



## What Africa needs to do to spur growth and create more well-paid jobs

Poverty reduction in Africa has been held back by decades of stagnant economic growth that has failed to generate enough well-paid jobs to lift the income of workers in Africa's rapidly growing labor force. The weak demand for labor among employers in the formal sector reflects a variety of constraints on wages, education, and investment, all of which stifle job creation. Constraints include the lack of flexibility in wages across sectors, the shortage of workers with relevant skills, the low productivity of labor, the weak investment climate, and the poor quality of infrastructure in most African countries. Only by becoming internationally competitive and exporting more will Africa accelerate its economic growth and create enough formal sector jobs to reduce poverty. To become internationally competitive, African firms must increase productivity.

African governments can make a variety of specific policy changes to enable firms to increase productivity, become more competitive, and therefore increase formal sector employment. This study documents how labor demand has changed in Africa over the past two decades, suggests reasons for the outcomes that have been observed, and outlines the range of policy options that need to be considered to ensure that growing labor demand helps to reduce poverty.

### The economic context for job creation in Africa

One of the key problems in labor markets in Africa is the uniformly low demand for labor in the formal sector, with job creation failing to keep pace with labor force growth. In almost all African economies, most employment expansion has occurred in the low-wage informal sector. This growth has

not provided the kind of jobs that could rapidly reduce poverty. To create well-paid jobs, manufacturing exports need to increase. Exports are critical to economic growth in Africa, because most domestic markets are very small and demand for manufactured goods is low. Moreover, because Africa's manufactured exports are now a small share of world trade, their potential for growth is high. Investment in the manufacturing sector increases the demand for unskilled labor and therefore has the most direct impact on poverty.

In most African countries, efforts to promote export-led growth and the creation of well-paid jobs have to address three types of constraints: wage constraints, educational constraints, and investment constraints.

### Wage constraints

In a well-functioning labor market, wages can be adjusted over time to take account of changes in the demand, supply, and productivity of labor, and wage levels are reasonably homogeneous across different sectors (especially the formal versus informal sectors) and different kinds of enterprises (especially the large versus small firms).

Although the evidence presented in this study suggests that many African labor markets have been surprisingly flexible, with wages rising and falling erratically at times in the past decade, average wages in Africa remain above those of competitors in East Asia and South Asia. In fact, the gap increased in the 1990s (figure 1).

Many countries in Africa have significant wage differentials that constrain the growth of jobs in the formal sector—where earnings premia are as

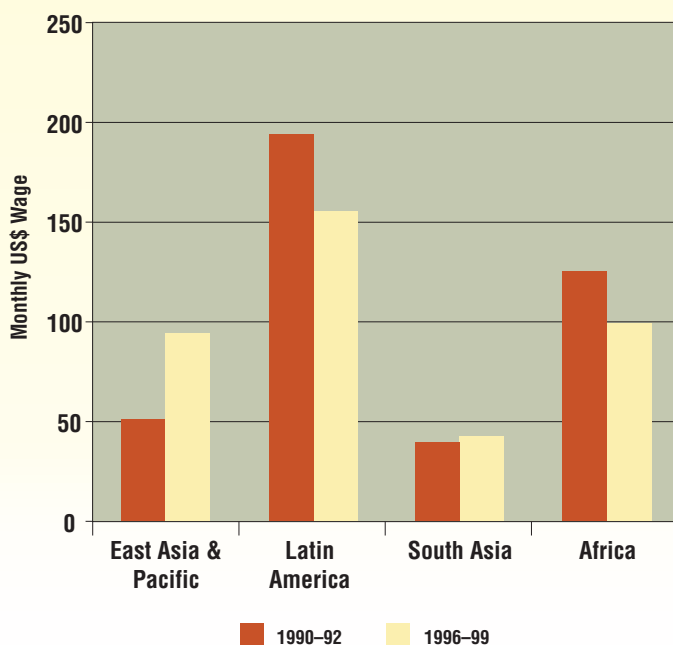
much as 60 percent in Cameroon, 57 percent in Burkina Faso, and 41 percent in Cote d'Ivoire. The tendency for large, export-oriented firms to face significantly higher labor costs than their smaller, informal counterparts is a source of severe allocative inefficiency. More important, this wage gap is a major obstacle to export-oriented growth on the continent.

## Educational constraints

Possibly the central fact about labor markets in Africa, and the fact most often used to explain low wages, is Africa's low skill levels. The percentage of educated workers in Africa is lower than in any other region of the world. In 1990 only 25 percent of the African population 15 or older had completed primary school (the comparable figures are 32 percent in South Asia and 85 percent in East Asia). At the secondary level, the gap is even larger: in 1990 only 4 percent of the African population 15 and older had completed secondary education (the comparable figures are 10 percent in South Asia and 50 percent in East Asia). To become more competitive internationally, Africa needs to boost the educational attainment of its labor force.

Furthermore, the private returns to education in Africa are low in the early years of schooling and

**Figure 1. Unskilled wages remain much higher in Africa than in East or South Asia**



increase with the level of education, which suggests that the market for human capital is central in explaining the wages of the highest-income workers. However, at the low skill levels observed among production workers in manufacturing and other industries, skill differences appear to play a relatively small role in explaining wage differentials. This evidence of low returns at low educational levels does not undermine the policy consensus that poor countries should invest in primary education, which provides a wide range of nonpecuniary benefits, particularly for girls. It does, however, emphasize the benefits of policies that support secondary and higher levels of education associated with higher returns—the educational level that meets the demand expressed by manufacturing firms.

## Investment constraints

Workers' wages and skills are not the only dimensions of productivity and labor competitiveness. Firms in almost every African surveyed report that skill constraints, for example, pose a less severe obstacle to their operations than the access to reliable infrastructure, the cost of finance, or the tax burden (figure 2).

Thus, problems with the legal and regulatory environment, the quality of infrastructure, and the costs and risks of doing business—all elements of a country's investment climate—all have the potential to erode returns on investment, dissuading firms from making investments that would generate new jobs.

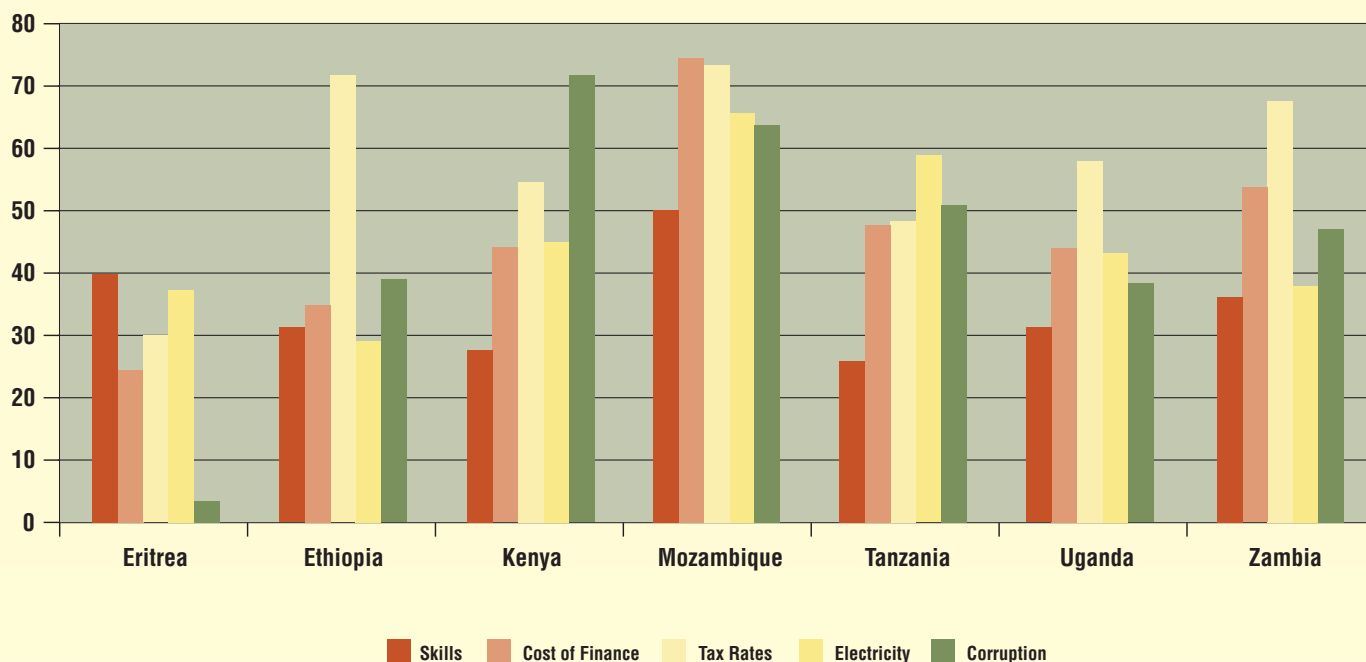
## Policy recommendations

African governments could make a variety of specific policy changes to enable firms to increase productivity, become more competitive, and therefore increase formal sector employment:

- Adjust labor market regulations to enable firms to change wage rates in response to demand and productivity shocks. Decreasing wage rigidity would help to create more jobs and narrow the differences in wage rates across sectors and firm sizes.

Lack of skills is a constraint in Africa, but other obstacles—such as corruption and high tax rates—are more severe.

Figure 2. Major Obstacles Facing African Firms




- Improve the investment climate and infrastructure. Encouraging more investment to facilitate exports must be a key part of any reform of Africa's private sector:
- Overhaul market institutions, such as laws, courts, business associations, and lobbies, to better ensure quality control and competitiveness of products, to protect property rights, and to improve enforcement of contracts.
- Encourage innovations in financial institutions, not just commercial banks, but also insurance and merchant banking, for example, by permitting hire-purchase or leasing of equipment and vehicles and more use of letters of credit, corporate bonds, and hedging instruments to provide alternative forms of finance.
- Improve commercial and business services, including the provision of warehousing, transport, utilities, auditing, marketing, market prospecting, export promotion, product design, and maintenance.
- Focus on the region of the country with the highest potential. Focusing growth efforts on a specific sector and location saves money and raises the probability of success, as the competi-

tiveness threshold required for exports is more likely to be achieved than if resources are spread thinly across a multitude of sectors and locations.

- Invest in manufacturing and agriculture. These sectors can produce for the export market, and the potential for positive consequences in related sectors appears significant in most countries.
- Adopt new technology and orient investments toward new export markets. Fostering an outward orientation designed to improve competitiveness in global markets must be a key component of African industrial policy

In sum, African economies should pursue policies that increase the skills of the labor force and complement these measures with policies that would facilitate labor demand for such skills—such as improving the investment climate and enabling wages to be aligned with productivity.

Africa's to-do list is long and may appear daunting. The good news is that not all reforms need to be adopted at once. A sound first step would be to bring down local production costs just enough to make



African firms internationally competitive, something that can be accomplished by adopting just a few reforms. The fundamental point is that Africa must build on its strengths and relax the wage, education, and investment policies that are now constraining growth. African manufacturing firms have the potential to do well internationally. In recent years, while most firms may have experienced limited success, some have performed very well. These tended to be firms that do new things, with a scientific approach

to business and state-of-the-art technology. They are often exporters. Policies that provide incentives and means to firms to adopt an export-oriented, scientific strategy are the most likely to succeed in enhancing competitiveness and generating more well-paid jobs in the formal sector. In contrast, continuing the status quo, in which firms simply aim to supply the small domestic market with basic and cheap products, will not generate the large number of new jobs needed to eradicate poverty.

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