Jobs, Growth and Manufacturing in Africa

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Reforms, Growth and Jobs

• African countries have undergone significant macroeconomic reforms since the late 1980s.

• Why have these reforms not resulted in more jobs in the formal sector?

• Rodrik and McMillan (2011) find that labor has moved from high- to low-productivity activities in many African countries.

• The demographics suggest that there will be significant demand for jobs in the coming years:
  – Next decade: Approximate 122 million new entrants on job market
  – Example: Zambia has 13 million people and under 500 000 employed in the formal sector, excluding public sector workers
The record on African manufacturing

- Manufacturing as a share of GDP is falling
- Almost no manufacturing exports that are not immediately based on the processing of raw materials
- Lack of labor-intensive growth is problematic

Source: WDI

Source: CGD calculations, based on UN COMTRADE.
The nature of firms in Sub-Saharan Africa

Enterprise Surveys: 50 percent or more industrial value added is from relatively few large firms, often foreign or minority-owned

- Sutton enterprise maps: only about 17% of leading firms are indigenously-owned
- Minority advantages: history, trading relationships, education, networks
Lack of convergence in productivity over time

There are more people employed in agriculture in Zambia in 2005 than in 1950, while the share of employment in manufacturing has declined in the same period. This is in sharp contrast to Mexico (and to many countries in Asia and Latin America).

Labor productivity and employment shares for selected sectors, Zambia and Mexico

Notes: agr = Agriculture; man = Manufacturing; min = Minerals. Source: Calculations based on McMillan and Rodrik (2011).
Africa has smaller firms in the formal sector than other regions of the world: missing middle.

Labor costs are high: After controlling for firm characteristics and country effects, African firms pay a markup of about 50% {high cost, high productivity—not job-generating}

Predicted labor costs per worker (constant 2005 US$)

$2,218

$1,480 + 50%

Comparators

Sub-Saharan Africa

Adjusted Predictions (model 11), 95% CIs, 3 SD outlier correction

Note: Adjusted predictions holding all factor and continuous variable at their means.

Wide spread of management scores: US, Japan & Germany leading, and Africa, South America and India trailing

Source: Bloom and Van Reenen: Data includes 2013 survey wave as of 9/20/2013
African countries are expensive relative to GDP/capita

Balassa-Samuelson Relationship of Price Level and GDP per Capita (5-year Average 2005 to 2009)

Note: Specification replicates Rogoff (1996, p. 660), 188 observations (Zimbabwe excluded). Grey area shows 95 percent confidence interval.

Source: Gelb, Meyer and Ramachandran, 2013
Why has productivity not converged?
Why is the private sector not more competitive?

• Business climate
  – Power outages
  – Burden of regulation
  – Transport costs (reflects rents as well as lack of physical infrastructure)
  – Policy uncertainty
  – Access to finance

• Business-state relationships
  – Ambivalence about the private sector
  – Small, sparse economies with limited competition
  – Capabilities of the state and the lack of state-business partnerships

• Firm ownership and management capacity
  – Concentrated ownership
  – Significant differences between minority-owned and indigenous firms
  – Poor management, as a result of weak rule of law, government ownership
The way forward

• The political economy of the private sector is also evolving, with growth of larger-scale African entrepreneurship, including a number of emerging trans-Africa businesses.

• This can strengthen the power of *domestic* business constituencies.

• Any approach will need to open up opportunities for indigenous businesses as well as for foreign and minority firms, and must be complemented by measures to strengthen the business climate and access to skills and management capacity.
Existing Interventions

– Traditional lenders hampered by investor/lender risk-aversion
  • coupled with limited capacity to develop projects
– High cost to finding well-established small high growth enterprises
– High-risk environment as regards institutional infrastructure, such as creditor rights and insolvency
– High search and high transaction costs
Mechanisms to assist a faster transition

Quasi Equity Risk Fund:

- Reduce transaction cost by using lessons from the Business Plan Competition in Nigeria (competitive selection, supervision);
- Quasi equity position in selected firms instead of grant
- Quasi equity position held in a fund created in each jurisdiction or at regional level
- Exit through sale to owner (mezzanine finance) or to third party
- Investment of 500K to 1 million USD equivalent in local currency
- 4 Pilot countries, 50 investments per country
Service Performance Guarantees

• Countries are like malls or hotels: need to attract clients
• Countries have certain advantages: location, costs, etc
• Governments can guarantee a minimum standard of service

What is a Service Performance Guarantee?

A service guarantee is an explicit promise made by the service provider (example: electricity authority)

(a) To deliver a certain level of service to satisfy the customer who has purchased a contract (example: steady power supply)

(b) To remunerate the customer if the service is not sufficiently delivered against the standard.

Loss of reputation can be devastating
How Does a Service Performance Guarantee Work?

• It is an insurance contract for service delivery (to a standard)
  – Examples: quality of power supply, speed of port and customs clearance, administrative efficiency, time limit on VAT rebates for exporters…..

• A contractual legal agreement
  – Limited in relation to firm size and business to avoid excessive losses or gaming
  – Standardized and automatic payment. Customized only for largest firms
  – Not all service performance can be standardized and monitored but technology can help. (Fedex, Amazon, UID India…..)
The Structure of a Guarantee Fund

– First risk: guarantee fund
  • Fees paid by firms
  • Contractual arrangements and revenue can be calibrated so that the fund can cover risk

– Backup guarantee to fund to enable it to meet obligations
  • Could be extended by MIGA or IBRD or…….
  • Could be financed by holdback of part of World Bank or other financing for a project
  • Payments triggered by excess calls on guarantee fund

– Unused balances back to government or service provider as performance bonus?