps on producing more and more products and the only way out is to grow. They had to grow because otherwise they would have been forced to lay off workers and that's something they would not do.

So that's how I think Morris' story works. And the problem, of course, is that you have to ask what happened for the last couple of years. Japan has all of a sudden imploded and the United States is taking off, at least until last month. Now I'm sure we all have our own stories as to what happened in Japan but from the labour perspective the problem was white collar productivity. The Japanese had the most productive blue collar workers in the world, but their white collar workers, however you did the measurement, weren't nearly as productive as those elsewhere. The Japanese understood this long before their collapse, and I was part of a group that was asked to go and comment on the situation. Well, it takes a North American economist maybe 5 or 10 seconds to realize that you can add all the computers you want, but at the end of the day if you want to double your white collar productivity what you do is you fire half of your white collar workers.

Why didn't the Japanese do this? It is hard to make this point without being offensive, but in some sense the fact that such a thing would be offensive is part of the story I am trying to tell. It would be like us going into dinner tonight and discovering that they're serving German Shepherd on the menu. Such a thing is well within the technological capabilities of our society but culturally it is just inconceivable.

So, to summarize this rather rambling set of comments, I support quite strongly the general points in Morris' paper. Worker involvement can be a key factor in growth. However, a simple high wage / secure employment policy may be a very brittle instrument, as the experience in Japan has revealed.

At a more general level, it is harder for me to accept the idea that growth and inequality should be related in any particular way. I do not see a compelling theoretical justification for a relationship in either direction. Differences in culture may make the cross-country correlations meaningless.

Finally, I think that all of us share the goal to have a society where workers invest in the appropriate skills, use these skills to create quality products, and do this with pride. This situation would be one of high growth and I'm sure it would also be one that has a lot less inequality than we have right now. But to simply move money in the direction of workers without thinking about the incentives that are created will bring no guarantee of success. Income redistribution is a good thing, but it will find its justification elsewhere.

END DISCUSSION