Drivers of Mobility in the Global South

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Introduction

- Evidence of positive correlations in SES across generations for every society for which we have data and for different markers of status

- Higher intergenerational persistence in developing countries (Hertz et al, 2007; Narayan et al., 2018)

- What drives high intergenerational persistence?
  - most stylized facts on drivers of mobility are derived from analyses of high-income countries
  - this chapter focuses on drivers of mobility that are likely to be of greater relevance in the developing world
    - (i) labour market segmentation
    - (ii) credit and risk market failures
    - (iii) information frictions

Segmented Labour Markets

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

- 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
  - which barriers to mobility across sectors can be considered inherited?

Segmented Labour Markets

- *Location*:
  - it is more difficult for youth born in the poorest parts of rural areas to look for work in areas of higher employment and wages
  - evidence on intergenerational effects arising from the arrival of a stable source of income in rural South Africa (Ardington et al., 2009)

- *Connections*:
  - children inherit a network that can help them land a job in the same sector as their parents
    - evidence on 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 increase persistence

Segmented Labour Markets: agenda

- Promise for analyses of the variation in economic mobility across spatial, sectoral, and occupational segments
  - similar to empirical studies of the ‘geography of mobility’ in high-income countries

- Such efforts could be coupled with more narrow-focused (and less descriptive) investigations of various barriers to sectoral, geographical, and occupational mobility

Imperfect credit markets

- Differential ability to secure credit creates a pathway of intergenerational persistence
  - higher human capital investment by richer parents
  - 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 (Solis, 2017). Closes gap in enrolment and attainment by SES → implications for intergenerational mobility
  - lower-income families in Mexico were responsive to changes in the direct costs of education (Kaufmann, 2014) → consistent with binding credit constraints

Credit constraints: agenda

- Producing credible evidence on the contribution of credit constraints to lower mobility is not straightforward

- Difficult to know which households are truly constrained
  - existing studies have resorted to different forms of “indirect” evidence

- Credible tests must take into account the 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 can have positive effects on a many 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 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
  - the parent may not be presently constrained but has a positive probability to be constrained in the future (Heckman and Mosso, 2014).
  - volatility and uncertainty may be higher in the earlier periods of a parent's working life, which will affect early-education investments

- 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

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

- Link to the literature on poverty traps in development economics:
  - 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
  - younger workforce with limited work experience

- If firms are particularly uncertain (or underestimate more) the productivity of disadvantaged job seekers, these 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 show that frictions disproportionately affect disadvantaged people

- 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)

Information frictions: agenda

- Low-income families may be more likely to be affected by imperfect information because of limited access to accurate sources

- 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