

Invisible Sectors:



How Poor Levels of Human Capital Threaten the Rise of Asian Economies

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The rise of Asia

- Most of Asia, especially East, Southeast and South Asia, are growing
- A majority of the nations are now somewhere inside a bracket known as “Middle Income”
- The goal of everyone of these countries is to continue their climb into Upper Middle Income and onto High Income!

But, in many countries, there is a **crisis** lurking ... in most nations at the time of Middle Income, it is still quite **INVISIBLE**

- There are many “things” that are needed to continue to climb through middle income and escape the middle income trap and become a high income country
 - Good Macro Policies
 - High quality Infrastructure
 - Export Success

But, in many countries, there is a **crisis** lurking ... in most nations at the time of Middle Income, it is

Many countries have these features ... or are working on improving them ...

- The Of course, some don't and have needed challenges in the coming years to provide them ...

income and escape the middle income trap and become a high income country

- Good Macro Policies
- High quality Infrastructure
- Export Success

But, there is one key element that seems to be aligned with the rise through and (especially) out of middle income ... and that is the

Nature of the Human Capital of the Labor Force

(when the countries are still at middle income)

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There is much less discussion of this ... because it is something that can take decades to create ... and it is an element that initially has a low rate of return (though its rate of return is super high in the long run)

Today's presentation

- Show the importance of human capital for being able to graduate from middle income ...
- Look at the case of China
 - To be clear, China is still middle income ... and there are **HUGE CHALLENGES** for China to face before they will be able to “graduate” to high income
- Some lessons for other Asian Countries

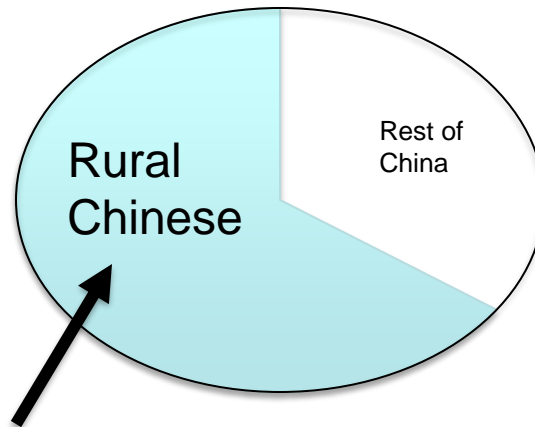
What is the Invisible China?

The “Invisible China” is easy to define.

Invisible China = Rural China.

It's the place where most of the people in China are from.

China's population is now 1.4 billion people.



840 million of them are rural Chinese

[1/10th of the world's population / > 2 x US population]

Who are these 840 million people?

They are the workers



They are the self employed service workers



They run the farms



Who are these 840 million people?

They are the elderly left in the villages



They are the children left in the villages

They are the families in migrant communities



When I first started working in China, more than 85% of Chinese lived in rural communities and even a higher percentage had families (grand parents and brothers and sisters) that were farming or working in rural factories.



In those
Student
govern
these fa

Rural China was NOT invisible 30 to 40 years ago

went back-and-forth between their city lives and their immediate families in their home-villages.



When one went across country, the buses had to traverse the countryside on the nation's poorly developed road system and people would stop at night in small village guest houses and eat farm house restaurants.



But, today, it is so different.

Less than 5% of students in elite universities in China have rural roots.

If you don't fly across the country ...

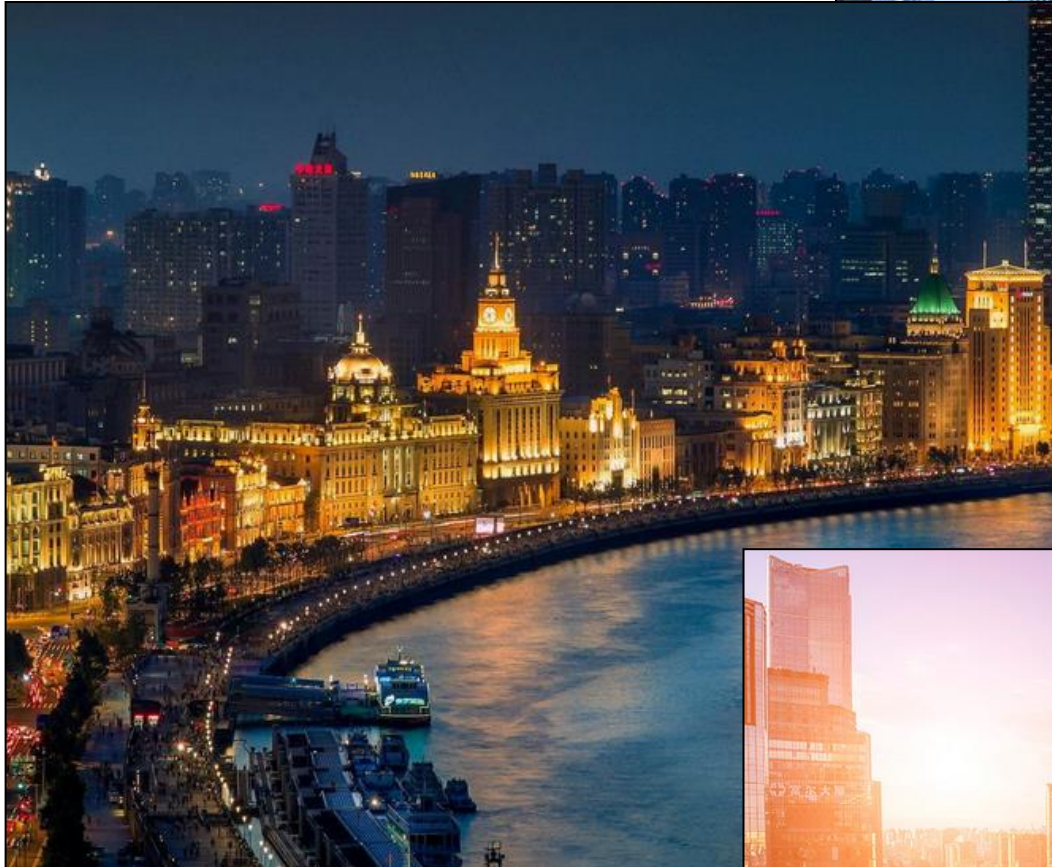


... you get on a high speed rail at 350 km/hour!

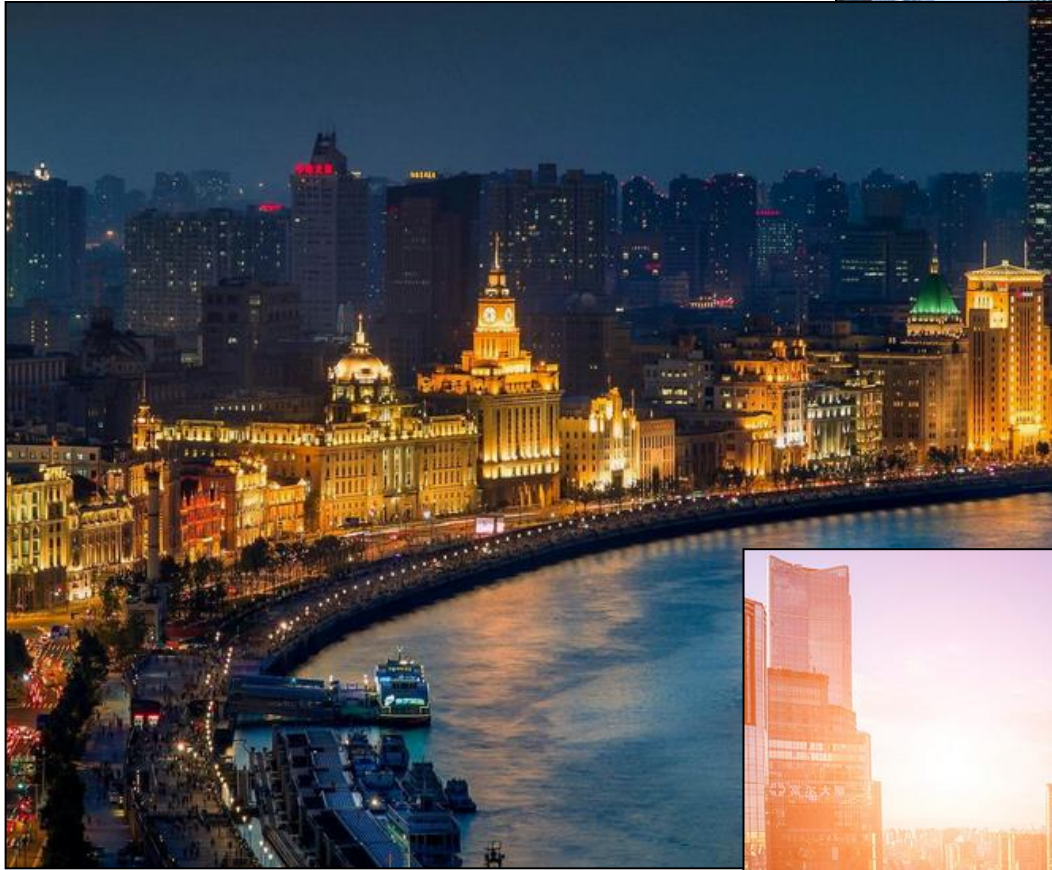
At those heights and speeds it's almost impossible to even take a picture of a farm field or village road.



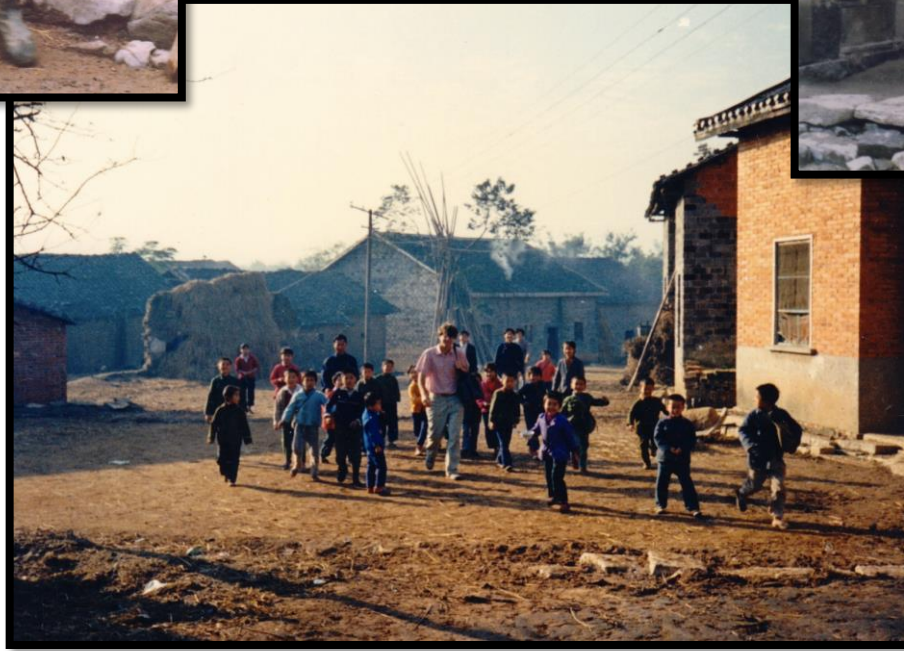
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Scott in rural China,
circa 1988





Scott in rural
China today

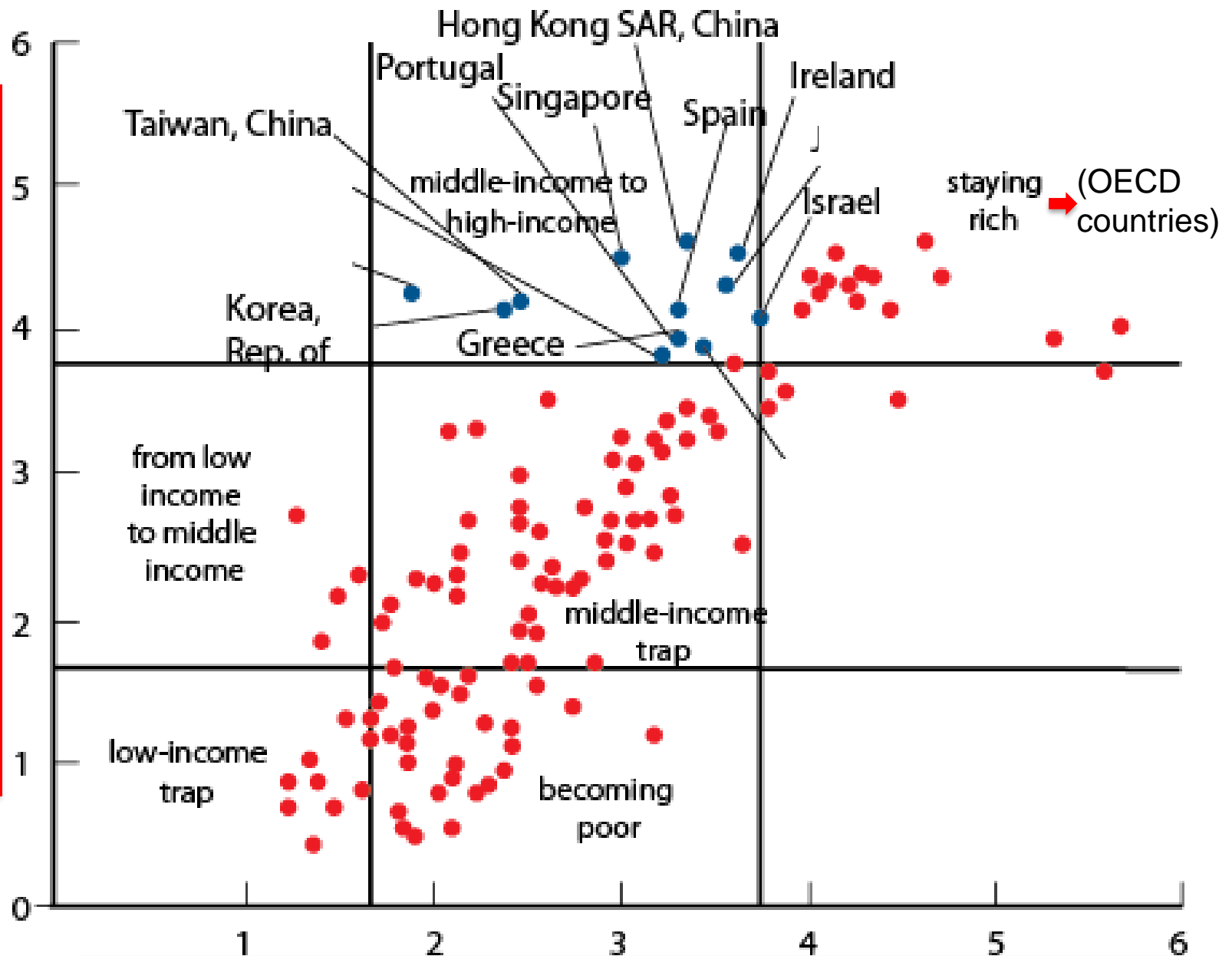
Part 1:

“Theory”

So how does the poor human capital in certain sectors of the economy of Asian Nation's threaten the rise in those countries?

The theory of why: the ***Invisible China*** threaten China's rise?

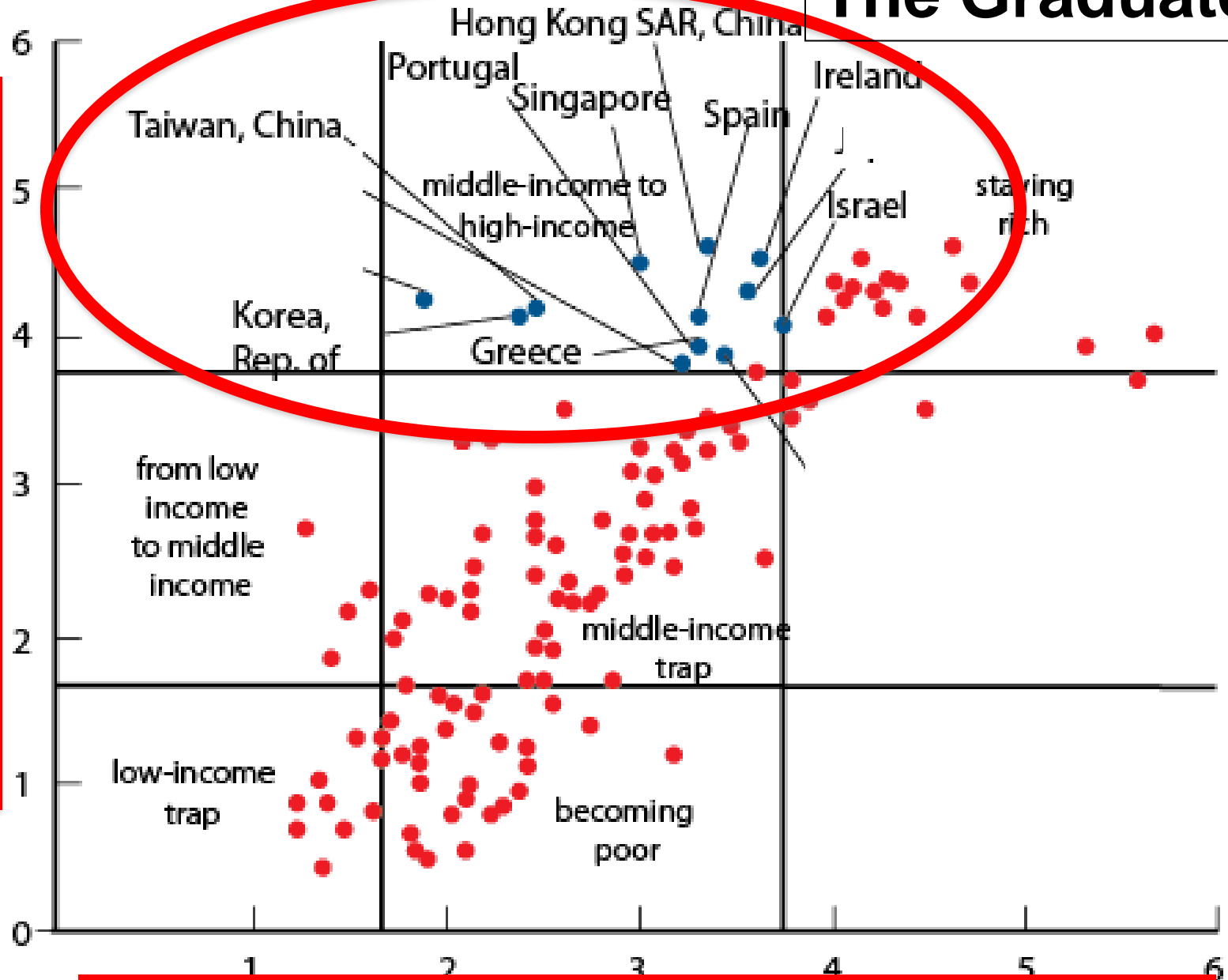
2008 per capita income relative to United States (log of %)



1960 per capita income relative to United States (log of %)

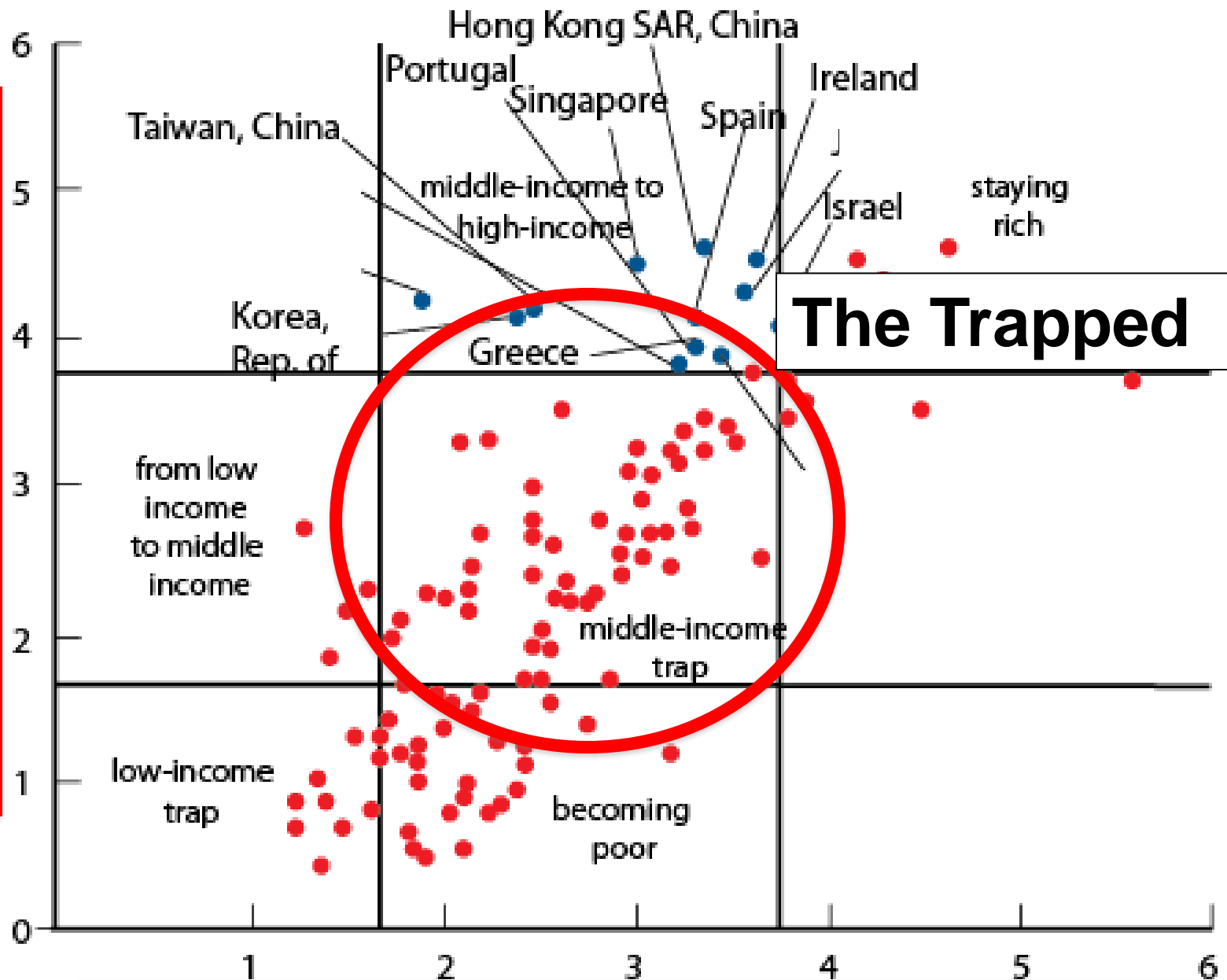
The Graduates

2008 per capita income relative to United States (log of %)



1960 per capita income relative to United States (log of %)

2008 per capita income relative to United States (log of %)



The Trapped

1960 per capita income relative to United States (log of %)

One fundamental difference between the Graduates and the Trapped

- At the time of middle income, the levels of human capital (think levels of education) of the ENTIRE labor force need to be high ...

Why is this important?

- When a country moves from middle-income to higher income, wages rise fast and the nature of work changes from “low wage, low skill” to “high wage, high skill.” If a large share of the labor force is NOT able to participate
 - polarization (demand side problems) & low productivity (supply side problems)
 - high unemployment/high crime/social unrest & low productivity and poor investment climate
 - stagnation

Share of Labor Force that Attained Upper Secondary Education, Middle Income Countries

Country

Share
in 2010

OECD

74

*In Developed Countries,
between Seven to Eight out
of Ten Individuals in the
Labor Force has been to
High School*

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Middle income grads:

72

When they were middle income countries, their levels of education were almost as high as developed countries (which they have now become ...)

Share of Labor Force that Attained Upper Secondary Education, Middle Income Countries

Country	Share in 2015
---------	------------------

- Turkey 36
- Brazil 46
- Argentina 42
- Mexico 34
- South Africa 32

The Trapped

Average Middle Income 36

OECD 74

Middle income grads: 72

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Average Middle Income 36

OECD 74

Middle income grads: 72

The Trapped

We could add:

1. India
2. Indonesia
3. Malaysia
4. Pakistan
5. Philippines
6. Thailand
7. Vietnam
8. **Others**

Share of Labor Force that Attained Upper Secondary Education, Middle Income Countries

Country Share
 in 2015

- | | |
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**Compare the
Trapped and the
Graduates**

One fundamental difference between Graduates and the Trapped

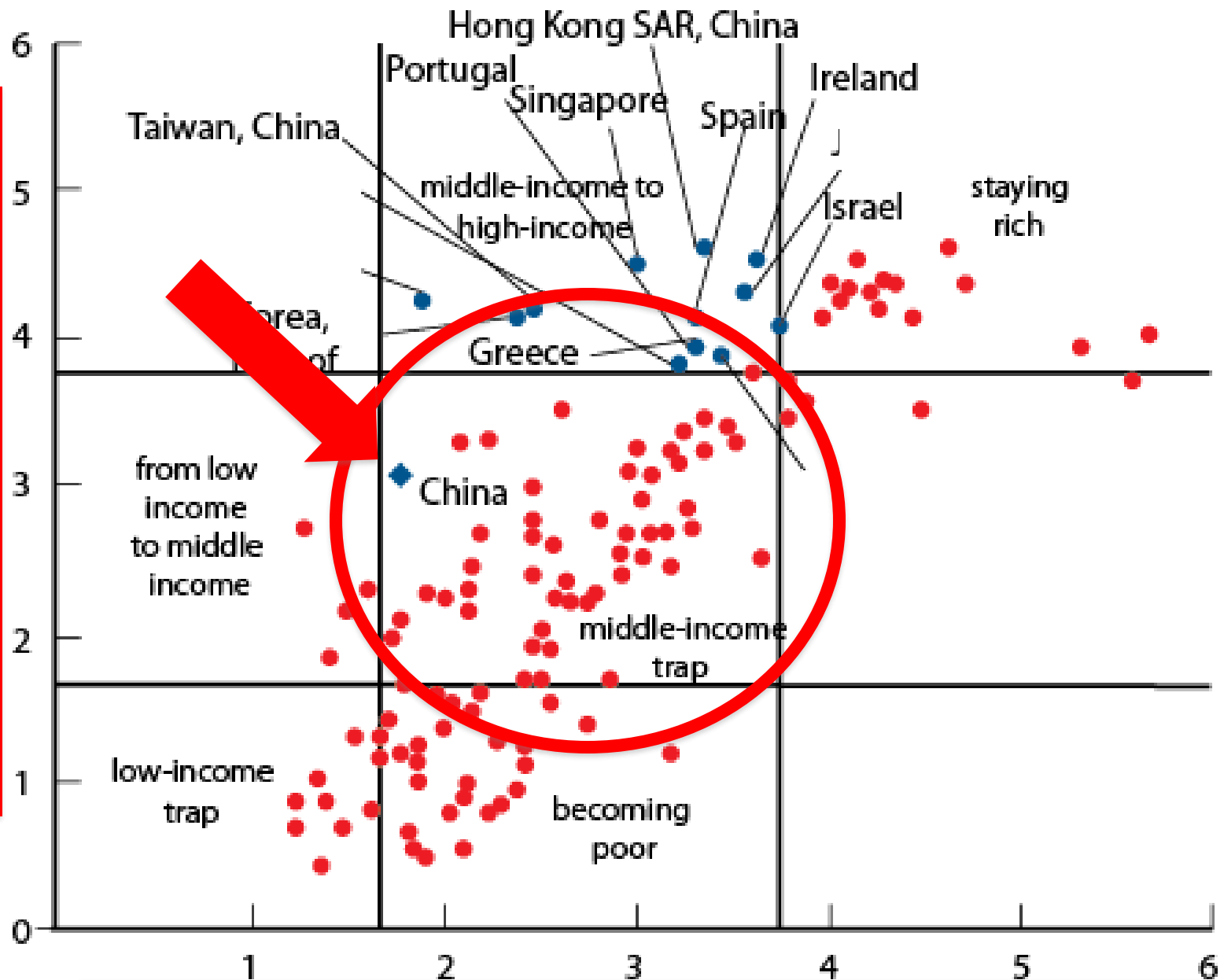
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 - polarization (demand side problems, for example, high unemployment/rise of **informality**/high crime/social unrest
 - low productivity (supply side problems, e.g., poor investment climate/absence of qualified workers
 - **Stagnation** → **more polarization** → **etc.**

Part 2: Now lets look at a case
study of China

2008 per capita income relative to United States (log of %)



1960 per capita income relative to United States (log of %)

Summarizing above ...

While all kids do not need to go to college, **all children should be going to high school**

This is critical at this stage of development to get all children the skills they will need in the future: *Where is China?*

- Actually: China has the lowest levels of human capital in the middle income world!

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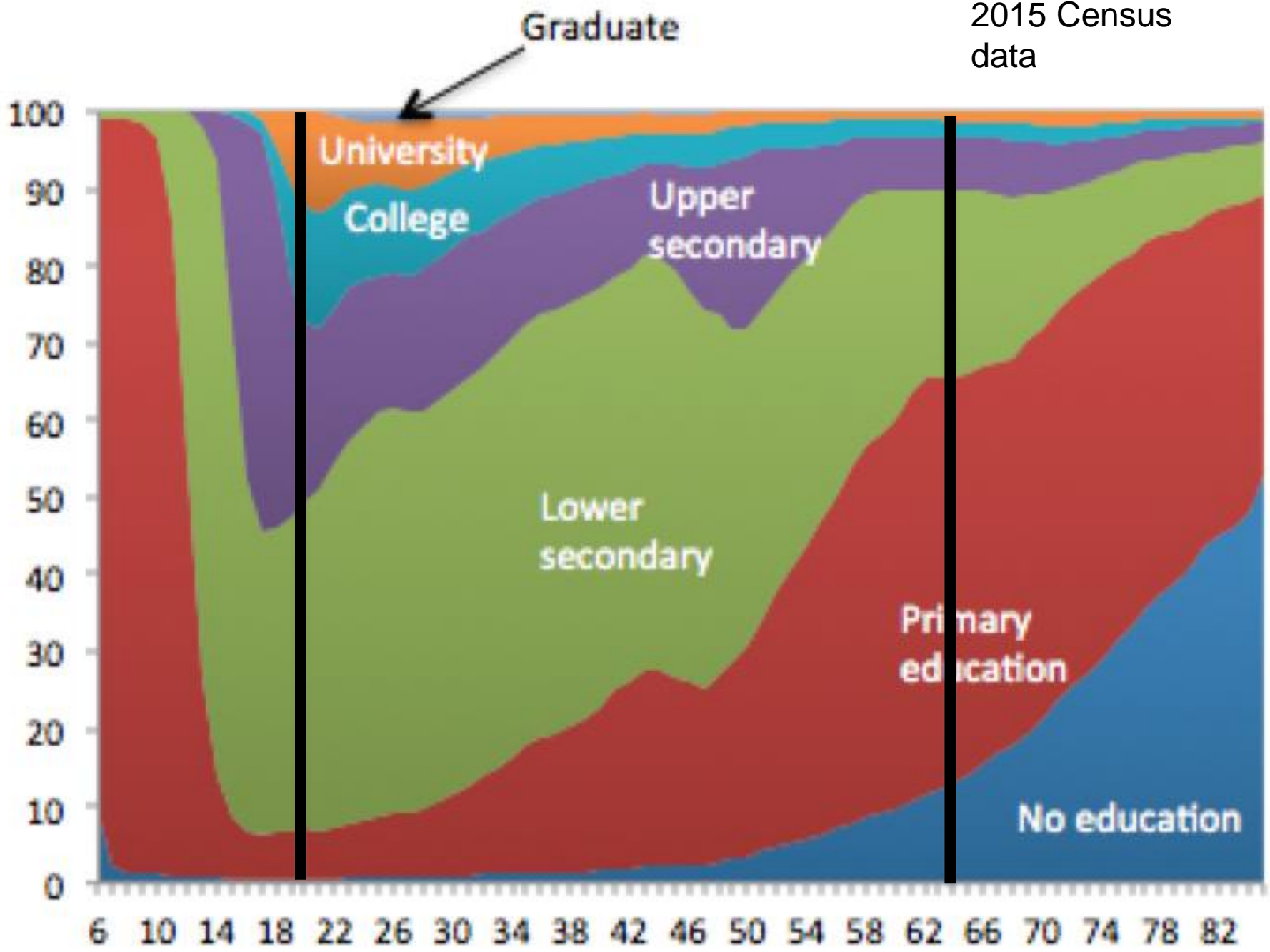
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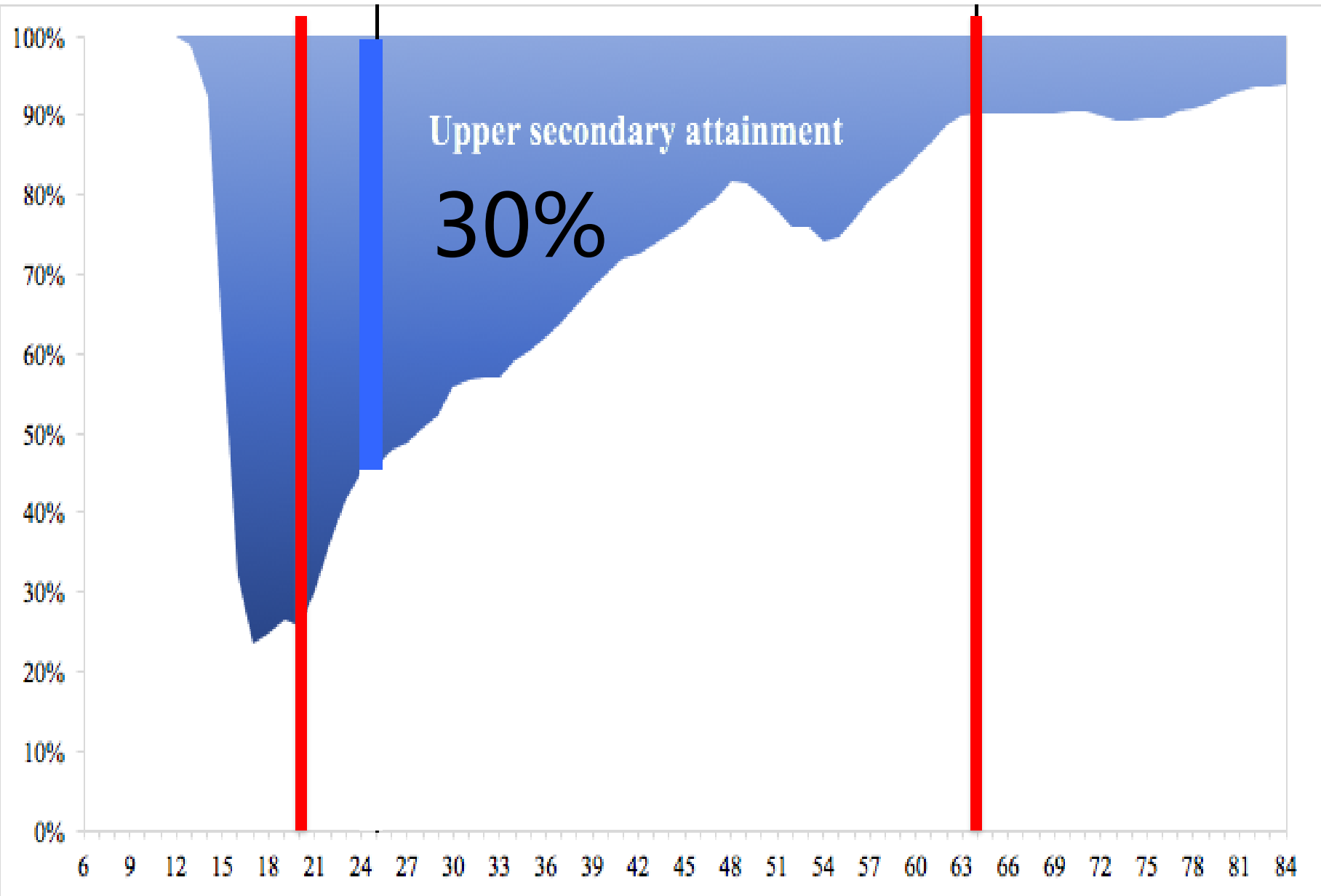
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2015 Census data





Today's Labor Force

$$\frac{\text{Upper Secondary Attainment}}{\text{Total Labor Force}} = 30\%$$

How does that compare to the rest of the world?

Middle Income Countries Human Capital Crisis

Country	2015
Turkey	36
Brazil	46
Argentina	42
Mexico	34
South Africa	32
China	30
Middle Income (avg)	36
OECD	78
Graduates	72

What does this mean?

→ If only 30% of those in the labor force have graduated from high school ...

... this means that 70% of those in the labor force are **“high school drop-outs”**!!

What does this mean?

Why is this a problem?

→ If in a high income country, such as the US, if an individual is a high school drop out ... does not have skills in math, science, computers, language ... then the probability of him/her having these conditions:

- **In jail**
- **Unemployed**
- **On welfare**
- **Disabled**
- **Homeless**

... t
fo
Is 5 times the probability that he/she is living:

- **Middle-income life**

So is there any evidence that this affecting China's economy?

Lets look at two key indicators:

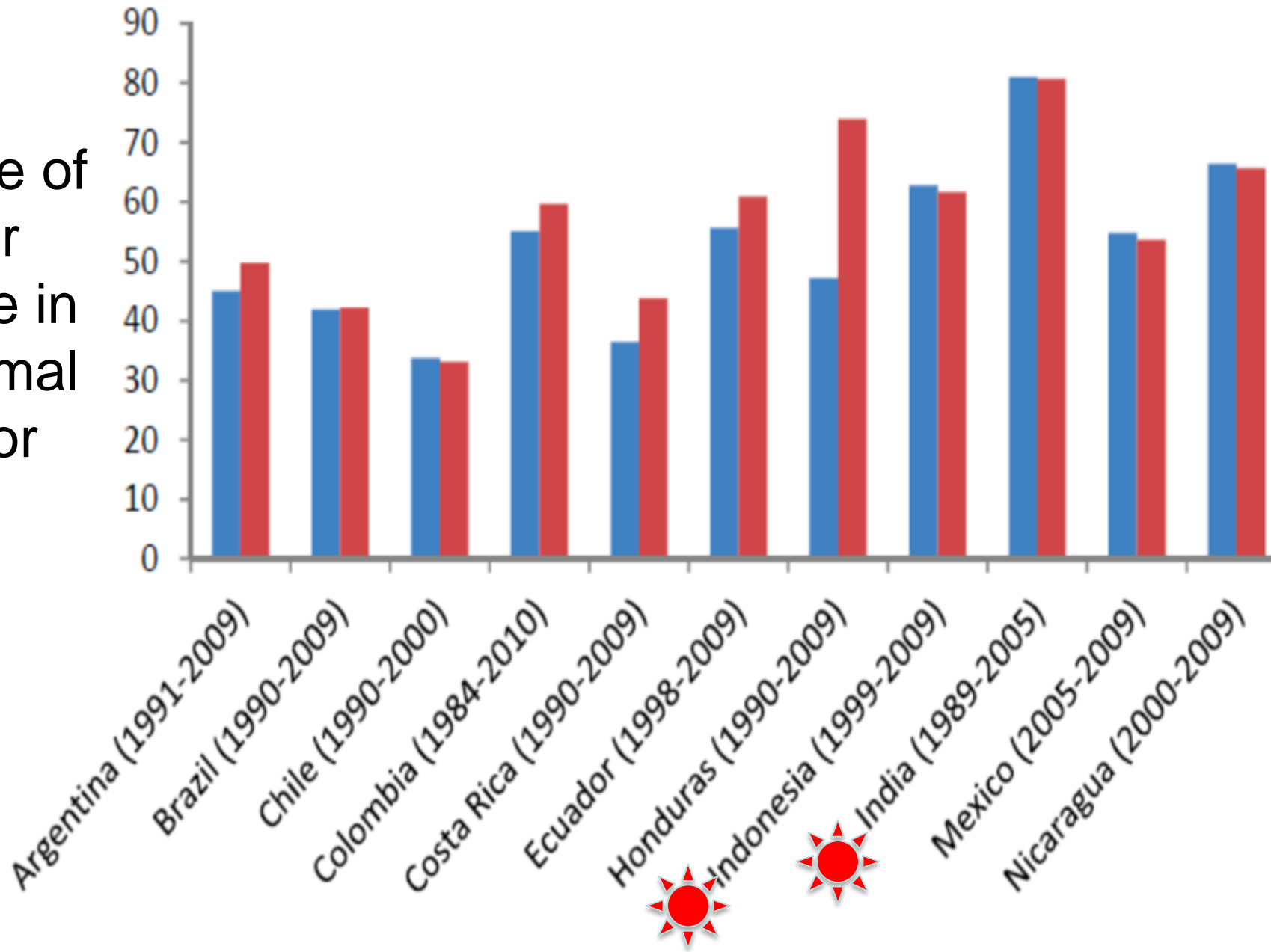
- Employment
- Wages

Using data/statistics from the government of China

Lets answer your questions now!

What happens when a large share of the labor forces sinks into the informal economy?

Share of Labor Force in Informal Sector



Data source: ILO KILM





Recent talk by Santiago Levy (IADB)



In this lecture, Dr. Levy elaborated on what he calls a *Mexican paradox*. He explained that Mexico demonstrates "solid macroeconomic performance, export success and accumulation of physical capital ... but very little growth." He went on to ask the audience, "Why? Productivity has stagnated. Is that because the informal sector is too large? What explains persistent informality and stagnating productivity?"

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This means that in 2015, more than 65 percent of Mexico's labor force were "high school drop outs" →

Maybe this is one of the reasons for the "inevitability" of the rise of the informal sector →

And stagnation of healthy growth for many middle income nations

There are so many people today that listen to the argument that we are making in this book and say:

“Hasn’t China already made it?”

But, remember, what they said about Mexico in the late 1980s ... when the country was allowed to enter OECD (because Mexico was supposed to become a high-income country)... Mexico was called:

“The next Taiwan!”

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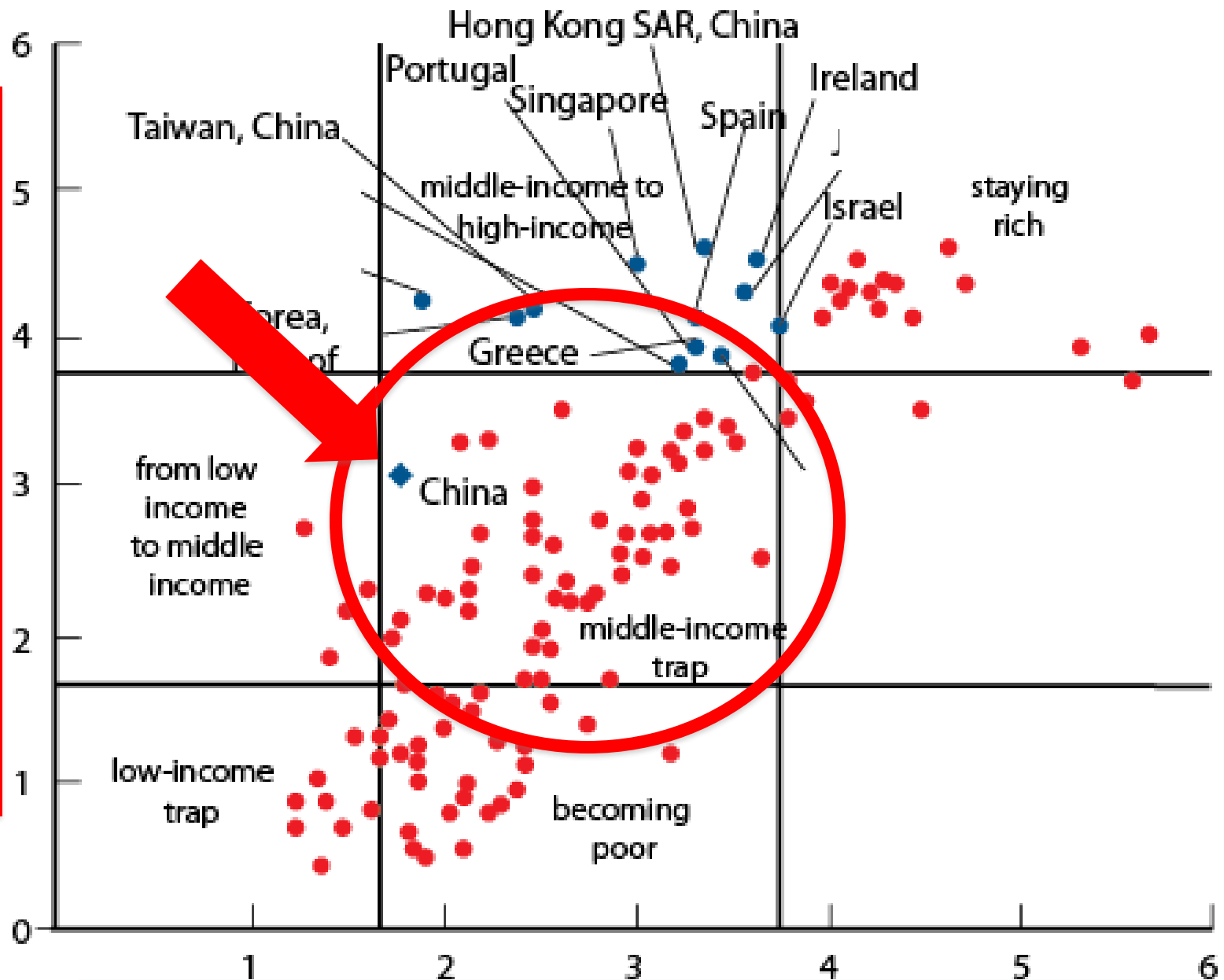
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So where is China in
this human capital
world of nations?

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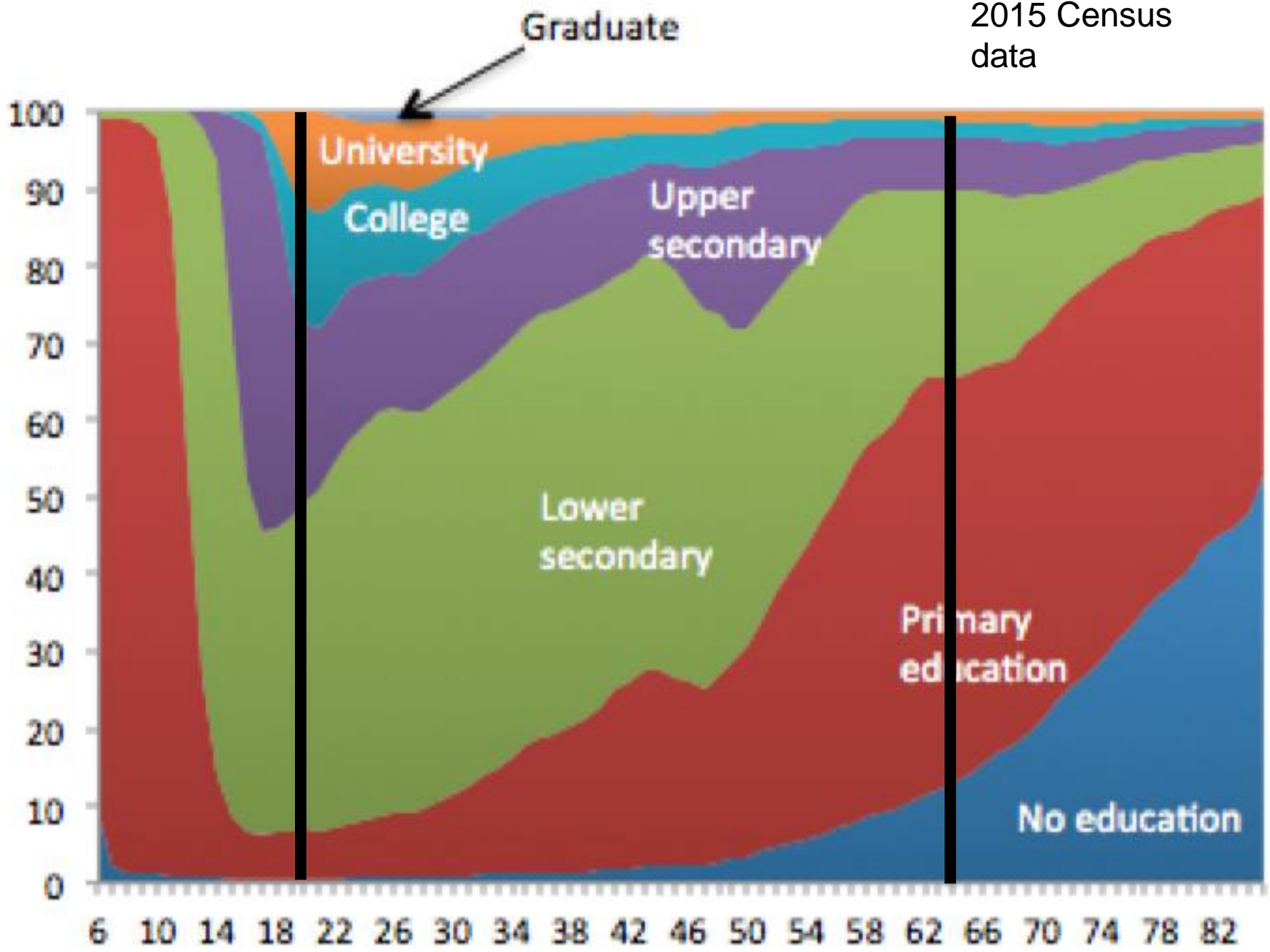
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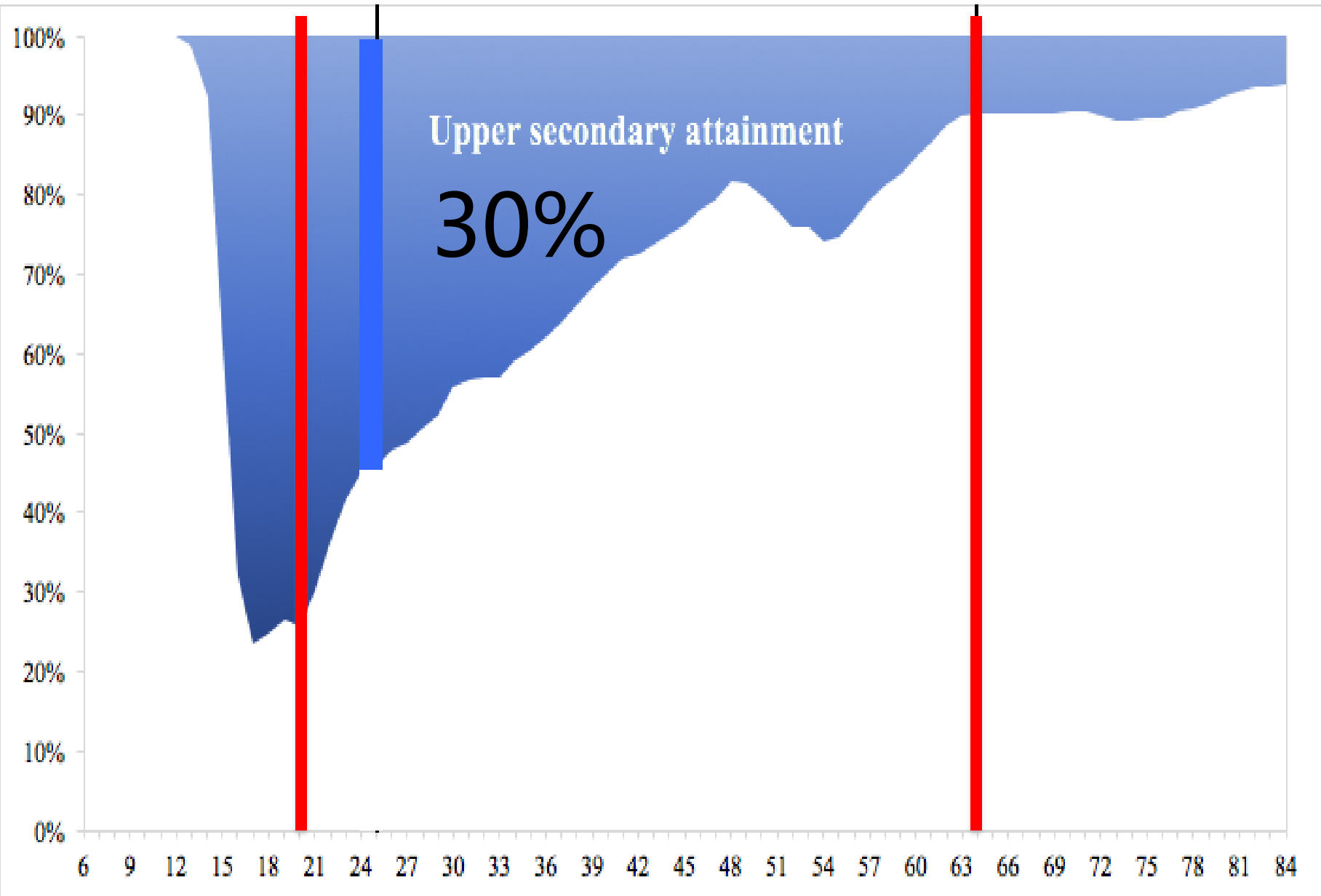
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Upper secondary attainment

30%

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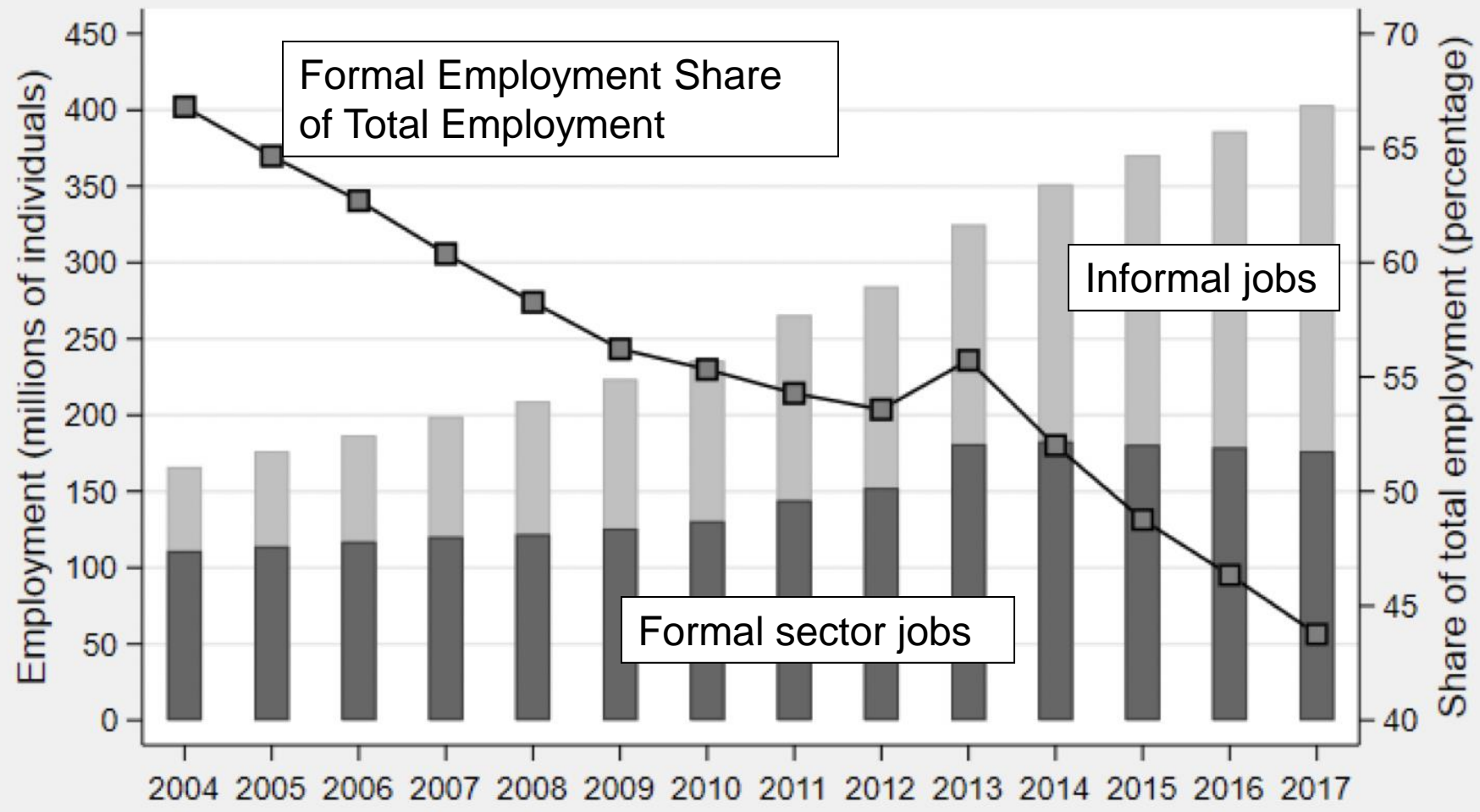
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- Employment
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Using data/statistics from the government of China

Figure 5: Urban Formal and Informal Sub-economy Employment in China, 2004–2017



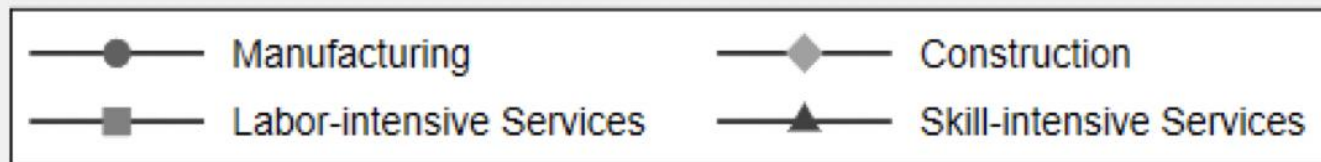
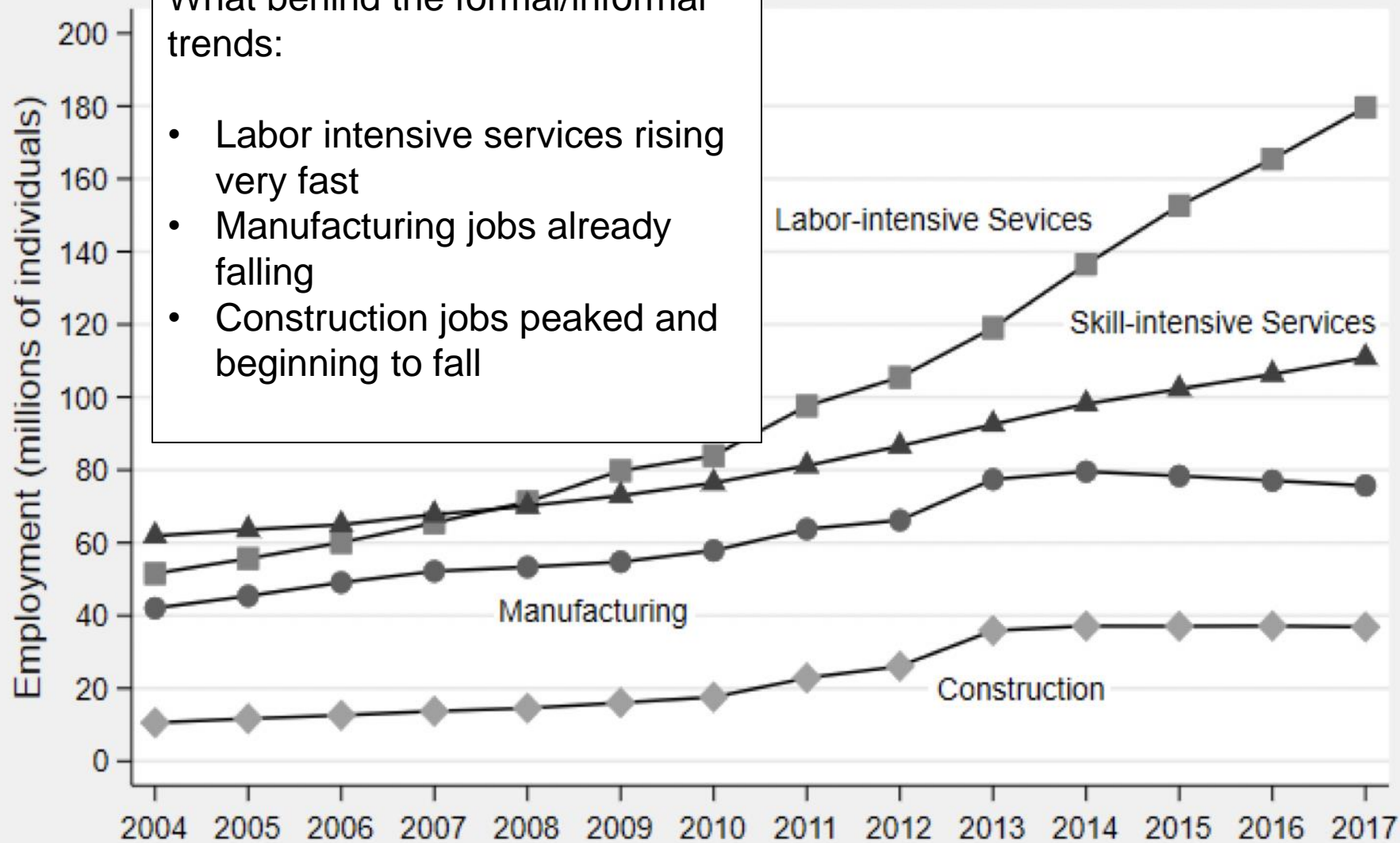
Summary of trends:

- *Jobs in formal economy have dropped from 67% in 2004 to 44% in 2017*
- *Informal sector now accounts for 56% of all jobs in the urban sector*

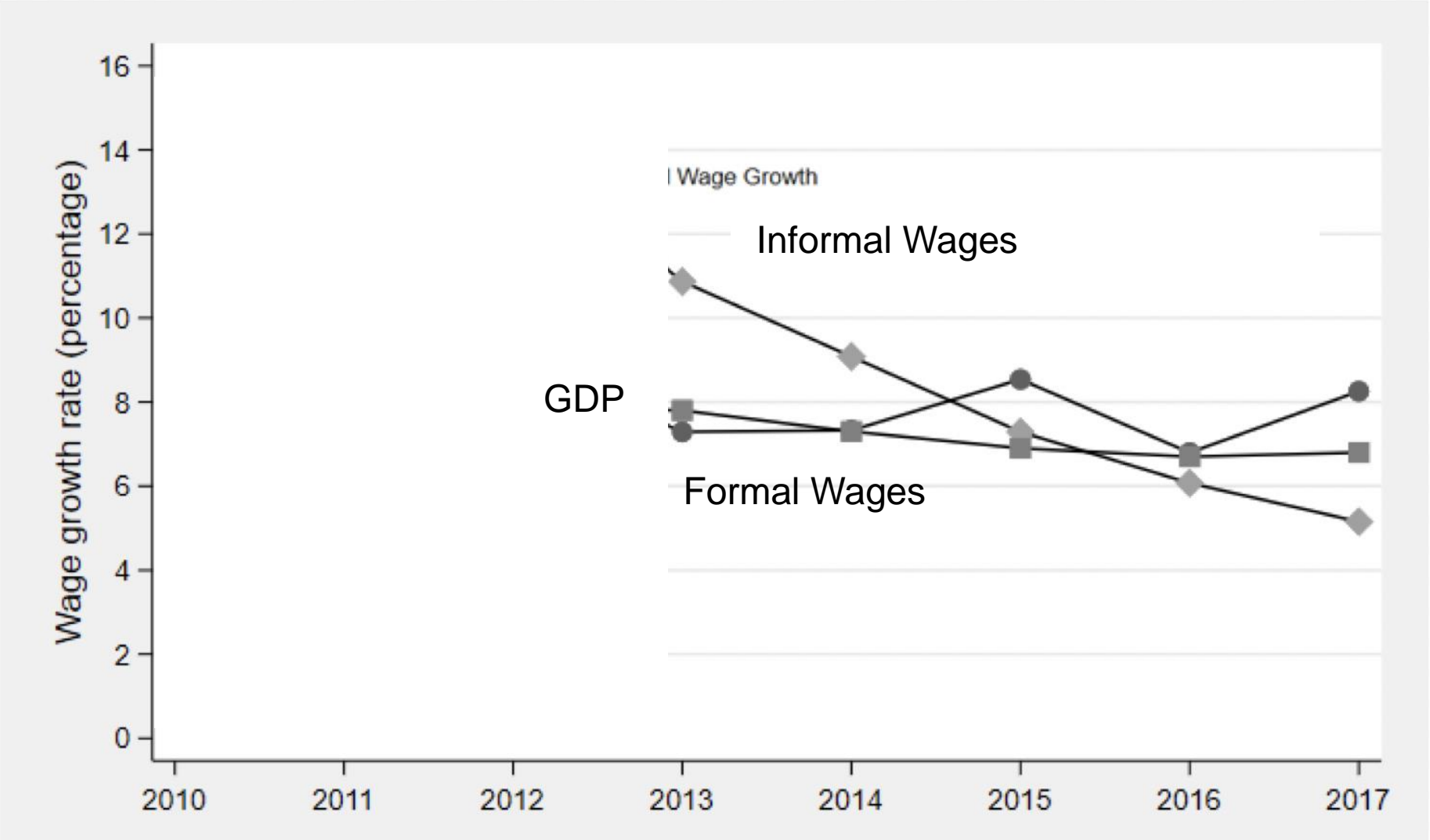
Data source: China's National Bureau of Statistics

What behind the formal/informal trends:

- Labor intensive services rising very fast
- Manufacturing jobs already falling
- Construction jobs peaked and beginning to fall



Real Growth Rates of Average Annual Wages (by Skill) and GDP in China, 2013 -2017



Data Source:
China National Bureau of
Statistics

Real Growth Rate of Wages, by Skill Type 2013-2017

Table 1: Average Real Growth Rates of Wages in China by Skill Type

Average Annual Growth Rate	Formal Skill-intensive Wages	Informal Labor-intensive Wages
2010-2014	7.75%	10.68%
2015-2017	9.07%	6.02%
Change (percentage points)	1.32	-4.66

Summary of Employment & Wages

- Employment in China's economy is only growing in two (2) sectors

1. High skill / high wage / professional sector

- Growth rates of wages are rising

2. Informal economy (low skill / low wage / no benefits)

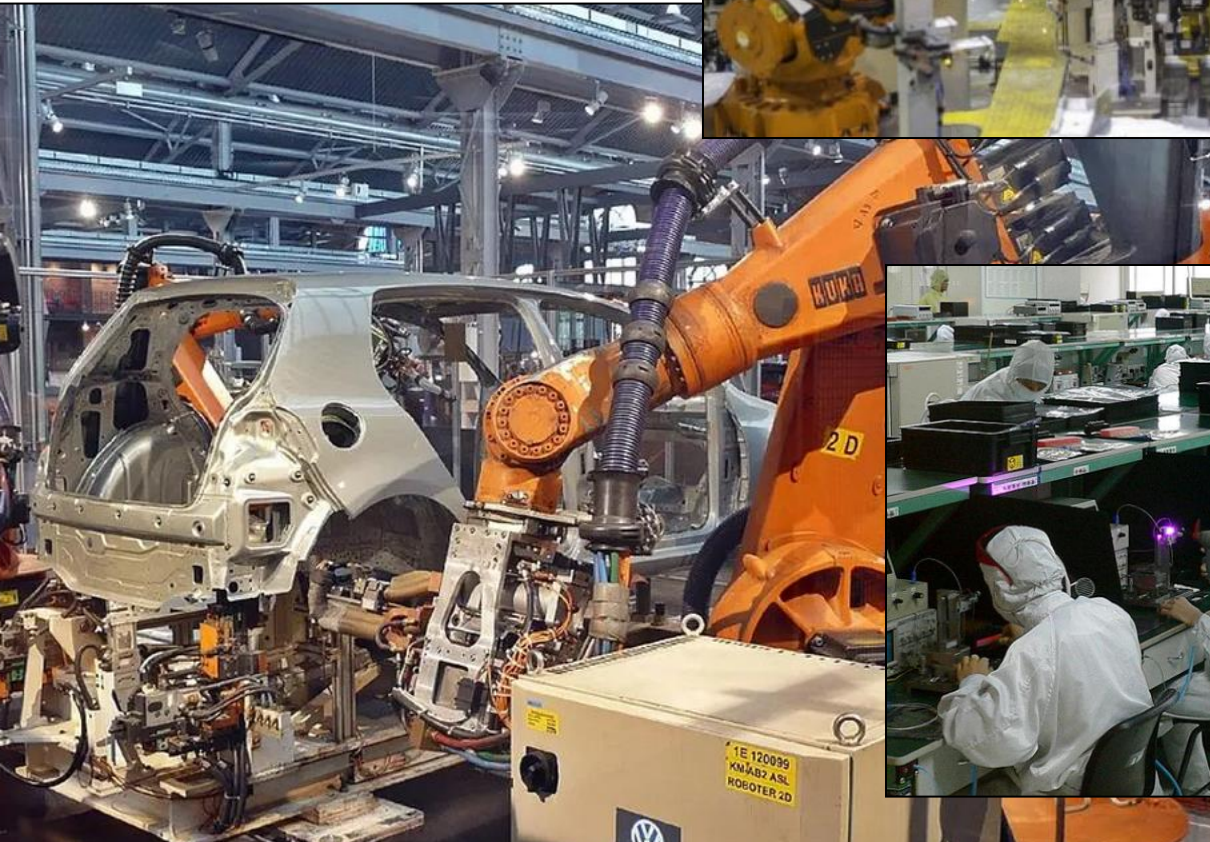
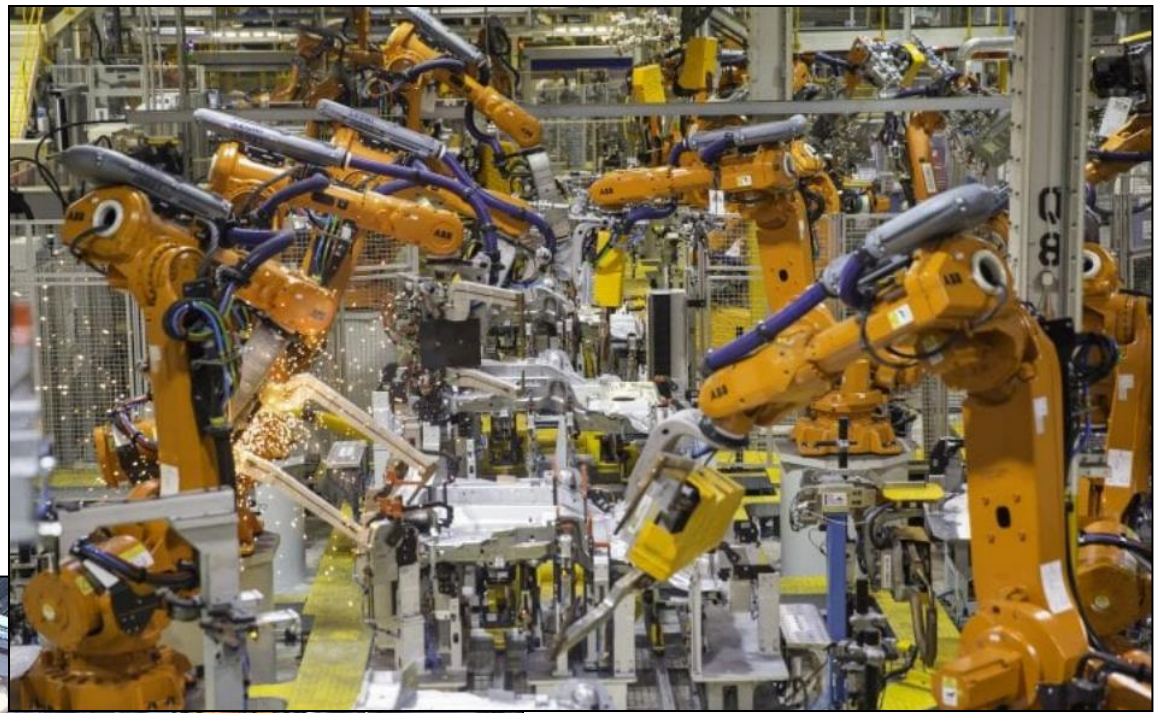
- Growth rates of wages are falling

Why are wages falling? Rising supply of informal workers → employment in all other sectors—manufacturing, construction, agriculture—is falling ... these laid off workers and most new entrants only have one option: informal / low-skill / service sector → supply > demand means wages fall [data source: China NBS]

What is driving these trends ...

... should we expect more in the
future?

Robots / automation



Levis now: "Made in Ethiopia"



Globalization

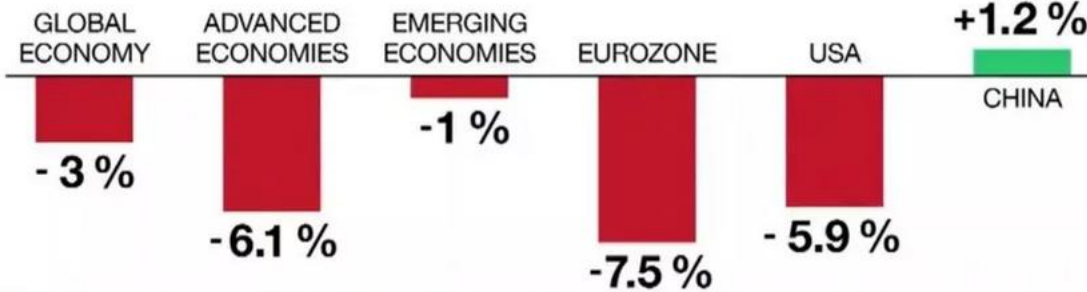


Chinese firms move to Bangladesh

SAMSUNG ELECTRONICS VIETNAM
SEV IS PROUD TO BE THE BIGGEST MOBILE FACTORY IN THE WORLD



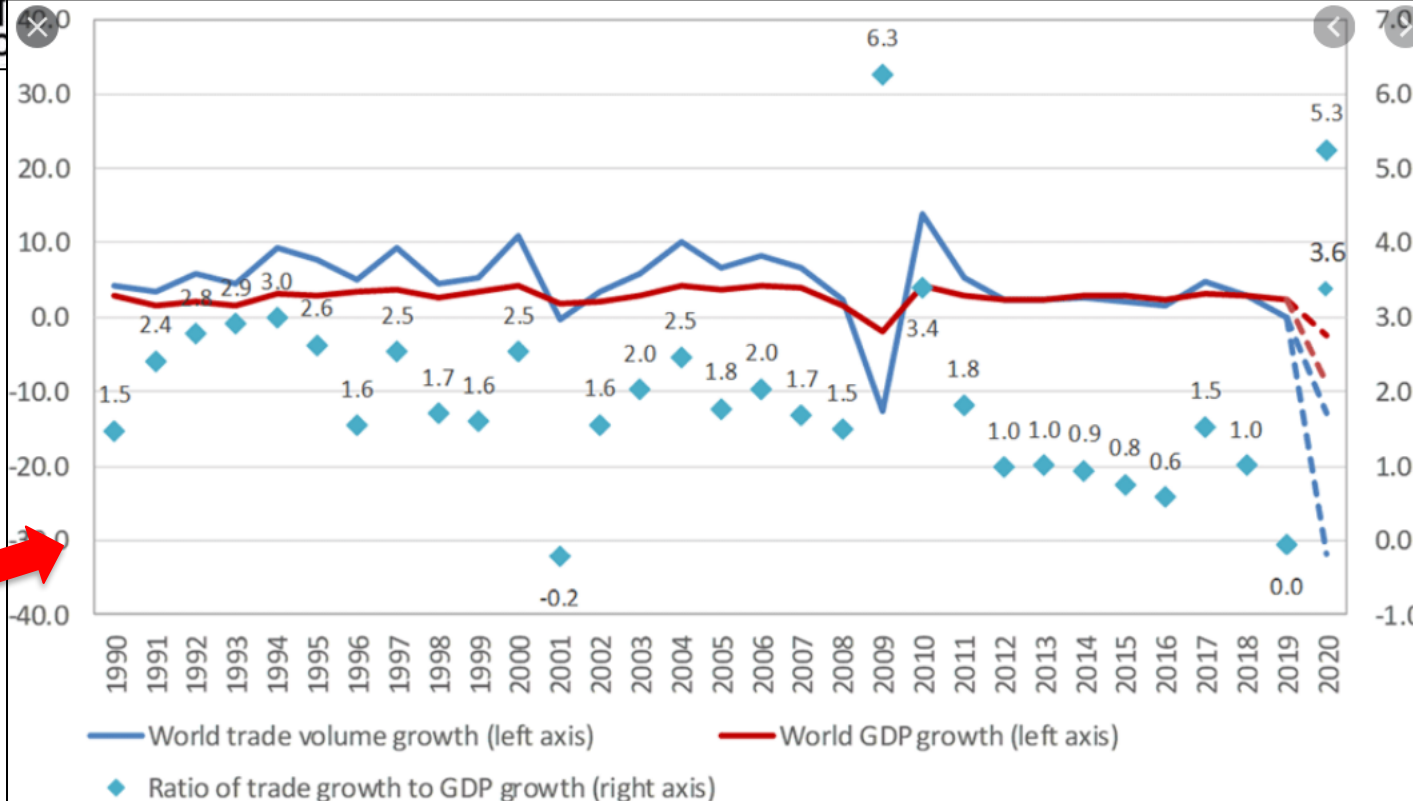
IMF WORLD ECONOMIC OUTLOOK 2020 ASSUMING PANDEMIC FADES IN SECOND HALF OF YEAR



COVID19 and global recession

CORONAVIRUS PANDEMIC
IMF PREDICTS WORST RECESSION

GDP around the world falling ...
... and ...
... international trade is crashing

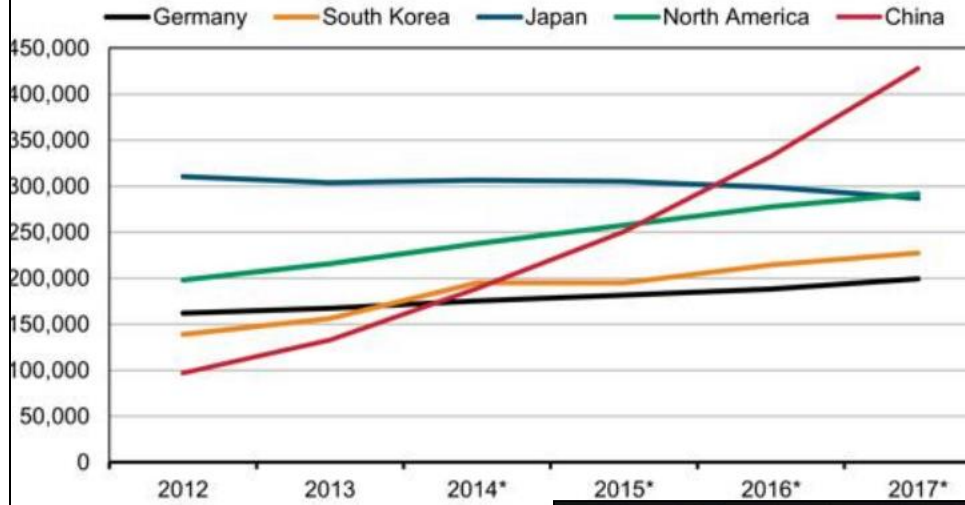


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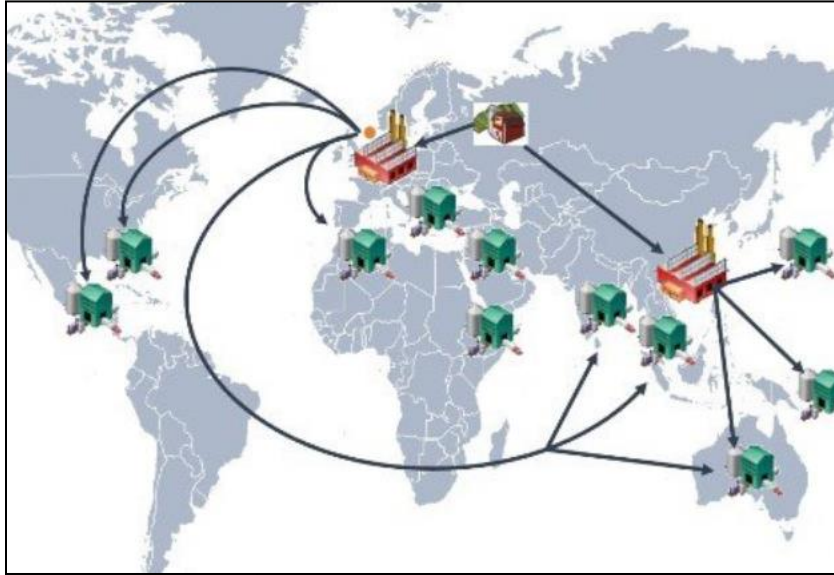
**... should we expect more in the
future?**

Programmed for Growth

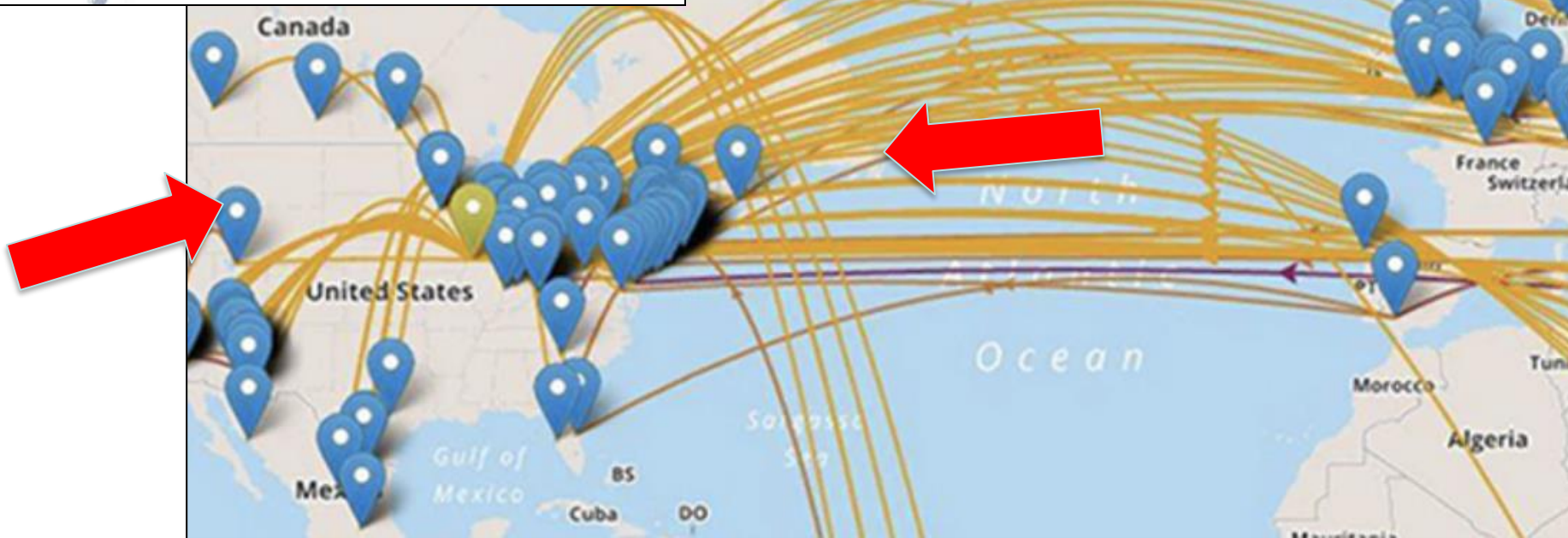
The number of robots in use in the five largest global markets, projected to 2017



Global supply chain shifts?



*From the old
to the new?*



What is driving these trends ...

... should we expect more in the future?

Maybe?

Probably?

Part 3: Lessons for Asia

- Human capital (of the entire labor force, 16-65) is IMPORTANT
- Must start early (even when returns to education at the high school level maybe low ... they are higher later)
- How to do it?
 - Invest in education
 - Invest in health
 - Invest in Early Childhood Development

Thanks you for
listening ...

... comments
always welcome!



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Thank You!



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