

Labor Market Flexibility, Wages and Incomes in sub-Saharan Africa in the 1990s

June 2005

Geeta Kingdon, Justin Sandefur and Francis Teal

Centre for the Study of African Economies
Department of Economics
University of Oxford

Abstract

This paper provides an overview of how African labor markets have performed in the 1990s. It is argued that the failure of African labor markets to create good paying jobs has resulted in excess labor supply in the form of either open unemployment or a growing self-employment sector. One explanation for this outcome is a lack of labor market 'flexibility' keeping formal sector wages above their equilibrium level and restricting job creation. We identify three attributes of labor market flexibility. First whether real wages decline over time, secondly the tendency for wages to adjust in the face of unemployment, and thirdly the extent of wage differentials between sectors and/or firms of various size. Recent research shows that real wages in Africa during the 1990s may have been more downwardly flexible than previously thought and have been surprisingly responsive to unemployment rates, yet large wage differentials between formal and informal sector firms remain. This third sense of the term inflexibility can explain a common factor across diverse African economies - the high income divide between those working in large firms and those not. Those working in the thriving self-employment sector in Ghana have something in common with the unemployed in South Africa - both have very low income opportunities relative to those in large firms.

*We are greatly indebted to Simon Appleton and Trudy Owens, both of the University of Nottingham, for assistance with the Ugandan and Tanzanian household data.

1. Introduction

How flexible are African labor markets and does the degree of their flexibility affect outcomes for poverty and growth? Theories of dual labor markets in which rigid wages in one sector lead to either open unemployment or a large informal sector have a long history in thinking about African development, Harris and Todaro (1970). As we will show in this paper the 1990s were a period when across many African economies there was a failure of labor markets to create good paying jobs with the result being either rising open unemployment or a rapid expansion of the informal sector. In this paper we ask what can explain these outcomes. We will argue that in doing so it will be useful to distinguish between several possible meanings to the term flexibility or its converse 'rigidity'.

Labor markets may be inflexible in at least three different senses of the term. The first is that real wage may not adjust over time to excess supply of labor or to macroeconomic shocks. As stressed by Horton, et al (1994), the need for downward flexibility of real wages to achieve full employment in response to budget cuts and other demand reductions was seen as a crucial feature of structural adjustment programs. The second sense in which labor markets may be inflexible is that, even without macroeconomic shocks, wages are unresponsive to high levels of unemployment. The third sense of the term is that there is a substantial differential across sectors distinguished either by whether or not the sector is unionised, or whether it is subject to minimum wage laws or whether the firms are simply large.

These various meanings of the term inflexibility all have in common the notion that wages do not, for some reason, adjust to a market clearing rate. However they differ both in the possible mechanisms by which wages may be inflexible and in their policy implications. If wages do not respond to unemployment then labor markets will not clear but there is no reason to think large firms will be disadvantaged by being made to pay higher wages than smaller ones. We will argue that understanding the nature of the inflexibility that does characterise African labor markets gives important insights into key similarities across economies which appear diverse in the structure of their labor markets.

In the next section we outline the overall trends that can be found in the development of labor demand and wages across African economies. How the range of outcomes can be characterised using the framework originally due to Harris and Todaro (1970) is set out in section 3. In sections 4 we consider which of the aspects of labor market flexibility summarised above are consistent with the existing evidence as to how labor markets work in Africa. In section 5 we consider in detail the answer to one question related to this general issue of flexibility: why do large formal sector firms pay high wages? A final section provides a summary and conclusions.

2. Recent macro trends in labor markets

The first step toward understanding the factors that affect labor demand in Africa is to understand how African labor markets have performed in the recent past. Even a basic appreciation of recent trends is often hampered, however, by the difficulty in acquiring comparable information across countries and time periods for many African countries. Thus our first task is to bring together data from diverse sources to provide as comprehensive as possible a picture of labor demand patterns in Africa in the 1990s. The data gathered in this section provide an overview of how the labor market has evolved in several African countries.

How is the African labor force distributed across sectors and which sectors, if any, are producing job growth? To answer these questions Figure 1 summarizes a wide range of data from individual household and labor force surveys to provide an overview of the distribution of employment across sectors at two points in time for five African economies: Ghana, Tanzania, Uganda, Ethiopia, and South Africa (details of the data sources are found in Table A1 of the appendix). These countries have been chosen as representative cases to illustrate the three part typology of labor market outcomes developed in the following section: structural unemployment in South Africa, search unemployment in Ethiopia, and a large informal sector serving as the employer of last resort in Ghana, Tanzania, and Uganda. Looking across all of the countries some common patterns can be observed.

#1. The level of wage employment has increased in absolute terms, but failed to keep pace with a growing labor force. Figure 1 shows that in all five countries formal wage employment has increased and that this very gradual trend in job creation has been driven primarily by the private sector, with the proportion of wage employees in the public sector declining in each country. However, expansion in the formal sector has not kept pace with population growth and/or growth in the size of the labor force, meaning that the relative proportion of workers in formal wage employment has either remained constant or declined in each country.

#2. The share of the informal sector in total employment has grown rapidly. The failure of formal sector jobs to keep pace with labor force growth implies an excess supply of labor to be allocated to other sectors. In all five countries the absolute numbers of self-employed persons increased greatly during the time span documented here, and in contrast to formal sector growth, this indicates that the informal sector has increased as a proportion of the work force as well.¹ Thus the familiar stereotype of the informal sector absorbing excess

¹ The category of non-agricultural self-employment is taken to be synonymous with the urban informal sector in interpreting these data. Clearly this is inaccurate for at least two categories of workers:

labor during a period of labor force growth seems somewhat accurate for the countries listed here. This also conforms with recent evidence presented by Calvés & Schoumaker (2004) for Burkina Faso, documenting a growing tendency for entry-level workers to turn to the informal sector.

#3. African economies with high unemployment rates have relatively small informal sectors. Figure 1 illustrates the great disparity in unemployment rates and the size of the informal economy across countries within SSA. Ghana, Tanzania and Uganda display low unemployment rates, while Ethiopia and South Africa have among the highest unemployment rates in the world. In terms of the size of the informal sector, the pattern is essentially the mirror image. It will be argued in later sections that both of these outcomes—unemployment and informality—can be viewed as manifestations of excess labor supply, due at least in part to wage distortions in the formal sector. However, Figure 1 makes clear that in addition to understanding the causes of insufficient formal sector demand, it is also necessary to address the large divergence between economies dominated by unemployment and those dominated by the informal sector.

3. Labor market segmentation: How are workers allocated between employment, unemployment and the informal sector?

The picture of African labor markets which emerged from the data in the previous section was of uniformly low formal sector labor demand, with job creation failing to keep pace with labor force growth. Beyond this general feature of insufficient demand and excess labor supply, however, there was very little uniformity in labor market outcomes across African economies. Specifically, the rate of non-agricultural self employment ranged from a low of 10% of the workforce in South Africa in 1995 to over 27% in Ghana in 1998/99. Meanwhile, measured unemployment in Tanzania and Uganda is below 1%, while economies both richer and poorer reported rates at or above 30%, as in the case of South Africa and Ethiopia.

What can account for this wide range of outcomes? This section presents a basic structure for understanding labor market segmentation and then proceeds to a more in depth analysis of three emblematic cases: structural unemployment in South Africa, search

entrepreneurs and business owners in the formal sector who constitute a very small share of the total, and high-income professionals such as attorneys, independent financial service providers or doctors. Inclusion of both groups implies that earnings data for self-employment will over-estimate earnings in the informal sector. Nevertheless, it should be stressed that the special attention given to wage employment in the following sections is targeted only at identifying sources of high-earnings opportunities, rather than at giving preference to wage employment over self-employment or informal activities per se.

unemployment in Ethiopia, and widespread informality in Ghana. One way of approaching this question is through an adaptation of the familiar Harris-Todaro dual economy model. Consider an urban economy which is divided between three classes of workers: formal sector workers, informal or self-employed workers, and the unemployed. Suppose that agents entering the labor market face the option of queuing/searching for a formal sector job or pursuing self-employment in the free-entry informal sector.² The number of workers falling into each category is depicted on the horizontal axis of Figure 2, with their respective wages on the vertical axes (formal sector employment and wages are read from the left, the informal sector from the right).

Agents base their choice of which sector to enter on two factors: the wages available to them and their perceived probability of finding a job in each sector. Individual characteristics may clearly influence both of these. In a perfectly competitive market wages would be the same in both sectors for an individual with given characteristics, with employment divided at the crossing point of the formal and informal sector labor demand curves (read from the left and right axes, respectively). In contrast, standard Harris-Todaro analysis of African labor markets posits an institutionally rigid formal sector wage, w_f in the figure, far in excess of the market clearing level. This high formal wage has two direct effects: first it constrains formal sector labor demand; second, the prospect of securing lucrative formal sector work entices some share of workers who would otherwise enter the informal sector to remain unemployed and search for formal employment. The probability of finding such a job is assumed to decline with the number of people searching, creating an equilibrium level of job searchers depicted by the line pp' . The overall result is a segmented labor market with large earnings differentials and insufficient labor demand, stemming from institutional rigidities.

Turning to the analysis of individual case studies, Figure 2 suggests at least three broad factors to be considered in studying the segregation of a given labor market. First of all, earnings differentials between formal and informal employment remain central. These may include public sector wages or the wage premium garnered by unionized workers. They may also include considerations related to efficiency wages and more general bargaining issues that drive a wedge between wages for identical workers. Second, differences in individual characteristics might influence a worker's probability of finding formal sector worker, making the decision to risk open unemployment more or less attractive. For instance, more educated workers may see fit to forego the informal sector and queue for government jobs. Finally, the decision to queue for formal work is almost certainly affected by an individual's ability to support herself in unemployment.

² This builds on the assumption, consistent with some evidence but open to debate, that agents cannot or do not simultaneously hold informal sector employment and search for a formal sector job.

The dominant view of unemployment in developing countries is that open unemployment is due to search. This indeed was the view underlying the initial presentation of the Harris-Todaro (1970) model. If search for a formal sector job from the unemployed state is more efficient than from informal employment, those able to afford unemployment remain openly unemployed and search. However, the poor cannot afford it. Thus, if most unemployment in the economy is of the voluntary search variety, the relationship between unemployment and household income is likely to be positive because the well-off will choose search unemployment but the poor will enter informal sector employment. Whether this is the case for South Africa is considered next.

Case 1: Unemployment and Self Employment in South Africa

Unemployment in South Africa, using the broad definition, rose from 31% in 1993 to 42% in 2003. On the 'narrow' definition, where the labor force is defined as the employed plus the searching unemployed, unemployment rose from 17% in 1995 to 32% in 2003. (See Tables A2 and notes to that Table). This high and rising level of unemployed reflects in part the failure of either the formal or informal sector to provide new jobs and in part an unprecedented growth in the size of the labor force. Labor force participation rates of women rose by a remarkable 15 percentage points in the eight years between 1995 and 2003. They rose by 5 percentage points for men in that period. The increase in participation rates for both men and women is likely due to the lifting of apartheid restriction on movement to urban areas and the new possibilities of employment that this was perceived to open. Education levels have risen and participation rates typically increase with education level, particularly so for women. Lastly, the significantly higher increase in female than male participation rate appears to be because of a decline in women's access to male income due to increase unemployment among males, the HIV epidemic, and increased female headship due to change in household structure (Casale and Posel, 2001).

Kingdon and Knight (2004) find little support for the idea that people choose to be unemployed, one interpretation of the unemployment outcome of the Harris-Todaro model set out in Figure 2. The unemployed are, on average, substantially worse off than the informally employed – both in terms of income and expenditure and in terms of a range of indicators of well-being. This contradicts the luxury or search unemployment interpretation, whereby higher income increases the incentive to remain searching and reduces the incentive to obtain informal employment.

It might be argued that, given the disutility of work, some people prefer to substitute leisure for higher monetary income, so that their apparent deprivation cannot be used to argue that they are constrained to be unemployed. However, in order to interpret unemployment as voluntary, such people should be happier (or, at least, not unhappier) than

employed people. Data show that the unemployed are very substantially (and significantly) less happy than informally employed people, suggesting that their unemployment is not due to choice. Finally the average duration of uncompleted spells of unemployment (2.2 years) is too long to sustain a person in search unemployment. The fact that the unemployed are significantly poorer and unhappier than the informally employed suggests that jobless persons' lack of entry into self employment is due to some impediments to entering the productive part of the informal work.

Kingdon and Knight (2004) show that despite recent growth in informal employment, South Africa is an international outlier in terms of the small size of its informal sector: the ratio of non-agricultural informal sector employment to unemployment is 0.7 in South Africa but 4.7 in Sub Saharan Africa, 7.0 in Latin America and 11.9 in Asia. As defined by the South African statistical agency, the 'informal sector' absorbed only 15.7% of the workforce in 1997 and 18.8% in 2002.

What prevents or discourages the unemployed from entering the informal sector? In a survey of 500 informal sector operators in the Johannesburg area in 1999, respondents listed crime, lack of access to credit, lack of access to infrastructure and services, and need for training as the top four constraints on their businesses. Chandra et al. (2002, pp. 26, 30) find that the informal sector operators had required substantial start-up capital (averaging over 2.5 times the average monthly earnings in the sample). New small businesses have to rely on their own financial resources: there was very little access to either formal or even informal credit. However, these problems exist in most developing countries and do not explain the smallness of the South African informal sector.

One thing that does distinguish South Africa is the observed effectiveness of enforcement of labor regulations. Labor market institutions such as Industrial Councils (now called Bargaining Councils) and Wage Boards set sectoral minimum wages and stipulate working conditions in many industries in South Africa. These minimum wages and stipulations are applied to all firms in the industry and region, irrespective of size, *via* the 'extension' provision. There are serious penalties for flouting the agreements of these institutions. Such provisions impose a burden of high labor costs on small firms and it is likely that they would seriously inhibit the entry and growth of such firms. This is one explanation for the large average size of firms in South Africa. These institutional features may inhibit small firms but they should not inhibit individual entrepreneurship, i.e., owner-operators.

Case 2: Search Unemployment in Ethiopia

As of 1994, the unemployment rate among urban males in Ethiopia was approximately 50%, one of the highest rates observed anywhere in the world. With per capita

GDP at the time of only \$520, Ethiopia provides a striking contrast to the folk wisdom that open unemployment is a rich country phenomenon and surplus labor is absorbed by the informal sector in poor countries. What do we know about the unemployed in Ethiopia and what affects their probability of finding work?

Examining the composition of the urban unemployed, Serneels (2004) finds that a majority are well educated and come from middle class households. They are predominantly young, with the highest unemployment rates at 19 years of age, have a median duration in unemployment of nearly 4 years, and a majority have never held paid work in their lifetimes. It is important to note also that approximately half of young unemployed males in urban Ethiopia report that they are searching for a job in the public sector, implying job queues for this sector far in excess of the employment opportunities.

Turning to the factors which determine whether a young male becomes employed or unemployed, Serneels finds that education raises the probability of unemployment up to the tertiary level, which has an indeterminate effect. Given that returns to education are significantly higher for males in the public versus private sector in Ethiopia (Krishnan, et al, 1998) this pattern is consistent with the basic framework described above: personal characteristics which increase an individual's potential earnings in the public or formal sector and/or increase their probability of securing such a job will likewise increase their probability of entering the unemployment pool vis-à-vis the informal sector. Similarly, young males whose father is a civil servant are more likely to be unemployed—perhaps due to a networking or informational advantage in public sector job search—while those whose father is self-employed are less so. However, while education and social capital appear to contribute to the likelihood of unemployment, one must be careful not to assume that it is purely a middle class phenomenon, the familiar “luxury unemployment.” Once unemployed, the probability of finding work is positively correlated with family wealth, with poorer job searchers exhibiting significantly longer unemployment duration.

Finally, although the precise causes and potential cures for high unemployment in Ethiopia require further research, the stylized facts reviewed here suggest that public-private and formal-informal wage differentials may play a central role. Wage data in Table A3 of the appendix show that while the public-private gap in the formal sector is small, the gap between formal employment and self-employment widened dramatically in the 1990s, reaching 85% by 1997.

Case 3: High Informality and Low Unemployment

While South Africa and Ethiopia represent two important cases within SSA, most of the labor markets in SSA economies for which we have comparable data display a very different pattern of labor market outcomes. Ghana, Uganda and Tanzania all have a large self-

employment sector which absorbs increases in the labor supply. The differences we observe are not due to differences in the rate of labor supply increase which has been rapid in all these countries. The inference would appear to be that the reason for the differential rates of growth of the informal sectors within these economies is a direct result of the rate of growth of formal sector employment. It is possible that for most African economies – we obviously exclude Ethiopia and South Africa – there is a competitive free-entry self-employment sector in which earnings are not significantly different from the lower part of the distribution among wage earners in firms. As we document below, wage dispersion within the firm sector is very large. In terms of our framework for African labor markets, this suggests that in these countries informal sector wages have fallen to clear the labor market. Rather than unemployment, the primary issue of policy concern is the low wages at which the informal market clears.

4. ‘Flexibility’ in African labor markets

How can the diversity of outcomes across Africa documented in the previous section be explained? In particular which, if any, of the three dimensions of labor market inflexibility identified in the introduction can help in explain the patterns we observe in unemployment and the lack of formal sector employment growth. In this section we review the evidence for each of the three dimension of inflexibility.

Wage adjustments over time

The most commonly noted aspect of labor market flexibility is the ability of aggregate real wages to decline over time. Based on country studies there are differences of view as to whether African labor markets can be considered flexible in this sense of the term.

Reviewing the Kenyan experience through the two oil shocks, a severe drought in 1984 and subsequent stabilization programs, Milne & Neizert (1994) conclude modern wages were quite flexible: “Through the adjustment phase, real wages in all modern sectors fell, although the drop in the public sector was more pronounced. Indeed, real wage rates seem to have provided the major part of the adjustment as there do not appear to have been major changes in the urban unemployment rate.” (p. 454)

Writing on Ghana in the same volume, Beaudry and Sowa (1994) note that wages differentials between sectors were fairly quick to respond to demand shifts (toward agriculture and industry, away from services) brought about by structural adjustment and that “a flexible labor market probably helped achieve the macroeconomic improvements observed in Ghana during the 1980s.” (p. 402)

Even in South Africa where, as will be discussed below, unions are an important part of the wage setting process, real wages for Africans have fallen over the period from 1995 to 2003 according to the data presented in Casale et al (2004).

Despite this evidence for flexibility, a detailed assessment of wage misalignment for CFA franc economies by Rama (2000) concluded that wages in these countries showed some evidence of real rigidity in that they closely tracked public sector wages and consumer price indices. In an international comparison, Rama found that wages in CFA countries from 1985-93 remained considerably higher than could be explained by their level of development, urbanization, industrialization or human capital intensity. Similarly, evidence presented by Krishnan, et al (1998) shows that real wages in the urban Ethiopian labor market have been surprisingly unresponsive to downward pressure from economic reforms, even amidst high rates of open unemployment.

For two countries more detail of real wage changes in the manufacturing sector can be given. Figure 3 presents data from the World Bank's Africa Regional Program on Enterprise Development (RPED) and follow-up work at the Centre for the Study of African Economies (CSAE) which enables real wage changes to be measured over the 1990s in which there are controls for the human capital characteristics of the worker and the size of the firm in which they work. As discussed in later sections, firm level variables such as unionization, capital stock, formal sector registration, and firm size itself are highly correlated with wages even after allowing for differences based on human capital. Controlling for firm size is a means of providing a more comparable picture of wages over time for workers in firms of a given size.

The first point to be drawn from Figure 3 is that real wages in these manufacturing sectors have experienced quite erratic fluctuations over the 1990s. For both countries the Figure shows the percentage change in real wage relative to the base year of 1992. Thus Ghanaian manufacturing wages experienced a 30% drop from 1990 to 1995 and then a substantial rise such that by the end of the decade they were only modestly below their level of 1992. Clearly, explaining this roller-coaster ride in real wages is a very important research question and at present we have little idea how these changes over time are to be explained. The contrast with Tanzania is striking in that over the decade real wages in the Tanzanian manufacturing sector grew quite rapidly. By 2000 they were some 40 per cent above their 1992 level.

Does this more detailed evidence from the manufacturing sector suggest flexibility of wages over time? It certainly suggests that any notion of a fixed real wage is not a useful way of modeling outcomes - very substantial changes in real wages within the sector have been observed. However it does not rule out the possibility that workers within a firm can in the long run resist pressures for declines in wages. The declines in Ghana occurred in the context

of a highly variable rate of inflation. It is possible - we need longer runs of data to know - that the changes in real wages reflect not the flexibility that comes from excess supply pushing down prices but from mistakes being made by workers in setting their nominal wages when they cannot accurately predict the rate of inflation.

So far we have considered country based data. What of comparison across countries and between Africa and other regions. Figure 4 shows average U.S. dollar wages across selected regions at the beginning and end of the 1990s (Freeman and Oostendorp, 2000, OWW database). What appears striking is that while average wages in Africa have fallen during the 1990s they remain above the level for East Asia. The data presented in the Figure are based on population weighted means which ensures that the data for East Asia for the 1990s is dominated by China. The contrasts between East Asia and SSA which have been a prominent aspect of relative international growth rates for a long period have, if anything increased in the 1990s. Certainly the macro data we have suggest that wages in SSA remain, on average, high relative to their East Asian competitors.

Wage adjustments in response to unemployment

Another aspect of flexibility stressed in recent empirical work on developed country labor markets is the responsiveness of wages to local unemployment rates, a relationship which Blanchflower and Oswald (1995) have termed the “wage curve.” Tests of this relationship in urban African labor markets by Hoddinott (1996) for Côte d’Ivoire and Kingdon and Knight (1999) for South Africa have yielded results strikingly similar to those for the United States and Canada: a wage-unemployment elasticity of approximately -0.1. The finding of a wage curve of this form, particularly for South Africa, is both a surprising and important result.

It is surprising because it has often been assumed that the South African labor market is particularly inflexible. Trade unions play an important role in wage determination in South Africa as will be discussed below. It is important for two reasons. First, it suggests strong similarities in labor markets across economies with very different levels of per capita income. The second implication of the finding is that the size of the wage fall is very large. Broadly the evidence suggests that a rise in unemployment of 10 per cent lowers wages by 1 per cent and that this elasticity appears to be constant over the range of unemployment from 0 to 30 per cent. These figures imply that a rise in regional unemployment in South Africa from 10 to 30 per cent reduce wages by 20 per cent. While the wage curve elasticity is low, the high levels of unemployment imply relatively large effects on wages.

Wage differences between formal and informal sectors

How important is the distinction between the formal and informal sector or between large and small firms for understanding the pattern of wage differentials in African labor

markets? The term the informal sector refers to a large range of activities from urban self-employment through household enterprises to wage employment in small firms. We first consider distinctions between the formal and informal sectors within wage employment before turning to the gap between self-employment and wage employment.

It could be objected that any differences between formal and informal sector wages simply reflect skill differences between workers in each sector. Thus comparisons across sectors need to use earnings regressions to examine differences between sectors while controlling for differences in personal characteristics including observable human capital. Lachaud (1995) uses this technique to compute formal sector earnings premia of 57.1% for Burkina Faso, 60.3% for Cameroon, 40.9% for Côte d'Ivoire, and 9.6% for Mali. Miller and Vallée (1995) and Vallée and Thomas (1994) confirm these orders of magnitude for Cameroon, as do Vijverberg and van der Gaag (1993) for Côte d'Ivoire. In South Africa, Kingdon and Knight (2004) find that 50-64% of the large formal-informal earnings difference remains after controlling for characteristics, depending on whether OLS or selectivity-corrected earnings functions are used.

A closely related approach is to compare the wages of similar workers in establishments of varying size. Firm size can provide a clearer basis for comparison than the formal-informal distinction which is often inconsistently defined across studies. Examination of employer-size wage differentials also allows for direct comparison with developed country labor markets, where the positive relationship between size and wages has been the subject of an enormous amount of research.

To show how these size premiums translate into effects on wages across firms Figure 5 shows the wage differential between a firm with 20 versus 100 employees for a production worker in the manufacturing sector with a given set of human capital characteristics. It seems safe to conclude from Figure 5 that wage differences between the large and small firm sectors are uniformly large across African countries, they significantly exceed those observed in developed economies and they cannot be explained by the observed skills of the workforce.

Recent work in this area has investigated if this size effect is due to the *unobserved* skills of the workforce. The collection of panel worker data, to match the panel data of the firm, has made this possible. Söderbom, Teal and Wambugu (2002, forthcoming) show that this size effect is only in small part due to unobserved skills. Changes in the size of the firm, controlling for all time-invariant aspects of both the firm and the worker lead to increases in earnings. While this firm size effect on wages is not attributable to skills (observable or unobservable), it is consistent with a wide range of possible explanations including aspects of efficiency wages and bargaining. The section below examines a number of these potential explanations in greater detail.

Measuring self-employment incomes

Looking at the raw earnings data it appears that wage earners, and public sector employees in particular, have a distinct advantage over the self-employed. Table A3 in the appendix shows that in 1998/9, for instance, the differential for wage-employment over self-employment in urban Ghana was 17%, while the public sector wage differential was over 50%. For Ethiopia by 1997 these gaps had spread to nearly 100 and 150% respectively. In South Africa in 1993 among Africans, the differential for wage employment over self-employment was 76%, while the public sector over self-employment wage differential was 170%.

However for much the same set of reasons that we think larger firms may employ different quality labor from that found in small firms we might expect the self-employed to differ in many respects from those in wage employment. There is in making these comparisons a further problem in that measuring self-employment incomes is far more difficult than measuring wage incomes.

In this sub-section we will use the Ghana data to investigate how the incomes of the self-employed can be measured and compared to incomes from wage employment. In the GLSS surveys which have been conducted over a long period from 1987/88 to 1998/99, questions were asked which sought to elicit the incomes of the self employed. There are in fact at least two quite different methods for seeking to measure self-employment incomes. One is to directly seek information on net income, the second is to impute income from a production function.

Direct Measures

In GLSS4, the section on employment asked individuals in the households what they received in payment for their activities - whether the payment be from wage or self-employment. Clearly there is for the self-employed some ambiguity as to how these questions were interpreted. Did the answer refer to their gross revenues or net and, if net, which costs were deducted from revenues? If the answers do refer to net incomes (ie. revenues less costs) then the income measure combines income from labor, human and physical capital. If we are interested in comparing the returns to labor across the wage and self-employment sectors we need some method of imputing the returns to capital (both human and physical).

What do the GLSS data imply for differences between wage and urban self-employment incomes using this direct method of measurement? Figure 6 shows the age-earning profiles for the self-employed and wage employees from all four waves of the GLSS data. Incomes are measured in US\$ so Figure 6 shows that incomes for those aged 20 incomes are virtually identical at US\$245 per year (= $\exp(5.5)$). The figure also shows that the earnings profile is steeper for the wage earner than the self-employed so that by age 45, the

wage earner has an income nearly 30 per cent higher than the self employed. [The figure shows that the wage earner income is US\$518 ($=\exp(6.25)$) and that of the self employed is US\$403 ($\exp(6.0)$)]. While this is a substantial difference, possibly the most striking aspect of the result is how close are measured incomes for the self-employed and wage employees over the age range from 20 to 30.

It might well be thought that the measures of income for the self-employed would be so poor as to offer little insight into their income opportunities. It is here that the advantage of having four independent surveys is relevant, for it is possible to see if a similar pattern emerges from all four cross-sections. Appendix Table A4 shows the regressions for the four cross-sections available. What seems striking is how similar are the age earnings profiles across these four independent surveys. This method of measuring incomes does pick up some systematic variation of the incomes of the self-employed with age.

Indirect Measures

The second method for imputing income to the self-employed is through the calculation of the incomes from household enterprises. There is a section in the GLSS survey which allows for this. As far as we are aware, no comparison has been done between these two sources of information. What we do in this sub-section, is to compare the incomes that result from the direct methods from household surveys (in the previous sub-section) with the use of the firm level data which the CSAE has collected since 1992.

This indirect method infers the incomes that accrue to labor from a production function. In the simplest case, a production function shows the relationship between two inputs, capital and labor, and the value-added these inputs produce. In work at the CSAE, we have shown that a satisfactory way to represent this requires slightly more generality in that raw materials and indirect costs are other important inputs that need to be modelled, see Söderbom and Teal (2004). In the simplest form of this production function, the marginal product of labor - the extra amount of output each person working in the firm produces - is proportional to the average product which is simply output divided by labor input. Thus in assessing the income available to the self-employed, we ask what is the marginal product of labor in very small firms. In doing so, we assume that the self-employed whose incomes are measured in the household surveys are similar to those working in micro enterprises in the firm surveys.

To infer incomes for the self-employed by this indirect method, we need to know both the average product of labor in small firms and the relative importance of labor in producing output. How much does labor productivity differ by firm size? For micro enterprises (those employing less than five people) the median labor productivity is US\$2,433. This compares with a median labor productivity of US\$8,600 for firms with more

than 100 employees. To convert this number for average productivity to the marginal product for labor, we need to know the relative importance of labor in producing output. Söderbom and Teal (2004, p. 380) gives a factor of 0.17 which implies a labor income to working in small enterprises of US\$414 ($0.17 \times 2,433$).

Thus this indirect method gives labor income to the self-employed of US\$414. The direct method used above gave a figure of US\$403 for a self-employed person aged 45. It would seem there is a remarkable similarity between the two methods in producing an estimate of labor income for the self-employed. Further the gap, at least for younger workers, between self-employment and wage earnings is small. We have evidence here that for the type of economy we have termed 'High informality and low unemployment' wages are sufficiently low to clear the labor market.

5 Why do large formal sector firms pay wages far in excess of workers' apparent alternatives?

In their analysis of wage gaps in Cameroon, Thomas and Vallée (1996) list six possible causes of labor market segmentation in Africa, i.e., high formal sector wages which are *not* explained by workers' skills and productivity.

- High formal sector wages may be due to the presence of trade unions in the formal sector.
- Minimum wages and other labor regulations, which are by definition only applicable in the formal sector, may dictate wage levels.
- Monopoly rents accrue to formal sector firms which are insulated from competition by the regulatory structure, and these rents may be shared with employees through a bargaining process.
- It may be worthwhile for only the most able managers to bear the expense of formal sector registration, contributing to higher productivity and, in turn, wages in this sector.
- Because larger size is often associated with higher turnover and monitoring costs, formal firms may pay efficiency wages to retain employees and increase productivity while informal firms do not.
- Finally, firms may discriminate on criteria not related to productivity, such as gender or ethnicity.

The source of wage differentials and labor market segmentation is a matter of contentious debate, precisely because the policy implications are so stark. If, on the one hand, high formal sector wages simply reflect the greater human capital and productivity of workers

who secure these jobs then the lack of formal sector labor demand in many African economies can be directly attributed to a shortage of skilled labor. On the other hand, if high wages in the formal sector are attributable to unions and government regulations, stimulating labor demand will require not an increase in skills but rather reforms in labor market institutions. Thus the task of this section will be to assess the evidence on the role of labor market institutions in explaining wage setting behavior in the formal sector.

The following paragraphs review the evidence on two categories of labor market institutions: unions and other bargaining mechanisms. The discussion draws heavily on several studies which have employed firm and worker data from Africa's manufacturing sector collected through the World Bank's Regional Program for Enterprise Development (RPED), as well as numerous household surveys.

Trade Unions

It is useful to distinguish the possible effect of unions on two separate dimensions of labor flexibility outlined earlier: wage adjustments over time and labor segmentation between sectors. In his analysis of wage misalignment in CFA countries, Rama (2000) addressed the first of these questions, asking whether unions can explain the incomplete adjustment of wages in these countries during the 1990s. He concludes that "private sector unions... seemed more instrumental in achieving wage moderation than wage drift. Their members usually had lower wages than similar, non-unionised workers, which probably reflects the 'subordinate' nature of the labor movement." This latter observation is based on a review of research findings measuring union wage premiums in which a number of studies report a *negative* union wage premium for CFA countries (see Table A5, the relevant part reproduced from Rama, 2000, in the Appendix).

A second question is whether unions can explain labor market segmentation between firms or sectors. While focusing on a different subset of countries, research on this topic has produced dramatically different findings on the size of the union wage premium in Africa. For the case of South Africa, Schultz and Mwabu (1998) find an average union wage premium for African workers of 47%.³ In addition, they use a quantile regression approach to examine the effect of unionization on wages for workers in each segment of the income distribution. For African workers at the 10th percentile, unionization is estimated to increase wages by 145%, while at the 90th percentile the effect is only 11%. For white workers the numbers are significantly lower, at 21% and negative 24% respectively.

Work undertaken by CSAE updating the Schultz and Mwabu (1998) work suggest that this union premium has risen markedly in the period from 1995 to 1999. Even controlling

³ Butcher and Rouse (2003) argue that a much lower figure for the union wage premium among Africans workers – around 20%, obtained by controlling for industry – is the relevant statistic. This places the South African union premium in 1993 at more comparable levels to the U.S. and U.K.

for industry the union premium in 1999 was 53.8 per cent, massively higher than that observed in OECD countries (see Table A5). Controlling for firm size, Blunch and Verner (2004) perform a similar analysis for the Ghanaian manufacturing sector and are unable to find a significant wage effect from unionization when looking at workers as a whole, but find a 34% premium at the 10th percentile.

Work to date emphasizes the remarkable divergence that has been observed for the union premium. More evidence is becoming available as a result of the firm surveys carried out in Africa's manufacturing sector. These surveys collected both labor market and firm information. It is thus possible to control for the human capital of the workers and for firm characteristics for similar types of firms over several countries. It may well be thought that the South African economy is an outlier within Africa as far as the importance of the union premium is concerned. Figure 7 draws from these labor and firm surveys for Ghana, Kenya, Nigeria and Tanzania to provide a comparison with the union premium for South Africa.

Figure 7 shows the union premium for the five countries for which we currently have comparable data. The first column shows the union wage premium for a production worker in the manufacturing sector with no controls, while in the second column there are controls for gender and differences in skills measured by age, years of education, and job tenure (though none of the underlying regressions includes controls for other aspects of the firm, either sectors within manufacturing or size). While controlling for skills dramatically reduces the union effect, the remaining union premia are still very large by international standards. Indeed, premia of 49 and 32% for Ghana and Nigeria respectively are as high or higher than the average union effects found for South Africa, suggesting this latter country may not be so idiosyncratic as sometimes assumed. Furthermore, the importance of differences across quantiles noted in the work discussed above suggests that these averages hide important differences that require investigation. As they stand, they suggest an important role for unions as part of the institutional structure that drives wages across workers with similar levels of human capital.

In conclusion, while there is an emerging body of evidence to suggest that unions play a central role in many African labor markets, systematic identification of their effects is complicated by the factor that unionization is highly correlated with other leading explanations for labor market distortions including the other regulations reviewed in this section, monopoly power of producers, and firm size more generally. The success of the quantile regression approach in identifying union premiums for low wage workers may relate precisely to their ability to compare these workers — concentrated in smaller firms — with a baseline of low-wage non-union workers for whom union contracts do not apply. Separating out such a control group within large formal sector firms is extremely difficult. Further research in this area should focus on disentangling such potentially correlated factors as union

status, regulatory coverage, firm size, worker skills, and capital intensity.

Rent-seeking, institutions and efficiency wages

So far we have focused on a model of the labor market where the large observed deviations from competitive wage levels (i.e., from wages based solely on individual human capital characteristics) are due to overt institutional or regulatory interventions. However, large formal sector firms may also pay high wages to increase labor efficiency, or as a result of rent-seeking behavior by workers which may or may not occur in a union context.

In the case of efficiency wage models, a link between wages and effort or productivity may arise for a variety of reasons, including the increased fear of dismissal when wages are high (Shapiro & Stiglitz, 1974), a tendency for better paid workers to be better nourished and in better health (Dasgupta & Ray, 1986), increased morale from above average earnings, and so on. Similarly, above market-clearing wages may reduce labor turnover, creating a necessary link between high wages and large formal firms (Stiglitz, 1974; Manning, 2003).

One major piece of empirical evidence already described which is consistent with the idea of efficiency wage setting in Africa is the wage curve literature discussed in Section 3. The causal link from unemployment to lower wages found in this literature is inconsistent with purely competitive wages based on human capital alone, but can be readily explained in an efficiency wage model such as that of Shapiro Stiglitz. Along these lines, Fafchamps and Söderbom (2004) use worker-firm matched data across 10 African countries from the RPED surveys to establish a connection between firm size and wages, and show that this prominent feature of the data is consistent with wage setting behavior determined by labor management concerns. In support of this hypothesis, they show that worker effort and productivity increase with both the level of supervision and wages, two incentive mechanisms stressed in many efficiency wage models.

One implication of these findings is that labor management may be a more acute problem for African firms than their competitors elsewhere. Fafchamps and Söderbom find that the wage-elasticity of effort is around 0.45, compared with 0.74 in Morocco, which the authors posit as a control case. A second key implication of the whole class of efficiency wage models is that the high wages observed in larger, more productive formal sector firms need not depend on labor market institutions, but rather are a necessary result of the firms' organizational structure. As far as policy is concerned, the link from labor market "flexibility" to job creation is effectively broken.

Rent-seeking models attribute wage differentials to a process of bargaining – implicit

or explicit – that takes place between workers and the owners of capital over the rents or profits from production. Evidence of such “rent-sharing” effects on wages has been found for a wide range of countries, including Ghana (Teal, 1996) and Zimbabwe (Velenchik, 1997) within Africa. Furthermore, as Blanchflower, et al (1994) note, these effects appear to be fairly consistent across countries with widely differing institutional structures and unionization rates, indicating a role for bargaining even in the absence of unions.

In conclusion, the evidence presented at the beginning of this section makes clear that a subset of African workers earn large wage premia which are inconsistent with competitive wage setting and cannot be explained by their skills alone. However, there are competing models to explain these wage differentials, and the relative importance of these different effects may produce very different policy conclusions.

6. Summary and Conclusions

This paper has sought to provide an overview of how African labor markets have performed in the 1990s and to ask how far these outcomes can be explained by the inflexibility of the labor market. In this section we summarise what we have found and draw conclusions for policy.

We began by drawing on a wide range of data sources to provide an overview of recent outcomes in African labor markets. We found that in all five countries formal wage employment has increased and that this very gradual trend in job creation has been driven primarily by the private sector, with the proportion of wage employees in the public sector declining in each country. However, expansion in the formal sector has not kept pace with growth in the size of the labor force, meaning that the relative proportion of workers in formal wage employment has either remained constant or declined in each country. Second, this common result of excess labor supply takes widely divergent forms across the continent delineated as either structural unemployment as in South Africa, search unemployment as in Ethiopia or the growth of the informal sector as in Ghana, Tanzania and Uganda.

South Africa, the largest economy in the region, suffers one of the highest unemployment rates in the world. Evidence suggests that individuals who are out of work are not unemployed voluntarily, in any meaningful sense of the word, thus the search for an explanation turns primarily to structural constraints preventing job creation. While at nearly the opposite income extreme within the region, urban Ethiopia records similarly high unemployment rates to South Africa. However, examining the profile of unemployed persons shows them to be disproportionately young, well-educated, and from affluent backgrounds (in contrast to South Africa). Evidence suggests high public sector wages may contribute to job

queuing by the relatively educated. Finally, a majority of African economies lie somewhere in the income range between Ethiopia and South Africa, but report low or negligible levels of open unemployment. Instead, a large informal or self-employed sector dominates the economy. We have focused on diagnosing the causes of this labor market segmentation and the failure of large formal firms to absorb the pool of low-wage labor.

Labor market policy debates frequently invoke the concept of “flexibility.” In this paper we have identified at least three distinct attributes of labor markets all related to the flexibility of wages and employment. The ability of real wages to decline over time; the tendency for wages to adjust in the face of unemployment; and the extent of wage differentials between sectors and/or firms of various size.

We have reviewed evidence showing that African labor markets may be surprisingly flexible in the first two senses—rising and falling erratically at points in the last decade, and exhibiting a “wage curve” relationship with respect to unemployment. However, there seems compelling evidence that “rigidity,” in the sense that we observe substantial wage differentials between firms and sectors, certainly characterizes African labor markets. This third sense of the term inflexibility can explain the common factor across African economies - the high income divide between those working in large firms and those not. Those working in the thriving self-employment sector in Ghana have something in common with the unemployed in South Africa - both have very low income opportunities relative to those in large firms.

In the case of Ghana this process of “informalization” implies a shift within wage employment to lower paid jobs so average wage earnings may be falling even if wage rates for given types of jobs are not. In the case of South Africa the increase in unemployment lowers average incomes as the proportion of the labor force with wage jobs declines.

Table A1. Employment by Sector for Selected Countries

Ghana	1987/88		1988/89		1991/92		1998/99					
	%	000s	%	000s	%	000s	%	000s				
Wage Employees	17.3	1,121	18.1	1,215	15.4	1,143	13.2	1,166				
Government	8	518	7.9	530	7.8	579	5.9	521				
State Enterprise	1.9	123	2.3	154	1.2	89	0.6	53				
Private	7.4	480	7.9	530	6.4	475	6.7	592				
Self-employment	19.5	1,264	24.2	1,624	23.5	1,744	27.3	2,411				
Unpaid Family	2.2	143	1.1	74	1.3	96	0.3	26				
Agriculture	58.7	3,804	54.6	3,664	56.7	4,207	55.7	4,918				
Unemployed	2.2	143	1.9	127	3.2	237	3.5	309				
Total Labor Force	100	6,480	100	6,710	100	7,420	100	8,830				
	1992						1999/00					
	Total		M		F		Total		M		F	
Uganda	%	000s	%	000s	%	000s	%	000s	%	000s	%	000s
Wage Employment	15.3	968	24.2	772	6.3	196	13.3	1,050	21.3	807	5.9	243
Public	5.4	343	8	254	2.9	90	3.4	265	5.3	201	1.6	65
Private	9.9	625	16.2	518	3.4	106	9.9	785	16	607	4.3	178
Self Employment	7.6	482	9.5	302	5.7	180	10.3	815	11.8	447	8.9	367
Agriculture	76.2	4,819	65.3	2,083	87.4	2,736	75.5	5,959	65.5	2,477	84.7	3,481
Unemployed	0.9	55	1.1	34	0.7	21	0.9	68	1.3	50	0.4	18
Total Labor Force	100	6,324	100	3,191	100	3,133	100	7,892	100	3,782	100	4,110
	1991/92						2000/01					
Tanzania					%		000s		%		000s	
Wage Employment					7.93		899		7.40		1,071	
Government					3.79		430		2.17		314	
State Enterprise					1.95		221		0.72		104	
Private					2.19		248		4.51		653	
Self Employed					5.23		593		8.44		1,221	
Unpaid Family					5.65		640		9.38		1,358	
Agriculture					80.41		9,114		69.04		9,992	
Unemployed					0.79		89		1.20		173	
Total Labor Force					100.00		11,335		100.00		14,473	
Total population							24,522				31,878	
	1993 (Saldru)			1995 (OHS)			2003 (LFS)					
South Africa (%)¹	Total	Male	Female	Total	Male	Female	Total	Male	Female			
Wage employment	60.9	66.4	54.5	60.2	70.8	47.0	47.7	52.9	42.3			
- Public	15.0	15.7	14.2				9.4	9.5	9.2			
- Private	45.9	50.7	40.3				38.3	43.4	33.1			
Self employment	7.9	6.6	9.3	10.4	6.7	15.0	10.6	11.3	9.8			
- Agriculture	0.4	0.5	0.3				1.3	1.5	1.2			
- Other	7.5	6.2	9.0				9.2	9.8	8.6			
Employment	68.8	73.1	63.8	70.6	77.5	62.0	58.2	64.3	52.2			
Unemployment	31.2	26.9	36.2	29.4	22.5	38.0	41.8	35.7	47.8			
Labor Force	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0			
Participation Rate				56.4	65.9	47.8	66.7	71.1	62.8			

	<i>1993 (Saldrú)</i>		<i>1995 (OHS)</i>			<i>2003 (LFS)</i>			
South Africa ('000s)	Total	Male	Female	Total	Male	Female	Total	Male	Female
Wage employment	7849	4657	3202	8231	5379	2852	9509	5302	4207
- Public	1933	1101	834				1869	949	920
- Private	5916	3556	2368				7640	4353	3287
Self employment	1018	463	546	1421	513	908	2111	1134	977
- Agriculture	52	35	18				269	148	121
- Other	967	435	529				1842	986	856
Employment	8868	5127	3748	9652	5892	3760	11622	6436	5187
Unemployment	4021	1887	2127	4015	1710	2305	8332	3579	4753
Labor Force	12889	7014	5875	13667	7602	6065	19954	10015	9939
Ethiopia (Urban Areas)	<i>1994</i>			<i>1997</i>					
	%			%					
	Total	M	F	Total	M	F			
Wage Employees	42.9	47.4	37	47.8	54.3	40.2			
Public	25	26.4	23.2	26.7	29.3	23.7			
Private	17.9	21	13.8	21.1	25	16.5			
Self Empl.	17.6	18.8	16	22.3	18	27.4			
Unemployed	39	33.8	47.8	29.9	27.7	32.4			
Labor Force	100	100	100	100	100	100			
Participation Rate	55.8	68.3	42	57.2	62.7	51.9			
Kenya (Urban Areas)	<i>1986</i>			<i>1998/99</i>					
	%			Millions					
				%			Millions		
Wage Employees	66.2								
Self Empl.	16.5								
Unemployed	16.9								
Participation	70.4								
Population									
Modern				38.0			1.56		
Informal				29.3			1.20		
Agriculture				3.7			0.15		
Not-stated				3.7			0.15		
Unemployed				25.1			1.03		
Participation				86.4			4.10		
Population							4.74		
Burkina Faso (Oufadougou & Bobo Dioulasso)	<i>1955-64²</i>		<i>1965-74</i>		<i>1975-84</i>				
	M	F	M	F	M	F			
Formal Sector	23.2	7.5	15.4	3.9	8.3	3.7			
Private	13.4	1.8	7.9	0.5	3.3	0.8			
Public	9.8	5.7	7.5	3.4	5	2.9			
Informal Sector	76.8	92.5	84.6	96.1	91.7	96.3			
Agriculture	11.9	5.5	9.9	5.4	7.1	2			
Craft	8.5	13.4	16.5	8	15.2	4			
Petty trade – food	8	61.6	5.3	54.8	11	52.6			
Petty trade – other	8.5	8	26.7	13.6	26.1	14.3			
Services	39.9	4	26.2	14.3	32.3	23.4			

Sources: **Ghana**: Teal (2000), based on Ghana Statistical Office surveys; **Uganda**: HIS 1992 and UNHS 1999/00, courtesy Simon Appleton; **Tanzania**: Household Budget Survey, courtesy Trudy Owens; **South Africa**: SALDRU (1994) “South Africans Rich and Poor”, South African Labor and Development Research Unit, University of Cape Town, August; StatsSA (1996) “October Household Survey 1995”, Statistical Release P0317.10. Statistics South Africa, Pretoria; and StatsSA (2004) “Labor Force Survey, September 2003”, Statistical Release P0210, Statistics South Africa, Pretoria; **Ethiopia**: Krishnan, et al (1998), based on 1st and 3rd rounds of the Ethiopian Urban Household Survey; **Kenya**: Urban Labor Force Survey, 1986; Labor Force Survey, 1998/99; **Burkina Faso**: Calvés & Schoumaker, *World Development* (2004), Table 1.

¹ See note below explaining the issues involved in comparing data sources across time in South Africa.

² Years represent birth cohorts. All numbers represent percentages from a 2000 survey who recalled finding their first paid employment in a given sector.

Table A2
The total labor force and unemployment in South Africa: 1995 -2003

	OHS 1995	OHS 1997	OHS 1999	LFS 2000:2	LFS 2001:2	LFS 2002:2	LFS 2003:1
Strict labor force (employed + searching unemployed)							
Total labor force	11 603 100	11 793 200	14 068 700	15 970 500	15 531 400	16 034 000	16 933 700
Total unemployed	1 971 900	2 688 700	3 671 200	4 231 900	4 687 600	4 986 900	5 354 200
Unemployment rate	17.0	22.8	26.1	26.5	30.2	31.1	31.6
Broad labor force (employed + searching and non-searching unemployed)							
Total labor force	13 648 000	14 468 000	17 169 800	18 250 200	18 556 000	19 276 700	20 259 600
Total unemployed	4 017 800	5 363 500	6 772 300	6 511 600	7 712 200	8 229 600	8 680 100
Unemployment rate	29.4	37.1	39.4	35.7	41.6	42.7	42.8

Notes: Estimates are for all labor force participants aged between 15 and 65 years. The searching unemployed were identified as those who were willing to accept work and had actively searched for work in the four weeks prior to being interviewed.

Source: Table 2 from Casale et. al. (2004).

Table A3. Wages for Selected Countries – Annual US\$ and PPP\$

Ghana	1987/88		1988/89		1991/92		1998/99	
	US\$	PPP\$	US\$	PPP\$	US\$	PPP\$	US\$	PPP\$
Public Wage Job								
	1103.17	1545.55	1056.60	1664.10	1232.84	1940.25	1277.80	3250.69
Private Wage Job								
	1106.78	1156.48	980.33	1161.00	1118.43	1423.07	1260.94	2093.57
Self Employment								
	1129.27	1156.48	1001.20	1208.38	1227.62	1212.66	1224.81	1766.27
Farmer								
	736.25	288.05	669.21	232.07	727.02	403.66	712.16	491.09
% gap between private and self employment		0.0		-3.9		17.4		18.5

Source: Teal (2000), Ghana Statistical Office surveys.

*Income from principal job

Ethiopia	1994		1997	
	US\$	PPP\$	US\$	PPP\$
Public Wage Job	1,281	3,696	1,664	4,248
Private Wage Job	1,206	3,479	1,426	3,496
Self-employment*	1,496	4,315	655	1,890
% gap between private and self employment		-19.4		85.0

Source: Urban Labor Force Survey, 1986; Labor Force Survey, 1998/99

*Median revenues per family worker

South Africa	1993		Premium over self-employed persons (%)
	US\$	PPP\$	
African Wage workers	2,958	5,800	76.3
African Public wage workers	4,530	8,883	170.1
African Private wage workers	2,488	4,878	48.3
African Self-employed workers	1,677	3,289	--

Source: Calculations from SALDRU survey, 1993. Note that these are arithmetic averages.

Table A4 **Log Annual Income in US\$ for the Urban Self-Employed in Ghana**

	<i>1987/88</i>	<i>1988/89</i>	<i>1991/92</i>	<i>1998/99</i>
Education in years	-0.045 (1.76)	-0.004 (0.18)	-0.035 (1.98)*	-0.010 (0.63)
(Education in years) ²	0.005 (2.48)*	0.004 (1.92)	0.006 (4.25)**	0.005 (3.78)**
Age in years	0.061 (4.18)**	0.091 (7.56)**	0.068 (6.64)**	0.075 (8.55)**
(Age in years) ²	-0.001 (4.65)**	-0.001 (7.90)**	-0.001 (6.48)**	-0.001 (8.47)**
Constant	4.971 (15.96)**	4.122 (15.62)**	4.659 (21.22)**	4.322 (22.68)**
Observations	1181	1511	1865	2871
R-squared	0.03	0.06	0.05	0.07

Absolute value of t statistics in parentheses
* significant at 5%; ** significant at 1%

Source: GLSS Surveys and author calculations. Each column shows the results of the earnings function for the survey year shown at the top of the column.

Table A5. Wage Premia for Union Jobs			
<i>Study</i>	<i>Estimation Technique</i>	<i>Country</i>	<i>Earnings Differential</i>
Miller & Vallée (1995)	OLS with dummy variable for union members	Cameroon	-8.1%
Vallée & Thomas (1994)	OLS for formal sector jobs plus Logit for self-selection	Cameroon	-10.7%
Terrel & Svejnar (1989)	OLS with dummy variable for union members	Senegal	-12.5%
Schultz & Mwabu (2003) (a)	Quantile regression with dummy for union members, <i>no industry controls</i>	South Africa (Africans)	145% at 10 th percentile 11% at 90 th percentile
Blunch & Verner (2004)	Quantile regression with dummy for union members, control for firm size	Ghana (manufacturing)	34% at 10 th percentile -9% at 90 th percentile

Union wage premium in South Africa				
	<u>African</u>		<u>White</u>	
	1993	1999	1993	1999
<u>Without controlling industry</u>				
Coefficient on union dummy	0.468	0.561	-0.051	0.030
t-value	(14.7)	(24.7)	(0.8)	(0.6)
Union premium	59.7%	75.2%	-5.0%	3.0%
<u>Controlling industry</u>				
Coefficient on union dummy	0.191	0.430	-0.097	-0.022
t-value	(5.9)	(17.9)	(1.4)	(0.4)
Union premium	21.0%	53.8%	-9.2%	-2.2%

Note: Dependent variable is log of hourly wage and independent variables were education in years, its square, urban dummy and union status dummy.

Source: Schultz and Mwabu (2001) for 1993 figures and own calculations from October Household Survey of 1999.

**Appendix A6 Ln (Real Earnings in Domestic Prices)
Production Workers in the Manufacturing Sector**

	Ghana	Kenya	Nigeria	Tanzania
[1] Union dummy (no controls)	0.401 (6.91)**	0.120 (1.91)	0.367 (3.18)**	0.214 (3.85)**
[2] Union dummy (controls for skills))	0.258 (4.90)**	0.030 (0.52)	0.238 (2.38)*	0.177 (3.49)**
[3] Union dummy (controls for skills and size)	0.063 (1.05)	-0.072 (1.23)	0.065 (0.60)	0.070 (1.35)
[4] Ln (employment)	0.127 (5.19)**	0.071 (3.40)**	0.126 (2.24)*	0.093 (4.12)**
Observations	3973	1312	295	2403

Robust t statistics in parentheses

* significant at 5%; ** significant at 1%

Note: All equations have time dummies.

Row [1] is the raw union premium with no controls.

Row [2] is the union premium with controls for gender, age, age squared, education in years (linear and squared) and tenure.

Row [3] is the union premium with controls for skills as in Row [2] and the log of firm employment.

Row [4] is the coefficient on the log of employment in the regression reported in Row [3].

	Ghana	Kenya	Nigeria	Tanzania	South Africa
[1] Union dummy (no controls)	0.397 (6.80)**	0.125 (2.02)*	0.284 (2.65)**	0.221 (4.04)**	0.284 (9.33)**
[2] Union dummy (controls for skills)	0.258 (4.92)**	0.039 (0.68)	0.155 (1.73)	0.181 (3.63)**	0.200 (7.06)**
Observations	4012	1333	500	2668	2246

Note: All equations have time dummies.

Row [1] is the raw union premium with no controls.

Row [2] is the union premium with controls for gender, age, age squared, and education in years (linear and squared).

Notes: There are nine years of Ghana data covering the period 1992 to 2000; five years of Kenyan data covering the years 1993, 1994, 1995, 1999 and 2000; six years of Tanzanian data covering the years 1992, 1993, 1995, 1997, 1999 and 2000; two years of Nigerian data covering the years 2000 and 2001. For all these countries the data is based on firm surveys of workers in the manufacturing sector, within the workers surveyed the regression confines the data to production workers. There are four years of South African household data taken from the OHS for 1993, 1995, 1997 and 1999. For these individuals the sample is again confined to production workers in manufacturing.

References

- Appleton, Simon. 2001. "Education, incomes and poverty in Uganda in the 1990s." CREDIT Working Paper 01/22, Economics Department, University of Nottingham.
- Appleton, S., J. Hoddinott and J. Mackinnon. 1996. "Education and health in sub-Saharan Africa." *Journal of International Development*, 8(3):307-339.
- Aromolaran, Adebayo. 2002. "Private Wage Returns to Schooling in Nigeria: 1996-1999." Yale University Economic Growth Center Discussion Paper No. 849.
- Baffoe-Bonnie, John. 1999. "The Dynamic Impact of Structural Adjustment Policies on Labor Market and Macroeconomic Aggregates in Sub-Saharan Africa." *Canadian Journal of Development Studies*. Special Issue 20(0): 829-57.
- Bass, Hans, and Robert Kappel. 1997. "Nigeria's Labor Market: Trends and Perspectives." In Hans Bass, et al, eds. *Regional perspectives on labor and employment. African Development Perspectives Yearbook 1996*, vol. 5. Munster: Lit; distributed in North America by Transaction, New Brunswick, N.J., 1997; 195-212
- Beaudry, P. and N. K. Sowa. 1994. "Ghana." In Susan Horton, et al, eds. *Labor Markets in an Era of Adjustment, Vol. 2*. EDI Development Studies. Washington D.C.: World Bank.
- Bennell, Paul. 1996. "Rates of Return to Education: Does the Conventional Pattern Prevail in Sub-Saharan Africa?" *World Development* 24(1): 183-99.
- Berthelemy, J.C. and F. Bourguignon. 1992. "Growth and crisis in Côte d'Ivoire." Unpublished manuscript, DELTA.
- Bigsten, Arne, et al. 2000. "Rates of Return on Physical and Human Capital in Africa's Manufacturing Sector." *Economic Development and Cultural Change* 48(4): 801-27.
- Bigsten, Arne, et al. 2001. "Exporting and Efficiency in African Manufacturing." In Fosu,-Augustin-Kwasi; Nsouli,-Saleh-M.; Varoudakis,-Aristomene, eds. *Policies to promote competitiveness in manufacturing in sub-Saharan Africa*. Development Centre Seminars. Paris and Washington, D.C.: OECD.
- Blanchflower, David and Andrew Oswald. 1995. *The Wage Curve*. Cambridge: MIT Press.
- Blanchflower, David, Andrew Oswald and Peter Sanfey. 1996. "Wages, Profits, and Rent-Sharing." *Quarterly Journal of Economics*, 111(1): 227-51.
- Blunch, Niels-Hugo and Dorte Verner. 2004. "Asymmetries in the Union Wage Premium in Ghana." *World Bank Economic Review*, 18(2): 237-252.

- Blundell, Richard, Christopher Heady, and Rohintori Medhora. 1994. "Côte d'Ivoire." In Susan Horton, et al, eds. *Labor Markets in an Era of Adjustment, Vol. 2*. EDI Development Studies. Washington D.C.: World Bank.
- Butcher, Kristin and Cecilia Rose. 2001. "Wage effects of unions and industrial councils in South Africa." *Industrial and Labor Relations Review*, 54(2): 349 – 74.
- Calvès, Anne-Emmanuèle and Schoumaker, Bruno 2004 "Deteriorating economic context and changing patterns of youth employment in urban Burkino Faso: 1980-2000, *World Development*, 32 (8): 1341-1354.
- Canagarajah, Sudharshan and Dipak Mazumdar. 1995. "Employment, Labor Markets and Poverty in Ghana." Background paper for *Ghana: Labor Markets and Poverty*, World Bank.
- Card, David and Alan Krueger. 1992. "Does School Quality Matter? Returns to Education and the Characteristics of Public Schools in the United States." *The Journal of Political Economy*, 100(1): 1-40.
- Casale, D. and D. Posel. 2001. "Why More Women are Looking for Work? A Study of Female Labor Supply in South Africa, 1995-1999", paper presented to the DPRU/FES conference, Johannesburg, 15-16 November.
- Casale, D., C. Muller and D. Posel. 2004 "'Two million net new jobs': a reconsideration of the rise in employment in South Africa, 1995-2003", paper to be presented at the African Development and Poverty Reduction Conference: Lord Charles Hotel, Somerset West, South Africa, October 2004.
- Case, Anne and Motohiro Yogo. 1999. "Does School Quality Matter? Returns to Education and the Characteristics of Schools in South Africa." NBER Working Paper: 7399.
- Chandra, V., J. Nganou. 2001. "Obstacles to Formal Employment Creation in South Africa: Evidence from Recent Firm Surveys". Paper presented to DPRU Conference, Johannesburg, November.
- Chandra, V., J. Nganou and C. Noel. 2002. "Constraints to Growth in Johannesburg's Black Informal Sector: Evidence from the 1999 Informal Sector Survey." World Bank Report No. 24449-ZA, June.
- Collier, Paul. 1995. "African Labor Markets." In Michael Bruno and Boris Pleskovic, eds. *Proceedings of the World Bank Annual Conference on Development Economics, 1994*. Washington, D.C.: World Bank.

- Dabalen, Andrew. 2001. "Economic Reforms and Wage Trends in Africa." Working Paper, World Bank.
- Dasgupta, Partha and Debraj Ray. 1986. "Inequality as a Determinant of Malnutrition and Unemployment: Theory." *Economic Journal*, 96(384): 1011-34.
- Devey, R. Skinner, C. & Valodia, I. 2002. "The Informal Economy in South Africa: Who, Where, What and How Much?." Paper presented to the DPRU Conference on Labor Markets and Poverty in South Africa, Johannesburg, 22-24 October, 2002. Forthcoming in *Transformation*.
- Dollar, David and Albert Zeufack. 1999. "Why are Thai firms more productive than Kenyan firms?" World Bank, mimeo.
- Fafchamps, Marcel and Mans Söderbom. "Wages and Labor Management in African Manufacturing." CSAE Working Paper WPS/2004-02.
- Fallon, Peter and Robert Lucas. 1993. "Job security regulations and the dynamic demand for industrial labor in India and Zimbabwe." *Journal of Development Economics* 40: 241-275.
- , 1996. "South African labor markets: Adjustment and inequalities." Draft. Poverty and Social Policy Department, World Bank.
- Forteza, Alvaro, and Martín Rama. 2001. "Labor Market Rigidity and the Success of Economic Reforms across More than 100 Countries." Policy Research Working Paper 2521. World Bank, Development Research Group, Washington, D.C.
- Freeman, Richard. 1993. "Labor market institutions and policies: help or hindrance to economic development?" in Summers, L. and Shah, S., eds., Proceedings of the World Bank Annual Conference on Development Economics, 1992; 117-44.
- Freeman, Richard and Remco Oostendorp. 2000. "Wages around the World: Pay Across Occupations and Countries." NBER Working Paper No. 8058.
- Ghana Statistical Service (1995) The Pattern of Poverty in Ghana: 1988-1992, Accra, November 1995.
- Ghana Statistical Service (2000) Poverty Trends in Ghana in the 1990s, Accra, October 2000.
- Glewwe, Paul. 1996. "The relevance of standard estimates of rates of return to schooling for education policy: A critical assessment." *Journal of Development Economics*, v.51: 267-90.
- Harbison, Ralph and Eric Hanushek. 1992. *Educational Performance of the Poor: Lessons from Northeast Brazil*. Oxford University Press for World Bank.

- Hanushek, Erica and Dennis Kimko. 2000. "Schooling, Labor Force Quality, and the Growth of Nations." *American Economic Review*, 90(5): 1184-1208.
- Harris, John and Michael Todaro. 1970. "Migration, Unemployment and Development: A Two-Sector Analysis." *American Economic Review* 60(1): 126-142.
- Hoddinott, John. 1996. "Wages and unemployment in an urban African labor market." *Economic Journal* 106: 1610-26.
- Horton, Susan, Dipak Mazumdar and Ravi Kanbur. 1994. "Overview," in *Labor Markets in an Era of Adjustment, Vol. 1*. Washington D.C.: World Bank.
- HSRC (2003). *HRD Review 2003*, Human Sciences Research Council, Pretoria.
- Jamal, Vali and John Weeks. 1993. *Africa Misunderstood; or Whatever Happened to the Rural-Urban Gap?* MacMillan Series of ILO Studies. London: MacMillan.
- Kingdon, Geeta and John Knight. 2001. "Unemployment in South Africa: a spatial approach." Centre for the Study of African Economies, Working Paper 99-12, Oxford University.
- 2004. "Unemployment in South Africa: the nature of the beast." *World Development*, 32(3): 391-408.
- Knight, John. 1997. "Market Issues in Zimbabwe: Lessons for South Africa." *South African Journal of Economics* 65(1): 69-98.
- Krishnan, Pramila, Stefan Dercon and Tesfaye Gebre Selassie. 1998. "The urban labor market during structural adjustment: Ethiopia 1990-1997." Centre for the Study of African Economies, Working Paper 98-09, Oxford University.
- Lachaud, Jean Pierre. 1995. "Public-Private Wage Differentials in French-Speaking Africa: A Comparative Analysis." *Labor*, 9(2): 295-341.
- 1993. "L'ajustement structurel et le marché du travail en Afrique francophone." Discussion paper no. 56, Geneva: Institut International d'Etudes Sociales.
- LaFraniere, Sharon. 2004. "Low labor standards lead South Africa to export jobs." *The New York Times*, March 13.
- Levy, V. and J. Newman. 1989. "Wage rigidity: micro and macro evidence on labor market adjustment in the modern sector." *World Bank Economic Review* 3(1): 97-117.
- Manning, Alan. 2003. *Monopsony in Motion*. Princeton University Press.

- Mazumdar, Dipak and Ata Mazaheri. 2003. *The African manufacturing firm: An analysis based on firm surveys in seven countries in sub-Saharan Africa*, Studies in Development Economics, vol. 31. London and New York: Routledge.
- . 2002. *Wages and unemployment in Africa*, Ashgate: Aldershot.
- Mazumdar, Dipak. "Wages in Africa." Mimeo, Africa Chief Economist's Office, World Bank.
- Mbaye, Ahmadou Aly. 2002. "Capital humain, competence et productivite du travail au Senegal: Une analyse empirique." *Economies et Societes* 36(3-4): 567-88.
- Mead, Donald. 1994. "The Contribution of Small Enterprises to Employment Growth in Southern and Eastern Africa." *World Development* 22(12): 1881-94.
- Miller, V. and L. Vallée. 1995. "Labor regulation and segmentation in Cameroon." In B. Gauthier, ed. *Economic Reform and the Development of the Manufacturing Sector in Cameroon*, RPED Country Study Series, Washington D.C.: World Bank.
- Milne, William, and Monica Neitzert. 1994. "Kenya." In Susan Horton, et al, eds. *Labor Markets in an Era of Adjustment, Vol. 2*. EDI Development Studies. Washington D.C.: World Bank.
- Moll, P. G. 1992. "Quality of education and the rise in returns to schooling in South Africa, 1975 – 1985." *Economics of Education Review*, 11(1).
- National Bureau of Statistics, Tanzania, Household Budget Survey 2000/1, Dar-es-Salaam, July 2002.
- Newman, Constance and Sudharshan Canagarajah. 2000. "Gender, Poverty, and Nonfarm Employment in Ghana and Uganda." Policy Research Working Paper 2367, World Bank.
- Owens, T. and A. Wood. 1997. "Export Oriented Industrialisation through Primary Processing?" *World Development*, 25 (9), September, 1453-1470.
- Pack, Howard and Christina Paxson. 2001. "Is African Manufacturing Skill Constrained?" In Adam Szirmai and Paul Lapperre, eds. *The industrial experience of Tanzania*. Houndmills, U.K. and New York: Palgrave; 50-72.
- Pritchett, Lant and Deon Filmer. 1999. "What Education Production Functions Really Show: A Positive Theory of Education Expenditures." *Economics of Education Review*, 18(2): 223-39.

- Rama, Martín. 2000. "Wage Misalignment in CFA Countries: Are Labor Market Policies to Blame?" *Journal of African Economies* 9(4): 475–511.
- Rogerson, C.M. 1992. "The Absorptive Capacity of the Informal Sector in the South African City." In D. M. Smith, *The Apartheid City and Beyond*. London: Routledge.
- Sabot, R. H. 1979. *Economic Development and Urban Migration: Tanzania 1900-1971*. Oxford: Clarendon Press.
- Schultz, Paul. 2004. "Evidence of Returns to Schooling in Africa from Household Surveys: Monitoring and Restructuring the Market for Education." *Journal of African Economies*, forthcoming.
- Schultz, Paul and Germano Mwabu. 1998. "Labor unions and the distribution of wages and employment in South Africa." *Industrial and Labor Relations Review*, 51(4): 680-703.
- Serneels, Pieter. 2004. "The nature of unemployment in urban Ethiopia." Centre for the Study of African Economies, Working Paper 04-01, Oxford University.
- Söderbom, Måns and Francis Teal. 2004. "Size and efficiency in African manufacturing firms: evidence from firm-level panel data." *Journal of Development Economics*, 73: 369-394.
- 2000. "Skills, investment and exports from manufacturing firms in Africa." CSAE Working Paper WSP/2000-8.
- 2003. "Openness and Human Capital as Sources of Productivity Growth: An Empirical Investigation" CSAE Working paper 2003-06
- Söderbom, Måns, Francis Teal and Anthony Wambugu. (2002) "Does firm size really affect earnings?" CSAE Working paper WPS/2002-08.
- (forthcoming) "Unobserved Heterogeneity and the Relation between Earnings and Firm Size: Evidence from Two Developing Countries" *Economic Letters*.
- Söderbom, Måns, Francis Teal, Anthony Wambugu and Godius Kahyarara, *The Dynamics of Returns to Education in Kenyan and Tanzanian Manufacturing*, CSAE WPS/2003-17
- Squire, L. and S. Suthiwart-Narueput (1997). "The impact of labor market regulations," *World Bank Economic Review*, 11(1): 119-43.
- Stiglitz, Joseph. 1974. "Alternative theories of wage determination and unemployment in LDCs: the labor turnover model." *Quarterly Journal of Economics*, 88(2): 194-227.

- Tan, Jee-Peng, Julia Lane, Paul Coustere. 1996. "Putting inputs to work in elementary schools: what can be done in the Philippines?" World Bank, mimeo.
- Teal, Francis. 1996. "The size and sources of economic rents in a developing country manufacturing labor market." *Economic Journal*, 106: 963-76.
- , 2000. "Real wages and the demand for skilled and unskilled male labor in Ghana's manufacturing sector: 1991—1995." *Journal of Development Economics* 61: 447—461.
- , 2001. "Education, incomes, poverty and inequality in Ghana in the 1990s." Centre for the Study of African Economies, Working Paper 01-21, Oxford University.
- Thomas, Mark and Luc Vallée. 1996. "Labor market segmentation in Cameroonian manufacturing." *Journal of Development Studies*, 32(6): 876-98.
- United States International Trade Commission (USITC). 2004. *Textiles and Apparel: Assessment of the Competitiveness of Certain Foreign Suppliers to the U.S. Market*. Washington D.C.: USITC, Publication 3671.
- van der Gaag, J. and W. Vijverberg. 1988. "Switching regression model for wage determinants in the public and private sectors of a developing country." *Review of Economics and Statistics* 70: 244-52.
- , 1989. "Wage determinants in Côte d'Ivoire." *Living Standards Measurement Study Working Paper No. 33*. Washington, D.C.: World Bank.
- Velenchik, Ann. 1997. "Market power, firm performance and real wage growth in Zimbabwean manufacturing." *World Development* 25(5), p. 749-762.
- Vijverberg, W. and J. van der Gaag. 1990. "Testing for labor market duality: the private sector wage in Côte d'Ivoire." LSMS Working Paper No. 66, Washington D.C.: World Bank.
- Weeks, John. 1997. "Employment, Livelihoods and Macroeconomic Policy for the Sub-Saharan Countries." In Azizur Khan and M. Muqtada, eds. *Employment expansion and macroeconomic stability under increasing globalization*. ILO Studies Series. New York: St. Martin's Press; London: Macmillan Press; 154-90.
- Wood, Adrian. 1994. *North-South Trade, Employment and Inequality: Changing fortunes in a skill-driven world*, Clarendon Press, Oxford.
- Wood, A. and K. Berge. 1997. "Exporting Manufactures: Human Resources, Natural Resources, and Trade Policy." *Journal of Development Studies*, 34 (1), 35-59.

- Wood, A. and J. Mayer. 1998. "Africa's Export Structure in a Comparative Perspective," Study No. 4, African Development in a Comparative perspective, UNCTAD, Geneva.
- World Bank. 1993. *Kenya: Growth and structural change*.
- World Bank. 1994. *Adjustment in Africa: Reforms, results and the road ahead*, Oxford University Press.
- . 1995. *World Development Report 1995: Workers in an Integrating World*. Oxford University Press.
- Zeufack, Albert. 2001. "Export Performance in Africa and Asia's Manufacturing: Evidence from Firm-Level Data." *Journal of African Economies*, 10(3): 258 – 81.

**Figure 1. Trends in Non-Agricultural Employment by Sector
(Absolute No. of Workers in Thousands)**

Sources: Table A1 in the Appendix, based on national household and labor surveys. The right hand axis refers to Ethiopia and South Africa and the left hand axis to the other countries.

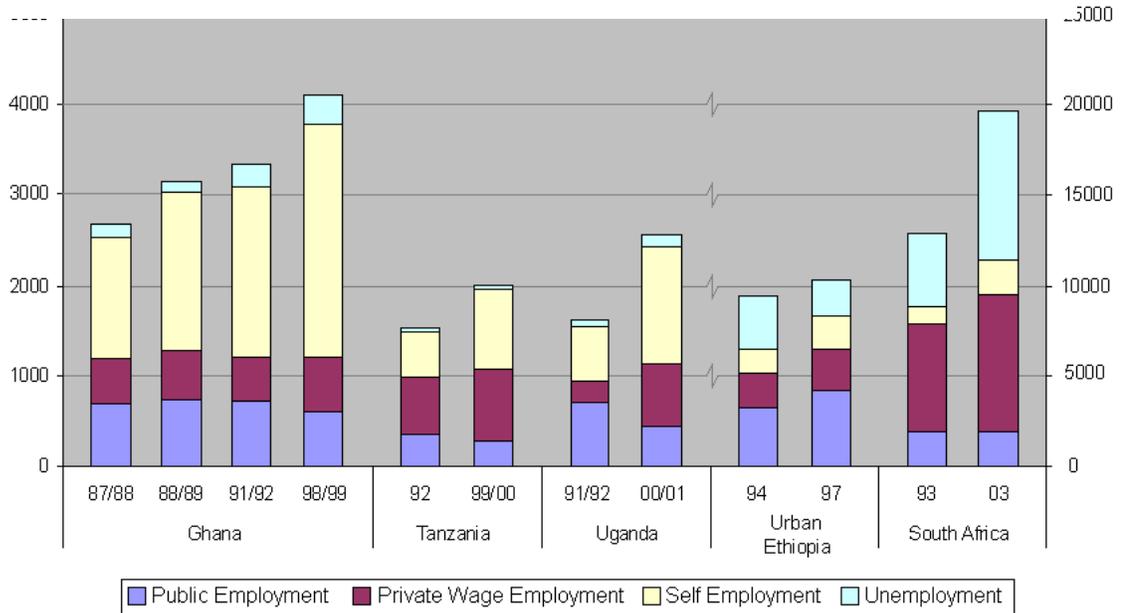


Figure 2. Wages and Employment in a Segmented Labor Market

Note that the labor demand curves shown here are drawn for workers with a given level of education and productivity, working in firms with a given level of capital stock—three factors which may outweigh the wage rigidity concerns highlighted here in the determination of labor demand.

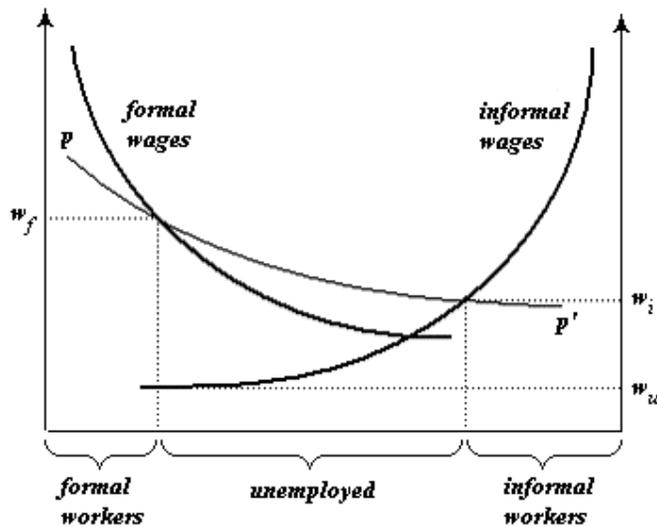


Figure 3

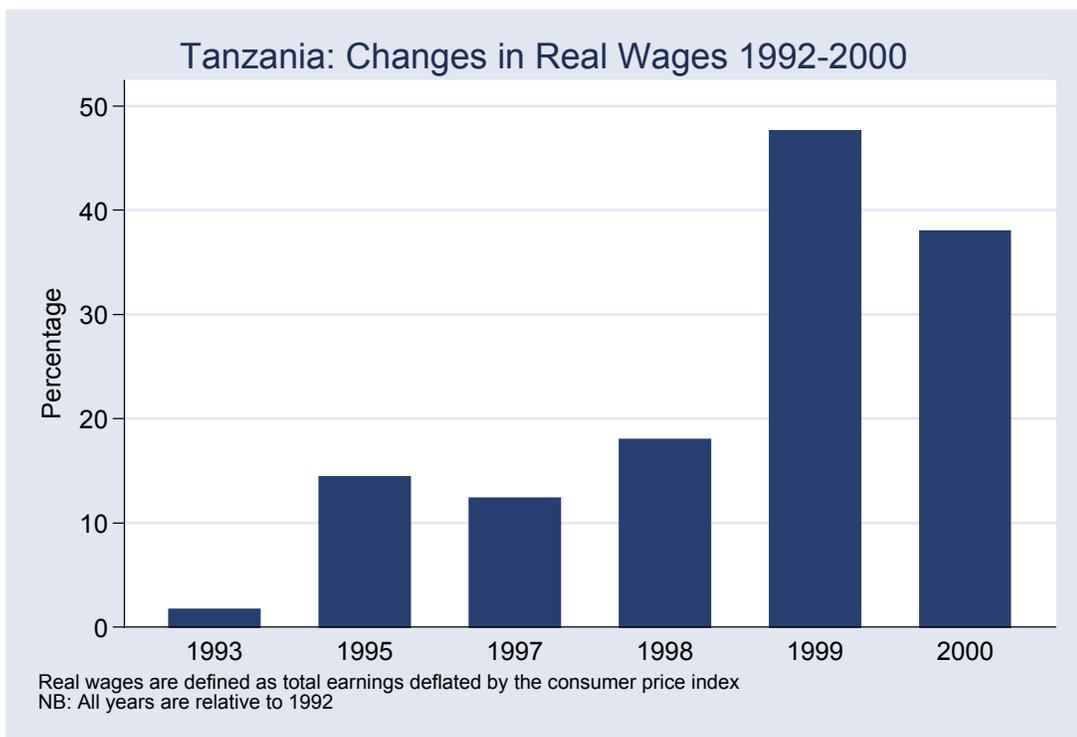
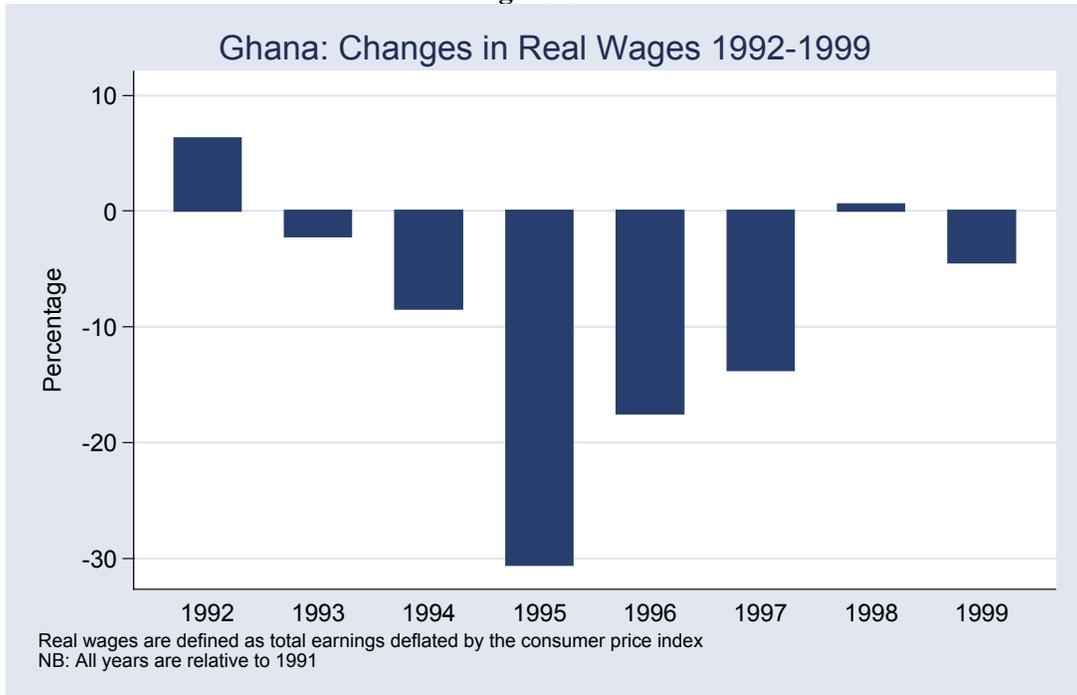


Figure 4 Monthly US\$ Wages for Unskilled Occupations

Source: Freeman and Oostendorp (2000), OWW Database

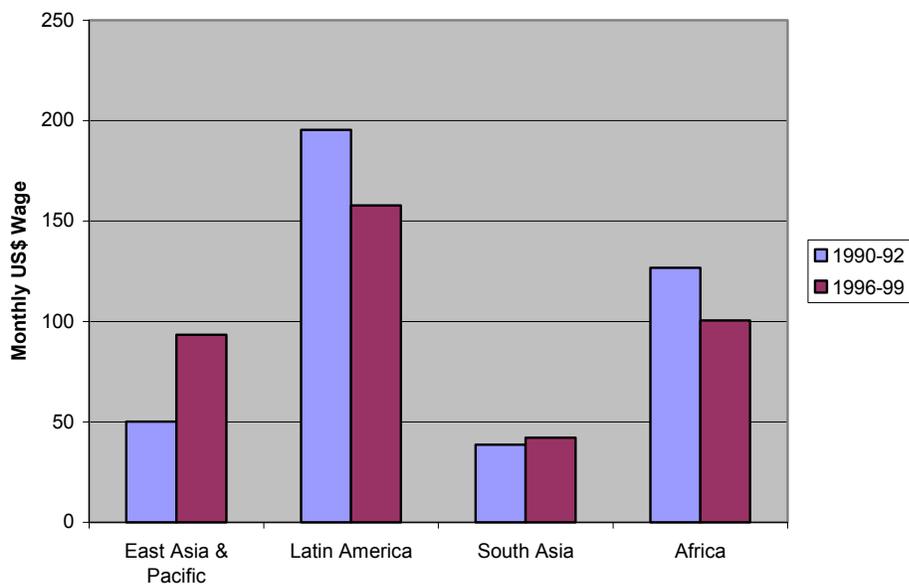


Figure 5 Wage Gap by Firm Size

% Difference in wages between a firm with 20 vs. 100 employees, controlling for workers' skills

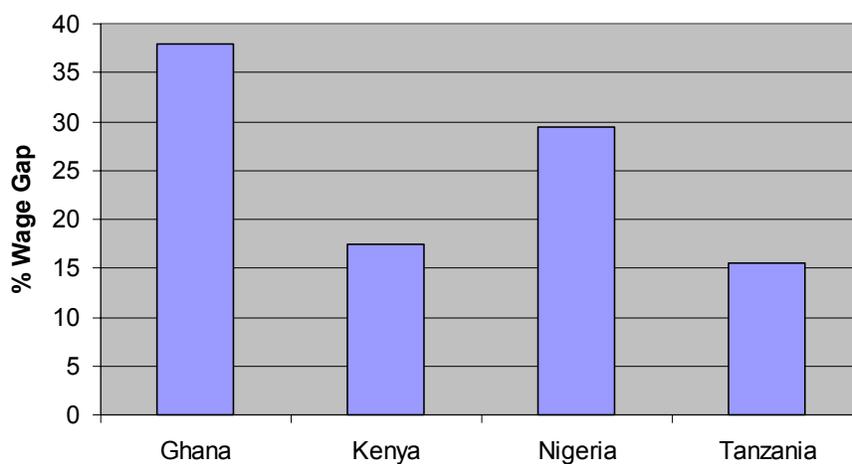


Figure 6

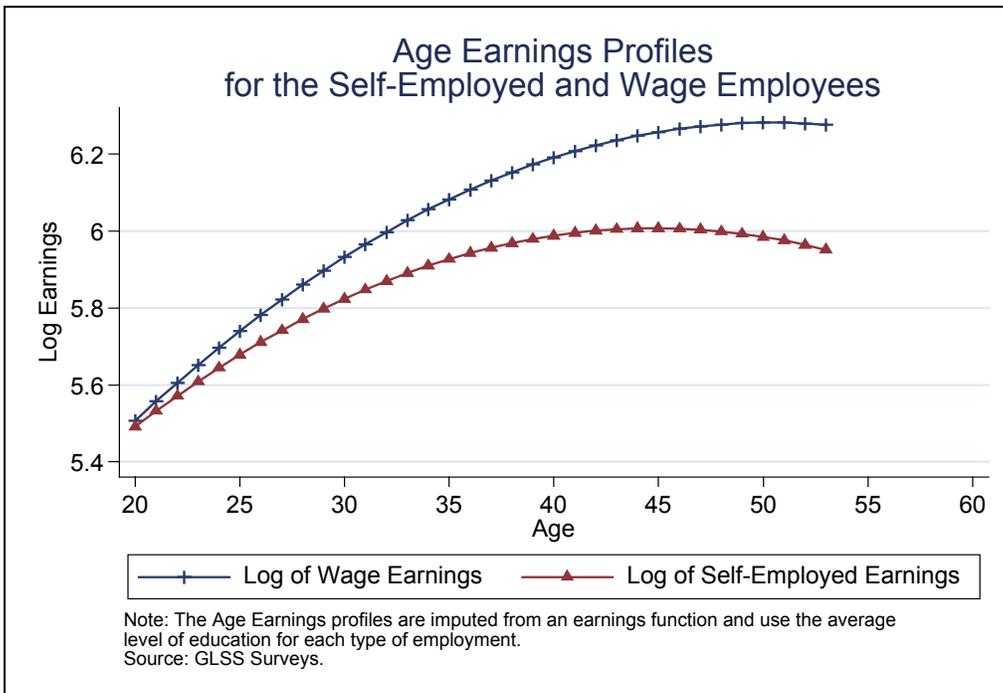


Figure 7 Union Premia for Production Workers in Manufacturing

