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To reduce inequality, focus on inclusive growth

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Burdened by too much debt and growing societal frustration, the global economy is faced with stark choices, including fiscal austerity and rising defaults. But what if we took a page out of Henry Ford's playbook, creating a highly paid, highly trained workforce to help usher in a new era of inclusive growth?

The global economy has been stuck in second gear since the financial crisis. Historically low interest rates and seemingly free-flowing credit have kept the economy from backsliding – and boosted corporate profits – but they have failed to reignite growth. Beyond the economic toll, we are seeing a host of social and political problems come to the fore, including a resurgence of populism and rising economic inequality.

There are no easy solutions to these problems; multiple approaches will be needed to truly fix the global economy and address growing levels of societal frustration. But one such approach may be encouraging governments and corporations to deliver "inclusive growth" – growth that is shared throughout society in a way that reduces economic inequality.

It will take multiple approaches to fix the global economy and address growing societal frustration

For an example of how this might work, consider the American automobile magnate Henry Ford. Although he is primarily remembered for his transformative success at using the assembly line to mass-produce the Model T, what is less widely known is how he used high wages to stabilise his workforce and improve productivity.

Key takeaways

- Today's slow-growth environment is creating social problems, including resurgent populism and rising economic inequality
- An "inclusive growth" approach – which includes higher pay for workers – might turn around the global economy while reducing inequality
- As Henry Ford proved, higher pay can result in greater productivity, reduced turnover and higher profits – and it can help the middle class grow
- A better-trained, better-paid workforce can make business models more profitable and sustainable – and could usher in a longer-term return to widespread growth

As the Model T's popularity grew, Ford realised that chronic employee absenteeism and high turnover were hurting his bottom line, so he decided to pay his workers a wage so competitive that they would be unwilling to risk leaving or losing their jobs.

Ford's strategy worked, and the payoff was significant: employee turnover decreased, workers became more skilled, production lines became increasingly efficient and profits soared. Beyond his factory walls, Ford's approach helped develop America's middle class, and helped create an economy that was increasingly driven by consumer demand.

Cost-cutting can boost short-term profits, but it can also hurt employees, the environment and product quality

In contrast to Ford's approach, what seems to drive many corporate management teams today is the pursuit of short-term profits by cutting costs – particularly the cost of labour. And instead of making wise capital expenditures, many companies conduct share buybacks that inflate their stock options, even though buybacks can actually diminish medium-term returns by starving investments that boost competitiveness. All too often, these boosts to profits and stock prices come at the expense of employees, the environment and sometimes the quality of a company's products.

To be sure, most companies exist to generate profits. But companies form part of the social and ethical structures of their societies, and the pursuit of profit should not be their only goal. Companies could be better off trying to make their business models more sustainable by managing long-term risks to their businesses, by focusing on productivity and innovation, and by finding ways to contribute to the societies they depend on for their prosperity.

Higher wages are part of the inclusive growth approach that society needs, but simply boosting payrolls will not instantly repair decades of increasing inequality and failing economic growth. There are too many other economic pressures at work, including the rise of artificial intelligence and robotics; according to a survey by Oxford University, 47% of US jobs could soon be lost to computerisation.

So if corporations want to make their business models profitable and sustainable, they should focus on raising the skill levels of their employees, not just pay levels. And if governments truly want to reduce some of the longer-lasting effects of inequality, they should implement policies that help workers evolve into new roles.

There may be downsides to this inclusive-growth approach –profits and investment performance may take a short-term hit – but the medium- to longer-term payoff could be a widespread return to growth. This is surely more in line with what society needs: a rising tide of economic prosperity that lifts all boats and carries us towards a more sustainable future.

Paying down debt in a low-growth world

Inclusive growth could be a more palatable solution to the slow-growth environment that is preventing economies from reducing their debt levels, especially since some of the alternatives are a lot less appetising:

1. **Enforced austerity.** This approach would require economies to go on a severe diet by becoming more efficient and repaying excessive debts, without counting on debt forgiveness. This could foster more economic inequality and add to the appeal of populist politics.
2. **Debt default.** This could deliver a devastating blow to the financial system and impose severe economic conditions for years to come, and it might transform the political system in untold ways. Just look at Argentina, which has yet to recover from a century of defaults.
3. **Default through inflation.** This solution is arguably just as pernicious as direct default, since inflation hurts society's poorest citizens more than its richest. Many central banks have a target rate of around 2% inflation per year, but even relatively low levels of inflation can significantly erode purchasing power over time.
4. **Default through hyperinflation.** History shows that this option causes not only economic collapse but also social collapse, as seen in the Weimar Republic of Germany in the 1920s and in Zimbabwe and Venezuela today.

Further reading

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