Nobel Prize 2021 for Economics - Public Policy Relevance

What is the issue?

- David Card, Joshua Angrist and Guido Imbens were the 2021 Nobel Prize winners in Economics for their contribution in the field of labour economics.
- Here is how their work, based on cause-and-effect related issues, is particularly relevant in public policy.

What is the normal practice?

- Randomised experiments are carried out to find out the cause and effect of any economic phenomenon.
- Question is posed to the participants without telling them the purpose.
- But this has the problem of selection bias and tends to be narrow.
- E.g. the impact of the pandemic on schooling and children is hard to be analysed through random trials.
- To overcome this shortcoming, Card, Angrist and Imbens used the observational data approach for answering questions of causation.

What is the observational data approach?

- This approach is within the realm of natural experiments which cannot be influenced by the analyst.
- In other words, it involves observing people's behaviour in the environment in which it typically occurs.
- It makes observations as unobtrusively as possible so that participants are not even aware that they are being studied.
- The 2019 prize too had gone to Abhijit Banerjee, Esther Duflo and Michael Kremer for their work based on the 'experimental approach'.
- Evidently, both sets of theories have their place in economics and add value.

Applications

- To study the results of any action taken by, say, the government on the stakeholders concerned over a period.
- To answer simple questions on, say, a course which must be offered to students in an university.
- For companies, to fine tune their marketing plans.

What are the key questions in labour economics answered by their work?

Do more years of education lead to higher future income?

- Their experiments showed that students who studied more earned higher income.
- [Notably, this study cannot be done with a fixed set of respondents.
- Understanding the socio-economic conditions and observing the target populations over a time period is important, which the observational data approach helped.]

Does an increase in minimum wage lead to lower employment?

- This is a critical question for the labour market to find a balance.
- The labour wants a higher wage. But companies like to be selective in paying higher wage to the more efficient.
- David Card's analysis shows that employment does not suffer with an increase in minimum wage.
- Because, when minimum wage increases labour tends to become more efficient which helps the organisation to increase output.
- So, labour costs do not get burdensome.

Do immigrants create problems to the local labour force?

- This was one of the key issues in the US that came up especially under the Trump regime.
- It was alleged that immigrants tend to take over the jobs of the local population.
- David Card's analysis shows this does not necessarily happen, and it depends on the level of work.

What are the challenges?

- The larger question is whether corporates can wait for long to get these results before launching a product.
- Often the product is differentiated and cannot be compared with stories of other companies.
- So, such natural experiments tend to work better for government-driven programmes where experiences from the past provide signals for the future.
- In other words, from the public policy point of view, these theories are very relevant and more likely to be pursued.

Source: Business Line

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