WHAT ARE THE MOST IMPORTANT RESEARCH QUESTIONS ON THE ECONOMICS OF GROWTH AND LABOR MARKETS IN LOW-INCOME COUNTRIES?

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INTRODUCTION

One of the most important priorities of low income countries is to set themselves in a path of robust growth, so incomes can be raised and key investments in education, health and infrastructure can take place. But growth that is accompanied with an excessive build up of inequality of incomes can lead to poverty traps. Thus, another important policy priority for low income countries is to limit the increase in inequality that tends to be associated with economic growth in the early stages of development, fostering equality of opportunities and ensuring that scarce resources are well targeted to that end. Moreover, social and labor policy need to be adapted to the particular needs and characteristics of low income economies. This requires a profound rethinking of what is feasible in such contexts: transplanting well established models from high to low income economies is unlikely to work.

The following section delves in more detail into what, in my opinion, are the four fundamental questions on the economics of growth and labor economics in low income economies. The good news is that in many countries there is an emergence of micro data sets, allowing researchers to get deeper into such questions than ever before. In others, investments will need be made to produce these types of data. Economic research has also begun to take advantage of these new datasets. Until not so long ago, growth research operated at the aggregate macro level and cross-country growth regressions were the most often used methodology to study growth determinants and bottlenecks. The last 10 years, however, have seen an explosion of studies employing industry and firm or individual-level data to inquire about these same issues. Industry and individual firm or household data, particularly when compared across countries, can shed light on whether there are important growth bottlenecks and where such barriers are likely to come from. Disaggregated data is also needed to shed light on the evolution of income inequality and whether such income distribution is conducive or not to high growth. The study of micro data can also provide evidence on whether some types of individuals, for reasons associated to their race, ethnic background, gender, age, religion, etc, are held back, with unequal access to economic opportunities. Finally, the rapidly developing literature on program and policy impact evaluation provides an example of how the use of micro data can shed light on the targeting, workings and consequences of economic and labor policies, and therefore provide orientation on whether designs need to be adjusted. Ensuring that policies reach their intended beneficiaries and impacts is always important; but it is even more important in low income countries, where needs far exceed the resources at hand.

FOUR FUNDAMENTAL QUESTIONS FOR GROWTH AND LABOR ECONOMICS RESEARCH IN LOW INCOME ECONOMIES

1. WHAT ARE THE OBSTACLES TO PRODUCTIVITY GROWTH?

Productivity growth is the engine behind economic growth. It is therefore crucial to understand the process by which productivity growth takes place, particularly in low income economies, where the need to raise incomes takes precedent over many other policy objectives. Yet, productivity growth does not happen equally within each firm or sector. Nor are all firms or sectors equally productive. On the contrary, across the world one important characteristic is the high degree of heterogeneity in productivity levels across sectors and across firms within one sector, even when sectors are narrowly defined. This heterogeneity implies that the process of growth and development can be achieved by at least three related channels: (i) the creation and expansion of high productivity firms and/or sectors; (ii) the disappearance or contraction of low productivity firms and/or sectors, and (iii) productivity growth within firms. While the three are likely to be strongly interrelated, it is worth examining each of these channels to better identify where growth opportunities lie. [1]

1.a.What are the obstacles to the creation of high productivity jobs?

It is well documented that low income countries are characterized by having a large share of employment in low productivity jobs, traditionally in agriculture, commerce and labor-intensive industries. The process of development is characterized by a structural transformation in which employment shifts from low to higher productivity jobs. A promising area for research relates to understanding what is limiting the growth of high productivity jobs. Ideally, the analysis would look both within and across different sectors of the economy. It would examine patterns of creation of high productivity jobs and will compare across high and low growth economies. It would look at whether high productivity jobs are mostly created at large, medium, small or micro firms, and in newly created firms or well-established, older ones. It will also look at whether there is only one way to grow, namely shifting jobs from the agricultural sector towards manufacturing and lastly towards services, or whether there are other routes (i.e. without developing a large manufacturing sector). It would examine whether countries specialized in the production of row materials tend to create fewer high productivity jobs, concentrated in a few extractive industries, and would assess what are the implications for income inequality of such growth patterns.

Armed with this descriptive information, the research agenda could also explore whether weak high-productivity job growth is associated with particular economic characteristics such as (i) low international markets insertion and/or small market size for domestically produced goods, (i) insufficiently developed capital markets, (iii) policy uncertainty; (iii) high taxes, (iv) poor labor market regulations, (v) inadequate skill formation, (vi) insufficient investments in infrastructure. [2]

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[1] This section follows closely, chapter 4 in Pagés, 2010.
[2] For a number of references on these types of studies, see Pagés, 2010.

1.b. What makes possible the survival of low productivity jobs?

As stated, an important characteristic of low income economies is the prevalence of low productivity activities. One promising area of research is assessing what makes possible that such activities survive, particularly when goods produced in higher productivity firms within the same sector and country, are also readily available. A host of measures may be creating advantages for production in low productivity firms, slowing down the reallocation of labor and capital towards higher productivity activities. One crucial related question is whether informal, low scale activities, while relevant to provide a livelihood to many workers, may impede the development of higher productivity activities. This may be the case in countries where excessive red tape or government predatory behavior create large advantages for informal firms, thus fostering small scale, low productivity activities which can operate under the government radar. At the same time, the unfair competition from informal firms can slow down the entry or expansion of higher productivity formal firms in that sector.

1.c. What are the obstacles to productivity growth at the firm level?

Many firms start small and then grow in size and productivity over the years. In addition to the reallocation of labor towards high productivity uses, within-firm productivity growth is an important source of aggregate productivity and economic growth. It is therefore important to study how and whether firms invest in better technologies or/and train their workers to make them more productive. Given a high degree of heterogeneity across firms, it would be important to document the size and productivity at the time firms are created (or emerge in the formal sector). In addition, the analysis would look at whether individual firms grow in size and productivity over time, or only in size (signaling financial market bottlenecks) and which type of firms do so, distinguishing by sector (at two digit or higher level of disaggregation), age and firm size.

2. **HOW DOES ACCESS TO SKILLS AND CAPITAL DETERMINE THE DISTRIBUTION OF INCOMES?**

It is a documented fact that inequality increases as countries grow from low to medium-income levels (Kutnetz, 1955, 1963). At the same time, income inequality may lead to low growth, trapping countries at low levels of development. Unequal access to education and capital are the most important determinants of incomes at the individual level. Insufficiently developed financial markets may imply that those who have good productive projects cannot develop them or grow them to their optimal size due to insufficient access to capital markets, limiting income generation and growth possibilities. Unequal and insufficient access to financial markets, coupled with poor capacity of the States to provide free education, also limits access to skills, which again leads to strong inequities in income levels and possible growth bottlenecks. Exploring whether and how unequal access to skills and capital limits economic growth and skews income distribution is an important agenda, which becomes particularly relevant for low income economies.

The analysis would look at whether family background (education of parents, socio-economic background of the family) affects skill acquisition of individuals and how. It would examine returns to education and see whether those differ depending on whether individuals go to private or public schools. The analysis could also examine whether the type of education (level of achievement and whether private and public) as well as family and personal background determine who gets access to better paid jobs (in many countries, government jobs). It would also examine whether returns to education differ depending on whether individuals employ themselves in formal/informal jobs or in the private/public sector.

3. **IS THERE DISCRIMINATION AND OTHER BARRIERS TO EQUALITY OF OPPORTUNITY?**

In addition to the income differences associated to differences in access to capital and skills, many low income countries are characterized by other important barriers to equality of opportunity. These barriers that arise in virtue of gender, age, race, ethnic origin, religion, or area of residence of a person and generate another layer of inequality and exclusion, often predating access to skills and capital and therefore compounding the effects of differential access to the means of production. It is important then to document differences in access to education, capital markets, earnings and high productivity jobs across individuals with different personal characteristics.

4. WHAT ARE THE OPTIMAL LABOR POLICIES AND INSTITUTIONS IN LOW INCOME COUNTRIES?

As noted, it is imperative that a growth-oriented economic policy in low income countries is conducive to (i) allocating resources towards high productivity activities, and (ii) promoting better access to skills and capital. At the same time, labor policy should also attempt to level the playing field, guaranteeing equality of opportunities across individuals regardless of family background, race, ethnic origin, gender, religion, or age. Yet, in order to achieving this ends, the means may need to be very different than those employed in higher income economies. Low income countries tend also to be characterized by ineffective or low effectiveness States, large informal sectors, and low fiscal bases, all of which render policies styled after higher income countries ineffective. Examples of these problems abound.   Social Security for example, an institution that seeks to provide access to health and old age pensions to workers, has been instituted in low income economies without hardly any design adaptation and therefore, similarly based on payroll contributions mechanisms as in most developed economies.   Yet, the share of population in salaried employment tends to be much lower in low income economies than in higher income ones. Collecting contributions from own account or unpaid family workers is a major challenge, therefore in most low income economies hardly any of such workers contribute to social security. In addition, many workers employed at small and even in larger firms do not contribute as evasion is difficult to control in economies with low enforcement capabilities. As a result, coverage of social security is extremely low and regressive. All of this implies that either social security is adapted to the characteristics of low income countries, via for example, financing through other sources such as consumption taxes, or it would continue covering only a minority of workers.

Protection against unemployment is another policy that requires profound rethinking in order to work in the context of low income economies. In fact, some of that design adaptation already exists. Around the world, mandatory severance payments are the most common instrument to protect workers against the risk of unemployment, and such measures are more prevalent and generous in low income economies. Unlike unemployment insurance, which requires third party companies or the state to run insurance schemes, severance payments work better in low income economies because they are directly paid by companies to workers, and require little institutionality (although it is unclear whether such payments are made since, as mentioned, enforcement capabilities tend to be low, and such payments tend to go unrecorded). The predominant use of severance payments to protect unemployment however can be a major problem in low income economies since, as also stated above, the process of development requires major labor reallocation, a process which is slowed down and made costlier when states mandate (and enforce) high severance payments. Yet, transiting from severance pay to unemployment insurance schemes is difficult as the large predominance of own-account workers and workers employed in informal, small scale activities renders any unemployment insurance mechanisms ineffective, for at least three reasons: (i) collecting labor contributions is difficult; (ii) indentifying the event of unemployment is also difficult –as employment relationships often are unrecorded, and (iii) controlling costs is difficult as workers can collect benefits and work in the informal sector.

Another important area for policy oriented research is skill formation. Is education achieving the intended effects in terms of quality? Should workers be trained for general, academic skills, or for technical, vocational skills? What happens to workers who have achieved low education early in their lives, should there be second chances? And if so, what form those second chances should take? Can workers employed in firms be trained to increase their productivity? Who should pay for that training: workers, firms or the state? A research strategy based on the evaluation of existing policies, combined with policy experimentation and evaluation could provide very valuable answers to these questions.

REFERENCES

Pagés, Carmen. “The Age of Productivity: Transforming Economies from The Bottom Up”. Carmen Pagés, editor. Inter-American Development Bank. Palgrave Macmillan April 2010.