



No education, no good jobs? Evidence on the relationship between education and labor market segmentation

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ABSTRACT

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This paper assesses labor market segmentation across formal and informal salaried jobs and self-employment in three Latin American and three transition countries. It looks separately at the markets for skilled and unskilled labor, inquiring if segmentation is an exclusive feature of the latter. Longitudinal data are used to assess wage differentials and mobility patterns across jobs. To study mobility, the paper compares observed transitions with a new benchmark measure of mobility under no segmentation. It finds evidence of a formal wage premium relative to informal salaried jobs in the three Latin American countries, but not in transition economies. It also finds evidence of extensive mobility across these two types of jobs in all countries, particularly from informal salaried to formal jobs. In contrast, there is little mobility between self-employment and formal salaried jobs, suggesting the existence of barriers to this type of mobility or a strong assortative matching according to workers' individual preferences. Lastly, for both wage differentials and mobility, there is no statistical difference across skill levels, indicating that the markets for skilled and unskilled labor are similarly affected by segmentation. *Journal of Comparative Economics* 37 (3) (2009) 387–401. Inter-American Development Bank, Research Department, 1300 New York Avenue, Washington, DC, United States; African Development Bank, Development Research Department, B.P. 323 – 1002, Tunis Belvedere, Tunisia.

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1. Introduction

It is often assumed that education is a passport to good jobs. While better-educated workers tend to be more productive than less skilled workers, education may not provide access to good jobs if the labor market is segmented. Dualism and segmentation are often assumed to be basic features of labor markets in developing countries. However, the existence, magnitude, and origin of such segmentation are far from being established. In this paper, we assess labor market segmentation across formal and informal salaried jobs and self-employment, for three Latin American and three transition economies. We look separately at the markets for skilled and unskilled labor, inquiring if labor segmentation is an exclusive feature of the latter.

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The distinction across skill levels is relevant for various reasons. When barriers to entry into formal unskilled jobs are important, improving mobility between formal and informal jobs can bring welfare gains for the poorest workers. Instead, when the unskilled labor market is not segmented, easing access to education and skills may be the best route to raising workers' living standards. Yet, those investments in human capital may not pay much if the labor market for skilled workers is segmented.

The distinction across skill levels may also shed light on the drivers of segmentation. Theoretical models explain labor market segmentation as a result of labor market policies, labor market institutions or the payment of efficiency wages in the formal sector (Fields, 2005). Yet, policies and institutions impact the unskilled and skilled labor markets differently. For instance, if segmentation is caused by minimum wages, then duality is a feature that should only appear in unskilled labor markets. Assessing whether there are significant differences in segmentation among skilled and unskilled workers can yield important clues not only about whether labor markets behave differently across skill groups, but also about the possible sources, if any, of labor market segmentation.

Magnac (1991) defines labor market segmentation as the situation in which rewards in different sectors may vary for workers of equal productivity and the entry of workers in the formal sector is rationed.

A number of studies have assessed wage differentials and labor mobility in developing countries. Recent work has questioned the traditional view of informal work as the disadvantaged sector and posits that workers may in fact choose the sector of employment based on their comparative advantage, their preferences, or to avoid costly taxes and regulations (Magnac, 1991; Yamada, 1996; Maloney, 1999; Saavedra and Chong, 1999; Albrecht et al., 2006; Perry et al., 2007). Many of these studies have brought new empirical evidence, which conflicts with traditional segmentation theories. Magnac (1991) for Colombia, Yamada (1996) for Peru, Maloney (1999) for Mexico find little evidence that formal salaried workers have higher earnings than self-employed workers. Earle and Sakova (2000) also find positive earning differentials for self-employed workers in five out of the six transition countries they study.¹ Moreover, Yamada and also Earle and Sakova find positive selection into self-employment, suggesting that these workers have a comparative advantage at being micro entrepreneurs. There are very few studies that look at the skill dimension of wage differentials. One exception is Gong et al. (2004), which finds a positive formal wage premium in Mexico that increases with the skill level.

Evidence based on wage differentials is problematic because wage differentials do not reflect utility differences associated with variations in flexibility, independence or other attributes that may make informal sector jobs more desirable despite offering lower pay (Heckman and Hotz, 1986; Maloney, 1999). Moreover, estimates of wage differentials based on selection-corrected two-stage estimates can provide questionable estimates if the first stage selection model fits the data poorly.

To overcome these issues, a number of recent papers look at mobility across different states as an alternative way to assess segmentation. The majority of these papers refer to Latin American countries (Maloney, 1999; IDB, 2004; Duryea et al., 2006; Packard, 2007; Bosch and Maloney, 2007a,b; Bosch et al., 2007; Bigsten et al., 2007). Most of these studies find high levels of mobility across formal and informal jobs. There are also a number of studies assessing mobility in transition economies, mostly across public and private wage employment, although in some cases self-employment is also considered. The studies find low rates of mobility in transition economies relative to OECD countries (Boeri and Flinn, 1999) although some countries, such as the Czech Republic (Sorm and Terrell, 2000) or Estonia (Haltiwanger and Vodopivec, 2002) experienced higher levels of mobility and more efficient reallocation of labor during the transition to a market economy. Regarding differences across skill level – the main focus of this paper – Bosch and Maloney (2007b) find lower overall labor market mobility for skilled relative to unskilled labor in Argentina, Brazil and Mexico.

While studying labor mobility provides valuable insights, particularly when assessing the direction of labor market flows across the business cycle (Bosch and Maloney, 2007a, and Bosch et al., 2007), looking at mobility requires some measure of what mobility would look like in the absence of labor market segmentation. A world in which jobs are constantly created and destroyed due to idiosyncratic or industry-specific shocks requires large worker reallocation (Davis and Haltiwanger, 1999 and Davis et al., 1996). A number of studies have documented large levels of job reallocation in developing and transition economies (IDB, 2004; Bartelsman et al., 2004). This implies that workers do not get matched once and for all in a formal or informal job, but rather that every few years they may be searching for new jobs. In this context, a labor market may be characterized by differences in rewards for workers of identical productivity, and still display certain mobility between formal and informal jobs.

Our work adds to the literature on labor market segmentation in developing countries in several respects. First, we analyze segmentation assessing wage differentials and mobility across labor market states using consistent methods in six countries.² We adopt a broad geographical scope, comparing three Latin American and three transition economies – two of which (Albania and Georgia) are relatively understudied.³ We find many common patterns and a few important differences, that we attempt to relate to differences in the institutional and policy settings.

¹ Their sample of countries is: Bulgaria, Czech Republic, Hungary, Poland, Russia and Slovakia. They find positive differentials in all countries but Poland.

² The coexistence of wage differentials and mobility barriers fits the traditional definition of segmentation. The lack of both defines cases of no segmentation. In addition, there are two more possibilities, which cannot be identified by looking only at either wage differentials or mobility. In one, which we refer to as wage segmentation, wage differentials are associated with high mobility (although not sufficient to level earnings across labor market states). In another, which we refer to mobility segmentation, lack of measured wage differentials coexists with low mobility across labor market states.

³ Some exceptions are Yemtsov (2001) and Bernabé and Stampini (2009) for Georgia.

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