Drivers of Mobility

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5 September 2019

Introduction

- Evidence of positive correlations in SES across generations for every society for which we have data and for different markers of status
  - literature offers a number of plausible hints about where to look to improve social mobility

- Most ‘stylized facts’ on drivers of mobility are derived from analyses of high-income countries
  - relatively small share of the world population
  - findings from these regions may not easily apply to the the developing world

Introduction

- Lower levels of intergenerational mobility in developing countries (Hertz et al, 2007; Brunori, Ferreira and Peragine, 2013; Narayan et al., 2018)

- Limited literature on underlying drivers
  - data availability
  - over-emphasis on the Global North

- Chapter focuses on drivers of mobility that are either (i) not typically considered in high-income countries, or (ii) likely to be of greater relevance in the developing world

Theoretical framework

- Basic adaptation of Becker-Tomes model by Solon (2004, 2014)
    - 2-period utility framework for families consisting of one parent and one child
    - period 1 → parent allocates disposable income between own consumption and investment in the child's human capital
    - period 2 → child earns income depending on human capital and other 'inherited' endowments

- In some versions of the model, it is assumed that the parents can borrow against their child's future income (e.g. Becker and Tomes,1986, Mulligan 1997).
    - if credit markets are imperfect, low-income parents will face a higher cost of borrowing

- Earnings persist across generations as a result of two main 'transmission channels'

  (i) high-income parents invest more in their child's human capital

  (ii) high-income parents have better endowments, which are transmitted to the next generation through cultural influences and genetics

Theoretical framework

- Inheritable endowments can be separated in two types depending on how they enter the child's earnings function (Mulligan 1997, 1999; Corak and Piraino, 2016):
  - (I) *additive*: inherited traits that do not affect human capital investments
  - (II) *multiplicative*: inherited traits that alter efficient human capital investment and/or its returns

- To the extent that both types of traits are related to parental income, this will render the IGE more complex
  - additive endowments will increase the intergenerational earnings elasticity for the whole population
  - multiplicative endowments imply that better-endowed people will not only enjoy higher income via a direct effect, but also through greater human capital investments
    - interaction/complementarity with other channels of persistence (Magruder, 2010; Mulligan 1997)

- In this more general framework the IGE will depend on
  - importance of credit constraints
  - the size of the direct effect of additive endowments
  - the degree of heritability for both types of traits and the correlation between them

Determinants of social (im)mobility in developing countries

- What barriers to social mobility may be of higher relevance to the Global South?

- The chapter will focus on

  (i) labour market segmentation

  (ii) credit and risk market failures

  (iii) information frictions

Segmented Labour Markets

- Standard models of mobility implicitly assume a unitary labour market, where skills are equally rewarded across sectors.
  - this assumption is less realistic in the context of developing countries

- Does the existence of qualitative differences between labour market segments has implications for the level of social mobility?

- It is plausible to assume that obstacles preventing transitions from ‘good’ to ‘bad’ jobs are partly inheritable
  - this creates an additional channel of earnings transmission from parent to child
  - identify inherited barriers to mobility across sectors

Segmented Labour Markets

- *Location*:
  - while some individuals are able to migrate, the literature shows that it is difficult for young adults born in the poorest parts of rural areas to look for work in areas of higher employment and wages
  - significant intergenerational effects arising from the arrival of a stable source of income in rural South Africa (Ardington et al., 2009)

- *Connections*:
  - children also inherit a network that can help them land a job in the same sector as their parents
  - significant role for network-based intergenerational correlations (Magruder, 2010)
  - reallocation of jobs across young adults according to connections
    - imperfect correlation with ability → both inefficient and inequitable

- In terms of the theoretical framework, the intergenerational transmission of sectors/segments can have both an additive and multiplicative effect on the IGE

Segmented Labour Markets: agenda

- Promise for analyses of the variation in economic mobility across spatial, sectoral, and occupational segments

- The recent increase in empirical studies of the 'geography of mobility' in high-income countries provides an example of approaches that could generate credible evidence on this important question

- Such efforts could be coupled with more narrow-focused (and less descriptive) investigations of the various types of barriers to sectoral, geographical, and occupational mobility faced by different individuals in the population

Imperfect credit markets

- Systematic variation in the ability to secure credit creates a pathway of intergenerational persistence
  - higher human capital investment by richer parents

- The empirical validation of this theoretical insight has direct policy relevance:
  - easing credit market access for targeted groups would have desirable effects both in terms of equity and efficiency

- The evidence in high-income countries is not conclusive (Carneiro and Heckman, 2002; Restuccia and Urrutia, 2004)

- Studies in developing countries have produced more consistent results:
  - effects of a college loan program in Chile. Access to credit closes the gap in enrolment and attainment by income status, which has clear implications for intergenerational mobility (Solis, 2017)
  - lower-income families in Mexico are responsive to changes in the direct costs of education, which is consistent with binding credit constraints (Kaufmann, 2014)

Credit constraints

- Producing credible evidence on the contribution of credit constraints in explaining lower intergenerational mobility is not straightforward

- Difficult to know unambiguously which households are truly constrained
  - existing studies have resorted to different forms of “indirect” evidence
  - depending on the empirical approach, different studies have reached different conclusions (mostly evidence from US)

- If anything is to be learnt from studies in high-income countries, credit constraints do not appear to be especially important.

Credit constraints: agenda

- Given the inconclusive nature of existing evidence, as well as the underdevelopment of capital markets in many developing countries, there are opportunities for innovative research in this area

- Credible empirical tests must take into account the specific features of capital markets in the developing world
    - widespread lack of collateral
    - market penetration in rural areas
    - small credit institutions

- A large literature in development economics suggests that targeted transfers to the poor (e.g. conditional/unconditional cash transfers) can have positive effects on a variety of outcomes by allowing welfare-enhancing investments

- Policies removing barriers to investments, such as improved access to credit, can also have long-term multiplier effects (Barrett and Carter, 2013)

Risk and uncertainty

- Earnings volatility and imperfect insurance against shocks affect households’ budget decisions in developing countries much more than in high-income settings
  - farm production
  - informal sector
  - labour market regulation

- The combination of low-pay, unpredictable income, and underdeveloped insurance tools leads individuals to manage their resources more carefully

- This may result in sub-optimal risk taking

Risk and uncertainty

- With imperfect risk markets, uncertainty in the future child's earnings may lead risk-adverse parents to underinvest in their child's human capital

- Income volatility in the first period and imperfect insurance may also exacerbate the effects of credit constraints on intergenerational mobility
  - even if the parent is not presently constrained but has a positive probability to be constrained in the future (Heckman and Mosso, 2014).
  - if volatility and uncertainty are higher in the earlier periods of a parent's working life, this will affect early-education investments, which would render later parental investments less effective

- Since poorer households tend to be both more risk adverse and more likely to be constrained, these effects imply a greater role for parental income in determining the children's human capital and hence their future earnings

Risk and uncertainty: agenda

- Limited or no empirical evidence on the contribution of imperfect insurance markets and income uncertainty in explaining intergenerational mobility

- Given the high relevance of these factors in developing countries, this offers a direction for future investigations

- Risk preferences are often not measured in national surveys
  - identifying households that can be assumed to benefit from different types of insurance is not straightforward

- Link to the literature on poverty traps in development economics:
  - differential ability for households of different economic status to take on high-return investments, leading to poverty perpetuation (Dercon and Christiaensen 2011)

Information frictions: labour market

- Information frictions are prevalent in developing countries' labour markets, especially in the market for low-skill and entry-level jobs
  - lack of educational degrees to signal skills
  - low average quality of learning and highly variable
    - limits the use of education credentials to signal productivity
  - spatial frictions
  - much younger workforce with limited work experience
  - less widespread use of information technologies

- Firms have limited or unreliable information to screen job applicants

- If firms are particularly uncertain (or underestimate more) the productivity of disadvantaged job seekers, information frictions will contribute to social exclusion and limited upward mobility

Information frictions: labour market

- Informal referral systems may alleviate these frictions but can exacerbate inequality as they disadvantage less connected groups (Montgomery, 1991).

- This intuition is corroborated by a series of recent studies on how various types of labour market frictions can result in worker misallocation and higher inequity
    - information interventions in Ethiopia, South Africa and Uganda are shown to be particularly useful for those with the least education and experience, suggesting that information frictions disproportionately affect people from lower socioeconomic background

- Rational for governments to facilitate the information exchange
    - improve social mobility by increasing the labour market integration of disadvantaged groups
    - could also help reducing the barriers to mobility across segmented labour markets
    - policies to promote integration can also diminish room for nepotism and discrimination

Information frictions: returns to education

- Individuals are more likely to acquire education when the perceived returns are higher
    - accurate assessment of the returns to schooling is unlikely for most parents
    - underinvestment in the HC of children may result from biased beliefs

- Reliable information on returns to education may not be widely available
    - data constraints
    - schools less likely to have counselling on future career paths and earnings

- Parents can reduce this gap by relying on info they observe in their proximate environment
    - information people can gather depends on the 'quality' of the sources people have access to
    - segmentation and segregation imply that people with different SES will form different expectations about the returns to schooling

- Low-income students significantly underestimate the returns to secondary education (Jensen, 2010)
    - schooling costs and credit constraints may still prevent them from attending
        - complementarity in the barriers to upward mobility

Information frictions: agenda

- How people of varying socioeconomic backgrounds form expectations and make decisions?

- Low-income families may be more likely to be affected by imperfect information because of limited access to accurate sources
  - personal labour market experiences
  - fewer high-educated acquaintances that can serve as role models

- Different experiences and exposure to different social patterns can have long-lasting effects on judgment and behaviour by shaping the way with which information is interpreted
  - ‘habits of the mind’
  - link to behavioural economics interventions in LDCs

- Test the relative importance of information frictions compared to credit and risk market failures
  - high policy relevance as information asymmetries and biased beliefs may be effectively influenced at a fraction of the cost of interventions offering financial assistance