

**JOBS DIAGNOSTICS**  
**ASSESSING MARKET AND POLICY FAILURES**  
**TENTATIVE JOBS “SYNDROMES”**

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# THE JOBS DIAGNOSTICS APPROACH



Identify the right Jobs-related question from standardized data symptoms and global benchmarks

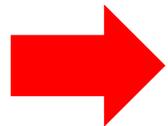
- Standard Data Tools
- Guided Enquiry
- Country Context and Benchmarking to check outcomes are within normal ranges



Identify the key Jobs problem as a constraint or syndrome

- Interpret the symptoms using other evidence
- Is it a demand or supply problem?
- What's the likely cause?

We are here



Identify the right solutions to treat the constraint or syndrome (taking account the labor market model that best fits)

- **What is the market or policy failure?**
- **Can the constraint be directly removed?**
- Review research for solutions (solutions notes)
- Consider political economy

# THE ROLE OF THE STATE 1.01

1. **Set Government Policy and Budget Priorities** stability, growth, social contract on equity/opportunity
2. **Provide “public goods”** (non-excludable, non-rival)
  - Basic education
  - Disease control
  - Security
  - Street lighting
3. **Regulate the private sector**
  - Address externalities (eg air quality, water quality, road safety, litter)
  - Competition policy
  - Natural monopolies
  - Health and safety
4. **Regulate the public sector** (school inspections, curriculum, public pharmaceuticals in LICs)
5. **Provide transactional services** relating to 2,3,4 and redistribution
  - Redistribute: tax and transfer (eg to provide social protection)
  - Registering a business, patents, licensing, etc.

# THE POLICY MAKER SHOULD JUSTIFY PRESCRIBED SOLUTIONS USING THE PRINCIPLES OF PUBLIC CHOICE<sup>4</sup>

If we adopt a neoclassical view on markets, then:

- Economic agents ***act rationally with perfect information***,
- Product and factor markets (labor and capital) clear quickly at a ***Pareto-efficient*** point in the absence of market or policy failures.
- A “healthy” and liberal market economy will always ***converge optimally***;
- Price changes create incentives for investors to enter markets or increase production when market conditions allow
- An ***increased demand for workers*** from these investors raises wages.
- The supply of labor responds to higher wage opportunities: people enter the workforce to seek work.
- This increased supply matches the increased demand and wages stabilize again at a new equilibrium.
- The main barrier to optimal efficiency in markets in the neoclassical framework is “***government failure***” – ie under-investment in public goods or inappropriate policy fundamentals that restrain markets.
- Jobs problems can also arise from underlying ***market failures***.

# GOVERNMENT FAILURES: THE “*SINS OF OMISSION AND COMMISSION*” EXAMPLES

1. **Unstable Economic Policy slows growth, slows demand for labor**
  - Stop/start macro imbalances:
    - inflation,
    - indebtedness, fiscal imbalance
    - exchange rate controls and instability
    - trade bans / restrictions
  - Poor and volatile investment climate
2. **Price controls** – which distort product price signals for investors may lead to low productivity investment
3. **Subsidies**
  - for unviable investments reduce labor productivity and earnings
  - for inefficient firms, for products or factors
4. **Tax Policies** – that discriminate against labor, create disincentives to work
5. **Licensing** – that creates rent-seeking behavior and uncompetitive protection stymies job creation

# GOVERNMENT FAILURES: THE “*SINS OF OMISSION AND COMMISSION*” EXAMPLES

## 6. Under provision of public goods;

### a. Poor infrastructure provision:

- Regions or Districts where market potential, land, and human capital are suitable and sufficient to attract labor intensive private investment that creates markets and economic transformation may be lacking public investments in infrastructure.
- Examples were identified in spatial analysis undertaken for the Bangladesh, Zambia, Tanzania and Uganda Jobs Diagnostics

### b. Inadequate provision of basic education

- Workers enter the labor force without basic cognitive ability to function successfully in waged work

### c. Inadequate land titling

## 7. Under-regulation

- competition policy, restrictive practices, private sector monopolies, monopsonies;
- Poor certification, product quality standards,

## 8. Over-extending statutory bodies (nationalized industries, SOEs)

## 9. Inadequate banking supervision

# MARKET FAILURES AND JOBS

## 1. Imperfect competition:

- limited competition among buyers or sellers prevents the equality between demand price and supply price
  - Many sellers one buyer in rural villages for farm produce
  - Many buyers one seller for agric. inputs, see, fertilize

## 2. Information asymmetry: occurs when buyers and sellers or investors in a market do not have access to all the same information - This can cause the equilibrium quantity of a product demanded or supplied to be greater or less than that which is best for society.

- Input supply (fertilizers, seed)
- Isolated markets (non-integrated process) One party can use their information advantage to exploit the other.
- hirer's lack on information on whether a job applicant really possesses the skills they claim to have.

# MARKET FAILURES AND JOBS

## 3. **Spillovers:** The benefits or costs of a good or action spill over to a third party

- **Positive spillovers** can occur to R&D, and from innovative rather than rent-seeking behavior. The expected return to an investment in R&D increases with the stock of ideas in the public domain, so that if R&D findings become common knowledge, this may raise the incentive for more R&D, and raise productivity.
- **Negative spillovers** can occur in labor markets where workers spend time and money seeking jobs whilst employers must spend money seeking suitable workers. If employers spend less on posting vacancies, then workers have a lower probability of finding work and so may be less inclined to search.
- **Training and innovation** provide good practical examples where high or low productivity equilibria can ensue. Within any single firm, training and innovation may pay off only if a sufficiently large fraction of the population of firms and workers trains and innovates.

# MARKET FAILURES AND JOBS

4. **Coordination failures:** Occur when profitable investments go unfunded because they depend upon the simultaneous actions of others.
5. **Jobs Market Failures:**
  - opportunity cost (marginal product) of an under-employed worker in the low-productivity traditional sector may be zero or close to zero,
  - But firms need to pay the market wage to hire that worker.
  - That the market may demand a sub-optimal level of “better jobs” in the modern sector in LICs is even more problematic if “better” jobs create externalities.

# **TOWARDS JOBS SYNDROMES**

## **A WORK IN PROGRESS**

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# TOWARDS JOBS SYNDROMES:

**1. THE UNDER-INVESTING STATE:** The public sector under-invests in public goods the symptoms of an under-investing state might include:

- A slow pace of economic transformation
- Persistent wage gaps between regions and districts in the country
- Wide dispersion of prices (high margins) due to transport costs
- Labor Force Participation and Employment patterns reflect spatial connectivity
  - Low Participation in areas outside of the capital or line of transport corridors through the capital;
  - High unpaid family work outside of the capital and in lagging regions
- Slow growth in waged employment outside of the capital
- Low education quality as determined by PISA scores
- Low levels of public investment as a share of GDP and as a share of total spending;
- Bias in the allocation of spending towards the capital city and away from secondary towns, or away from opposition regions;
- Poor fiscal policies or public subsidies may reflect in high recurrent spending on energy, fuel or input subsidies or in interest payments on domestic debt.

# 1. UNDERINVESTING STATE

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**A: Lagging regions:** the jobs symptoms are:

- Most jobs – especially in the lagging regions are in agriculture, where there would be a large subsistence sector.
- Economic transformation of workers out of agriculture and into secondary towns is slow, especially in poorer rural areas;
- Few new firms locate outside of the established capital and main towns despite market and agro-potential (market accessibility, good topography, reliable rainfall, good soils and vegetation indices)
- An example would be Zambia.

# 1. UNDERINVESTING STATE

**B: Urban congestion:** inadequate infrastructure in urban areas would most likely cause the following symptoms:

- Slow the rate of economic transformation
- Labor productivity in *urban areas* stagnates.
- Businesses may be concentrated in urban areas, but costly transportation, poor access to electricity and water may reduce the competitiveness of larger private investments in manufacturing.
- Employment is concentrated in small enterprises and those which require limited access to transport and energy, and do not employ a large workforce that needs to commute in heavy traffic.
- Urbanization may be slow or else if occurring, may not be associated with high gains in productivity from the reallocation of labor.
- An example would be Bangladesh.

# 1. UNDERINVESTING STATE

**C: Skills gaps:** Symptoms may include:

- High and rising returns to tertiary and technical vocational education.
- Private firms import skilled labor (applications for work permits rising for skills groups).
- Due to spillovers, private sector firms complain about skills gaps but are not training their staff.
- Public sector vocational training colleges under-funded,
- Graduation is low relative to private sector demand for trainees,
- Public colleges lack external efficiency
- Low public spending shares on education
- Poor PISA scores
- South Africa shows elements of this type of jobs constraint.

# TOWARDS JOBS SYNDROMES:

**2. OVER-REGULATING STATE:** The over-regulating state intervenes in product and labor markets beyond what is needed to correct for market failures. Often this is done for social protection or some desire to support infant industries. Symptoms include:

- Stringent labor regulations (more generous than benchmark countries) on payroll deductions, pensions, health insurance severance pay, overtime payments, minimum wages, and maternity leave.
- Low share of formal work within waged work (as firms stop giving contract of work and take temporary workers).
- Slow growth in waged employment (as expanding firms either substitute labor for capital, subcontract services including from small informal firms).
- productivity and wage differentials which persist.
- many informal firms and SMEs coinciding with a small number of large formal firms in activities (ISIC defined).
- Firms clustered around threshold sizes for regulatory compliance.

Examples include: Central America (Honduras Jobs Diagnostic), LAC countries more generally, and some Indian States

## 2. OVER-REGULATING STATE

**A: Over-regulated business environment:** the symptoms of which include:

- high compliance costs with overlapping product or safety standards that increase the costs of doing business and can reward rent-seeking behavior.
- Reporting requirements for private firms increase administrative costs and reduce profitability.
- Onerous procedures eg for land title and construction permits create incentive for rent-seeking behavior.
- low and slow growing formal employment relative to self-employment and informal waged employment.
- Low share of formal firms compared to informal firms,
- low entry rates for new formal firms.

Examples would be Jordan and Moldova

### 3. UNDER-REGULATING STATE:

**A: Under-regulating state:** The under-regulating state fails to correct market failures arising from unfair competition in product markets, asymmetric information, or spillovers.

- Government fails to correct unfair competition, or to protect innovation or copyright to reward innovators for R&D expenditures.
- Monopolies dominate pricing in strategic input sector or raw materials, making investment in some manufacturing industries non-competitive with imports.
- Import licenses are granted openly without adequate inspections, and customs inspection allow for smuggling, and so imports compress the ability of local firms' supply response to increased domestic demand.

Symptoms depend upon the type of market failure that is not corrected for, but could include:

- Formal firms complain that informal non-taxpaying firms steal their markets.
- A large share of firms in wholesale and retail trade activities (shares of sales and employment),
- Net trade deficits in products widen despite the availability of producers of these products domestically to supply that demand.
- Activities in business census data are highly concentrated at both 2 and 3-digit ISIC.
- Monopolistic firms don't hire and don't have the incentive to reduce costs to enhance productivity.
- Low shares of waged and formal employment
- In doing business and ICA reports, firms complain about compliance and unfair competition.

An example would be Paraguay. Elements were also observed in Uganda.

### 3. UNDER-REGULATING STATE

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**B. Bad finance:** A subset of the under-regulated State. Poor regulations or a lack of banking supervision can lead to failures in financial intermediation. Symptoms could include:

- Unfair competition in the banking system manifests itself in high interest rate spreads on lending versus deposits, excessive collateral requirements, short-term lending horizons (short maturity on loans), high fees and charges on banking transactions, including on foreign exchange transactions.
- Borrowers may be unable to `shop around' for lack of a credit reference rating.
- The banking system may provide only a limited number of lending products for customers (eg there may be no movable collateral lending, no leasing credit, and trade financing may be tight).
- There may be no innovative banking practices (few electronic transfers, no mobile banking);
- Banks in tiers 1 and 2 may be unwilling to take the risks of lending to tiers 3 and 4.

### 3. UNDER-REGULATING STATE

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#### **B. Bad finance (cont.)**

- Businesses complain that finance is a constraint to business expansion,
- A relatively high share of businesses that report that they applied for a loan in Enterprise Surveys do not have received one, regardless of firm size.
- High turnover and exit levels for new firms which are unable to absorb short-term losses,
- Low shares of growing firms because growth requires financing new investments.
- Most firms are small,
- Most workers are self-employed.
- The business sector may respond rapidly to the availability of private sector lending when credit is available.

## 4. LABOR MARKET MISMATCH

**Labor market mismatch:** Negative spillovers in labor markets mean workers spend a lot of time and money seeking jobs, whilst employers spend money seeking suitable workers. Symptoms can include:

- persistent wage gaps across occupations, skills types and locations
- firms complain about the lack of skilled workers in ICAs, but do not provide training in-house for their staff.
- Workers face long periods of frictional unemployment,
- Youth take a long time to transition from school to work and panel data may show few transitions from unemployment to employment and from self- to waged employment.
- Businesses may apply for work permits for foreign workers despite the existence of unemployed or under-employed people with the requisite skills in the economy.

## 5. OVERGENEROUS STATE

**Over-generous state:** Public sector employment and wages, or social insurance payments are high relative to private sector wages and employment.

**A: Over-generous public-sector remuneration:** Symptoms include:

- The public-sector crowds-in skilled workers.
- The private sector faces shortages for qualified workers.
- High share of wages and salaries in total recurrent public spending and as a share of GDP compared to other countries,
- Public sector earnings exceed those in the private sector for a given level of education and adjusting for characteristics (wage regressions in the jobs diagnostic).
- Returns to education may be higher for public than private workers.
- Bimodal distribution for waged employment.
- Longer school-to-work transitions for tertiary-educated youth than secondary educated school leavers (and the children of wealthier families).
- Private sector wages may rise out of line with labor productivity, slowing employment creation in the private sector.

## 5. OVERGENEROUS STATE

### **B: Over-generous social insurance:**

The public sector either creates a higher reservation wage by:

- providing generous pensions (encouraging early retirement, eg Moldova),
- pays relatively high social transfers (South Africa),
- or else collects high payroll taxes for health insurance.

Symptoms could include:

- Low labor force participation rates for all socio-economic groups but especially for elderly and low-skilled relative to other countries.
- Formal waged employment in private businesses may be slow growing or else not growing in line with sales or total employment.
- Private firms may hire a disproportionate share of workers without contracts.

## 6. PREDATORY STATE

**Predatory state:** - In a predatory state, there is a preponderance of inspection laws, licenses and regulations that necessitate plant visits with the aim of rent-seeking or discrimination.

Symptoms would be more evident in business data, and could include:

- Poor ICA scores for dealing with tax authorities and compliance costs.
- Low firm entry,
- Large firms who have adapted to the feed the predatory state would likely be older and enjoy market dominance in their sectors.
- There would be evasion – reflected in a large informal sector – a preponderance of small-scale producers operating ‘below the radar’ remaining too small for the predatory state to extract from them; but possibly providing most of the waged jobs in the economy.
- Investment and innovation would be stymied, and profitability may be lower.

## 6. PREDATORY STATE (CONT.)

**Predatory state (cont):** Poor correlations between firm size (employment) and productivity.

- A smaller proportion of employment would in medium-sized firms.
- Low shares of waged work,
- Even lower shares of formal waged, as firms try to avoid registering workers for taxes.
- (In an agrarian society) smaller share of cash crop producers,
- smaller share of waged employment on commercial farms,
- higher share of unpaid family workers and subsistence self-employed producers in the agriculture sector.
- Economic transformation would be slow, and if it is happening, it would likely be characterized by large numbers of micro service firms and self-employed manufacturing.

An Example would be Moldova

## 7. DUTCH DISEASE

**Dutch disease:** constrained growth in jobs in tradeable sectors. In commodity, or aid-dependent or remittance-dependent economies, inflows of foreign exchange can lead to an expansion in the demand for non-traded goods. Symptoms include:

- Increased relative price of non-tradeable goods and services relative to traded
- Increases in real wages in the economy relative to other countries.
- Decline in the competitiveness of traded goods in the economy.
- where a large share of workers is in self-employment or waged employment in agriculture, an appreciation of the real exchange rate which reduces export competitiveness can have serious negative effects on employment and earnings in agriculture;
- slower growth in productivity in traded goods
- slower economic transformation.

## 8. JOBS EXTERNALITIES

**Jobs externalities:** To create positive jobs externalities and encourage a faster reallocation of workers from the traditional to the modern sector in LICs with surplus labor, Governments may need to reduce the costs, or increase the attractiveness of hiring workers in the modern waged sector. Where jobs externalities exist, the law of one price does not hold. Symptoms include:

- Wage gaps persist between rural and urban areas.
- Most workers are either unpaid family workers in rural areas or else are self-employed in low productivity farm work or service work.
- Workers may be underemployed, working just a few hours each day or a few days each week.
- Inequality in earnings would reflect in inequalities of consumption and therefore in a high Gini coefficient in household consumption surveys.
- Wages and earnings per hour are significantly lower than in the modern sector of the economy and yet a low probability of finding work prevents people from moving to urban areas in search of work.
- There may simultaneously be high urban unemployment.
- Formal waged employment in formal firms may be low relative to other employment types.

This syndrome would typically apply in labor abundant LICs. An example would be Uganda