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WEIGHTS AND MEASURES
Metric System

ABBREVIATIONS

ADLI Agricultural Development Led Industrialization
BDS Business Development Service
CEM Country Economic Memorandum
CSA Central Statistical Agency
GDP Gross Domestic Product
GOE Government of Ethiopia
MDGs Millennium Development Goals
MFI Micro finance Institution
MOFED Ministry of Finance and Economic Development
MOLSA Ministry of Labor and Social Affairs
NGO Nongovernmental Organization
PASDEP Plan for Accelerated Sustained Development to End Poverty
PPA Participatory Poverty Assessment
SMEs Small and Medium Enterprise

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EXECUTIVE SUMMARY

The development challenge facing Ethiopia is immense. Its people are among the poorest in the world, the economy is growing too slowly and population growth is rapid.

Over the past decade Ethiopia has made significant progress on a number of fronts. The economy recovered strongly following a severe drought in 2002/03 yet overall performance remains sluggish, even in the more dynamic urban sectors. While performing better than agriculture, the secondary and tertiary sectors contribution to total growth was only about 60 percent, much less than the African average of about 80 percent.

Structural transformation has been slow, both in terms of the traditional-rural to modern-urban transition, and of the transition from a socialist economy to one that is market-based. Agriculture has not been a dynamic source of rural job creation and its low productivity is associated with persistent poverty in rural areas and the growing attractiveness of towns and cities.

Ethiopia’s second generation PRSP (PASDEP), recognizes that fostering growth requires addressing not only the barriers to productivity in rural areas on which policy attention has been focused but tackling the bottlenecks which are preventing other parts of the economy to fully contribute to growth.

This renewed focus on growth and job creation in urban areas is particularly timely given signs of growing urban poverty and the rapid growth in the urban labor supply. Such growth has been fast and accompanied by several major shifts on the supply side:

- **A demographic shift.** With an estimated 44 percent of the population below the age of 15, Ethiopia now faces the opportunities and challenges of integrating a rising number of youth into the labor market. There is the potential for a demographic dividend, especially as large investments in education are paying off and new entrants to the labor market have higher educational levels. Yet this will require significantly accelerating the pace of job creation in the economy.

- **A geographic shift.** Internal migration, while limited by the current institutional framework, has been rising. The current situation is one of disequilibrium, and even without removing some of the constraints to mobility it seems likely that migratory pressures will continue to accelerate.

- **A qualitative shift.** The literacy rate of Ethiopia’s workforce is rising, albeit from very low levels consistent with Government’s strategic objectives, the latest data available show significant improvements in primary enrollment rates, which rose by over 20 percent over the period 1999-2004. Nevertheless, enrollments, at 74 percent, are significantly below the Sub-Saharan Africa (SSA) average, and are particularly low for girls (52 percent versus an SSA average of 81 percent).
Against this background and challenges, this study sought to cover three basic objectives. First, we provide a basic assessment of key labor market indicators and their recent trends, based on the 1999 and 2005 Labour Force Surveys, complemented by other data sources. Second, different segments of urban labor markets are analysed with the goal of explaining why job creation in urban areas has been sluggish despite recent good performance on growth. Third, policy options open to facing the Government to capitalize on its economic reform efforts and achieve higher rates of job creation are reviewed in light of Ethiopia’s and relevant international experience.

**Labor market trends: 1999 - 2005**

The data show a largely unchanged labor market situation between 1999 and 2005, with the notable exception of improvements in unemployment.

*Participation rates* remained stable at around 65%, with rises for women offset by declines for men. Ethiopian activity rates for older groups are comparable with those of Uganda and Kenya, but noticeably lower for youth. As expected, activity rates tend to rise with educational levels, though for youth, the distribution is bipolar, with higher activity rates at both ends of the education distribution.

The *employment rate* remained stable at around 55% with some underlying changes. For women there were improvements in employment for both the young and the adult cohorts, though overall (and particularly older women) they continued to be less likely than men to be employed. In terms of composition, urban employment is dominated by self-employment (42 percent of workers), with government employees a distant second (18 percent), followed closely by private organizations (16 percent). Government is the most skill intensive sector. Services, both public and private, have been driving net employment creation in urban areas, with strong growth in the “public administration” and “other household services”. Manufacturing has continued to add jobs, albeit at a reduced pace in the last five years. Within the services category financial services grew spectacularly (by more than 300 percent) since 1994, though from a very low base.

*Unemployment* measured on an internationally comparable basis declined from 14.8 to 13.5 percent, driven by the drops for youth and older males. However, youth continue to experience relatively much higher unemployment. Women, particularly older, are much more likely than men to experience unemployment. Between 1999 and 2005 passive unemployment declined most rapidly (the share of population in passive unemployment declined by 38 percent versus a decline by 9 percent of those actively seeking work) due to employment, but more so due to inactivity. The shift in passive unemployment was most visible for the youth, which is compatible with higher school enrollments.

*Median wages* for urban paid employees are generally low (Br 300 a month, or US$34 in 2005), although significant differences are found by type of employer, sector and worker characteristics. The employers that pay higher median wages are parastatals and government. In terms of industrial sectors, median wages are highest in the financial, real estate, and transport sectors, and for service providers and government workers; wages are lowest for domestic employees.
Emerging stylized facts

The size and quality of urban labor supply is increasing. In particular the skills profile of the urban workforce has been rising. By 2005 three quarters of youth had at least four years of schooling, while for the older cohort this was true for only half. In line with the overall decline in illiteracy and growing supply of skills, the composition of employment is changing, with lower education levels accounting for a smaller share.

An important part of the rise in education is that women are catching up with men on this front -- the decrease in their share of illiterates is more marked than for the group as a whole -- but females on average are still significantly less skilled. Further, adult women with some level of education are significantly less likely to participate in the labor market active than the average. The smallest gaps in activity rates are for the small but growing group of women with at least some higher education. And women continue experience the disadvantage which comes with traditional gender roles. Having children younger than ten years significantly lowers the probability of women being employed.

Supply trends are likely to increase labor market participation as better educated people are more likely to be active. Yet increased labor force skill and female participation also raise challenges, particularly in terms of youth expectations for better paying jobs.

An important role in this context is played by migration. While the current system discourages rural-urban migration, there is evidence of growing migratory pressures. To date most of migration is relatively short distance, with both step-migration and moves to urban areas directly from adjacent urban areas being quite common. The available evidence shows that those who migrate for work related reasons have a better employment performance than the others. While migrants do not seem to “compete” directly with non-migrants and to drive down their wages, except for those with very low skills, they do seem to be in competition with each other. These findings do indeed raise concerns for a possible scenario of increasing migration due to distress in rural areas, resulting in increasing poverty among migrants (and ultimately also among the long term resident population) in urban areas.

Education pays, particularly for women and in urban areas outside Addis. Returns to education are relatively high, with the high skilled premium equal to 90% the earnings of the illiterates (completed primary results in a 16% premium over the illiterates). While there is a gender wage gap of around 22 percent, controlling for individual characteristics, women do obtain much higher returns to education than men at the upper end of the educational spectrum. In urban areas outside Addis, returns to education are significant and higher than in Addis for all levels of education.

Some groups in the labor force face specific challenges. Over 80% of jobs found by youth is in the informal sector (including unpaid family labor), though they are better off when high skilled. Women are another group with specific challenges – despite an improved performance in terms of employment and activity rates, they experience higher unemployment and are found mostly in less productive and informal activities which can be traced to traditional gender roles, and therefore experience lower pay for equal characteristics.
Significant heterogeneity characterizes different types of urban areas. Larger towns including Addis, are characterized by lower employment rates and higher unemployment. Differences across urban areas partly reflect the different economic structures as, not surprisingly, smaller towns’ economies are also more oriented towards the primary sector, and are more integrated with the surrounding rural areas which are characterized by higher employment rates.

Why so little job creation?

Despite overall growth in the economy the urban sector has not yet become a dynamic engine for growth, employment creation and poverty reduction.

Two main factors seem to account for this picture.

First of all, segmentation. Labor markets remain broadly separated into three segments: the relatively privileged public sector; the private formal, and the large informal economy, which is mainly small scale and more ‘survival’ than entrepreneurial. Panel evidence over the period 1994-2004 shows since 2000 signs of weakening but still significant segmentation affecting the experience and prospects of individual workers.

Secondly, Ethiopia’s transition agenda remains unfinished. Expectations that reforms would lead to a gradual reallocation of resources from low-productivity sectors to more dynamic activities have been partly realized as reforms appear to have had some impact. New impetus, particularly on reforms that can energize the private sector, is needed as outlined below.

At the same time, there is some good news on the transition front. Panel evidence reveal significant increases in mobility albeit from a very low base – by 2004, yet fewer than 50% of those unemployed in 1994 had a job. Also, evidence from the Investment Climate Assessment shows signs of restructuring though overall hiring and separation rates are low by market economy standards.

Looking to overview the main segments of the labor market, the highlights are:

The civil service has expanded significantly due to decentralization – analysis of its compensation reveals that changes are needed: for positions below professionals compensation is much higher than in other sectors, for high level positions there are signs of internal “brain drain” particularly towards NGO and international organizations. Job security remains a key advantage of jobs in the civil service

Parastatals continue to account for a significant share of manufacturing employment, and are characterized larger firms and older equipment. The analysis reveals signs of labor hoarding, and working conditions (particularly remuneration) are more favorable than in the private sector. Panel evidence shows higher mobility out of the parastatals over the last years, yet privatization run out of steam in 2002.

The informal sector seems to be a residual or last resort in that flows are largely from the ranks of the unemployed and new entrants. This sector had been actively repressed during the Derg, and there is a sense that despite legal reforms the legacy of previous policies might still be felt. Analysis of firm level data shows that, the “dynamic” component of the sector is very small, and composed mostly by individuals who had
some experience in the formal private sector. Most firms however do not grow and most respondents say that they resort to in informal activities out of necessity. Constraints to business expansion (and supposedly formalization) include uncertainty on the regulatory environment, constraints in accessing factor markets (particularly land) and harassment by local authorities.

The **formal private sector** has not been a dynamic engine of growth and in general, Ethiopian firms are not internationally competitive. Labor market institutions do not appear to be a major barrier to doing business and firms (at least those already in operation) do not view the combination of labor taxation and regulation – such as hiring and firing costs, unionization, etc. – as exerting a major negative impact. In terms of overall business climate, however, access to land and the tax regime appear to be the major concerns voiced by the firms, although focus groups in 2004 revealed significant improvements in the business climate. While the personal tax system is now working well, the share of firms reporting taxes as a major constraint in the ICA is higher than in comparator countries (72 percent vs. 48 percent in Uganda and 68 percent in Kenya) and the number of days spent dealing with tax officials very high.

**The policy agenda**

As segmentation and the sluggish pace of job creation result from a variety of barriers, an agenda to tackle these challenges is correspondingly broad. The report discusses the scope for five main areas of intervention:

*Enhancing the private sector contribution employment* through improving the business climate and business support programs. Important actions to improve the business climate include identifying measures to increase tax collections without creating disincentives to private sector development; strengthening competition by reducing the regulatory and policy obstacles to competition in key sectors (e.g. trade, logistics and capital markets), and effectively operationalizing the Trade Practices Commission and Proclamation and extending its purview to state owned enterprises; and supporting activities in the informal sector by removing constraints directly related to government actions/regulations of the sector and of the land and credit (increasing security of tenure, facilitating private sector activity in microfinance). Additionally, as most of those who transit out of unemployment find work in the informal sector, business development schemes aimed at supporting entrepreneurship, and in particular access to finance, could have an impact. Indeed there seems to be significant unmet demand for the training and BDS schemes currently available.

*Integrating vulnerable groups.* The evidence shows that women and young people experience relatively greater difficulties in securing productive employment than adult men, suggesting that targeted active programs need to be designed to overcome the specific barriers they face (cultural attitudes, traditional allocations of labor, difficulties in the school to work transition). Strengthening Technical and Vocational Education Training (TVET) and ensuring that it develops in line with market needs and targeting women, particularly in the informal sector, are two important priorities in this area. Further, developing active labor market interventions to act as safety nets, while no
substitute for dynamic private sector job creation, can help alleviate the negative effects of unemployment for the most vulnerable. While Ethiopia has an extensive food for work program, it is only active in rural areas. Its extension to urban areas may be the best mechanism to directly expand opportunities for the unskilled unemployed.

Creating an effective civil service. Current remuneration and hiring practices appear to have two main consequences: relatively good conditions for the low skilled could distort the lower end of the labor market, make private firms less competitive and possibly also encourage “wait” unemployment; and the need to respond to a visible brain drain problem at the high end which, while not quantified in extent, appears to be undermining government capacity at the senior policy level. The current trend based on international experience is to disaggregate pay and employment reforms and sequence them sectorally (agency-by-agency reform) and/or by cadre (i.e., creating a senior executive service). In the short term, however, it is possible to introduce (with donors support) simple and focused measures to help retain the key staff who have been identified as essential to senior level management and policy functions.

Enabling migration to contribute to growth and poverty reduction. In the case of rural development, migration needs to be seen in a context of overall income diversification, favoring at least shorter range migration and connectivity with towns. Several policy elements currently pursued are in line with these objectives including strengthening the management, capacity and planning of rural towns, which play a key role in providing services and access to markets for the rural population; and scaling up the provision of rural infrastructure such as roads and electricity. Urban authorities, faced with the prospect of a growing population, need to consider how to create an enabling environment which can turn the challenges posed by increased mobility into opportunities. This involves developing new alternatives for service delivery, providing urban infrastructure and considering access to land and credit by the newcomers. Particularly important in this areas are policies aimed at facilitating flows of people and information, and deregulation (for example in terms of access to services and jobs related to official residence) to prevent the creation of a new urban underclass.

Strengthening monitoring and evaluation of labor market developments. The inclusion of employment creation as a strategic priority has been an important innovation in PASDEP and offers an opportunity to enhance the value and policy impact of labor market information. Monitoring and reporting on PASDEP should build upon an integrated Labor Market Information System. Collaboration among all stakeholders, a rationalization of the data collection activities and improved coverage of rural areas are important priorities in this area.
1. INTRODUCTION

1.1 The development challenge facing Ethiopia is immense. Its people are among the poorest in the world, the economy is growing too slowly and population growth is rapid.

1.2 Over the past several years at least, Ethiopia’s economy has made some major strides forward – growth has been strong, the private sector contribution to output and investment has expanded, some key exports have taken off, and inflation has been contained. The composition of recent growth reflects good performance across sectors, as does the increasing importance of the private and non-agricultural sectors as the driver of economic activity (Figure 1). Private investment’s share of GDP now exceeds 15 percent, and accounts for about 59 percent of total investment. Private consumption and investment represents about 80 percent of gross domestic expenditure.

Figure 1: Sectoral Composition of GDP

Source: MOFED.

1.3 This report focuses on a central element of Ethiopia’s challenge: the urban labor market.¹ We adopt this limited focus, for several reasons, most notably because the dual nature of the economy, a sharper emphasis on the problems, perspectives and environment of the non-agricultural sector² is useful. Moreover, it is in urban areas that the growth in labor supply will bring about the most visible changes. This in no way detracts from the need to develop the market and service-providing role played by rural towns and agricultural development.

¹ The Ethiopia CSA defines urban areas as “localities with 2000 or more inhabitants” though in practice (i) all administrative capitals (regional, zonal and wereda capitals), (ii) localities with urban dweller’s associations not included in (i) and (iii) all localities not included in either (i) or (ii) whose inhabitants are primarily engaged in non-agricultural activities are considered as urban.

1.4 The urban emphasis of this study is strategic. The recently finalized Government strategy – PASDEP (Plan for Accelerated and Sustained Development to End Poverty) – aims to supplement the existing Agricultural Development Led Industrialization strategy with a new emphasis on urban development, and adopts job creation as one of the priorities, cutting across all the elements needed for pro-poor growth. This shift is in line with international as well as Ethiopian evidence on the complementarities between urban and rural development, as well as the impacts of cities on growth and poverty reduction.

1.5 While Ethiopia is still a predominantly agrarian society, wherein an estimated 85 percent of the population lives in rural areas, and some 80 percent make a living through agriculture – over the last decade growth per capita in the non-agricultural sector has been more than two and half times higher than in agriculture (averaging 2.3 rather than 0.9 percent annually). The share of agriculture in GDP declined by 7 percent over the period.

1.6 The rebalancing suggested in PASDEP implicitly recognizes that urban agglomerations of all types across the urban spectrum (from small rural towns to large cities) are where the more dynamic secondary and tertiary activities take place. The agglomeration of people and firms in cities, when supported by a conducive institutional environment, leads to “increased efficiency in flows of goods and services, matching of workers to jobs, flourishing of markets, and spillovers of knowledge and information” (Kessides 2005, xiv). Yet in Ethiopia, despite a better performance than agriculture, the contribution of the secondary and tertiary sectors to growth has been about 60 percent, much less than the African average of about 80 percent. Fostering growth requires therefore addressing not only the barriers to productivity in rural areas, but also the bottlenecks which are preventing the non-agricultural economy from fully contributing to growth.

1.7 The emphasis on unleashing the productive potential of the urban economy goes hand in hand with a focus on jobs creation, particularly in urban areas. The pressures of a growing labor supply and of high levels of unemployment make this challenge very visible, particularly as in urban areas no safety nets system exist.

1.8 Focusing on growth and jobs in urban areas is also central for poverty reduction. While the incidence of poverty is higher in rural areas, and the majority of the poor lives in rural areas, the case of Ethiopia is notable in Africa (together with Nigeria) in the relative similarity of the urban and rural poverty rates – at 37 and 45 percent respectively. This is surprising as in the majority of African countries the greater economic opportunities offered by urban areas translate into much larger gaps in poverty incidence (Kessides 2005). While urbanization in itself can improve welfare outcomes over the

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3 It is very difficult to arrive at reliable estimates of sectoral growth, particularly as population numbers are based on projections in the absence of a recent Census.

4 Population growth since 1990 has been estimated at around 2.6 percent. The population 15+ in urban areas has grown by an estimated 827,000 between 1999 and 2003, and 93 percent of which has been for the age group 15-30. This has occurred while fertility in urban areas declined particularly in Addis Ababa where it is now estimated to be below replacement level.
medium term, in the meantime – as experienced by many developing nations in Latin America and Asia – urban poverty can become a new and more visible plight.

1.9 In Ethiopia the recent Poverty Assessment (World Bank 2005) identified signs that poverty in urban areas was on the rise, including a growing incidence among household heads involved in non-agricultural activities. This can be traced to trends showing an increase in the numbers of self-employed in urban areas, largely in low-productivity activities and in the informal sector. While more analytical work on poverty and urbanization is underway, the importance of creating functional cities with a supportive economic environment characterized by affordable basic services and without barriers to the economic inclusion of the poor is clearly part of the growth and poverty reduction agenda in urban Ethiopia.

1.10 Focusing on the urban agenda does not detract but rather complements the attention due to the rural agenda and the plight of rural poverty. The importance of rural-urban linkages for poverty reduction has been long recognized (IFPRI 2005) and recent evidence from Ethiopia (Dercon and Hoddinott 2005) illustrates these various linkages. As expected, local market towns play a major role in terms of selling and buying of products (as well as in the delivery of basic services) while larger urban areas and Addis offer opportunities for economic diversification through migration and the receipt of remittances. Thus, both the connectivity between urban and rural areas (roads, rural telephony) and the functioning of urban markets – of the labor market in particular – affect rural households’ returns to labor and skills.

1.11 One of the main linkages between urban and rural areas, where labor markets are central, is internal migration. While mobility in Ethiopia has historically been low, there are signs that internal migration is on the rise. Analyzing the performance of migrants in urban areas, and the impact of internal migration on growth and poverty reduction is therefore central to understanding an important part of the structural transformation process ahead.

**Summary Outcomes**

1.12 The performance of Ethiopia’s urban labor markets has been disappointing. The headlines, which are detailed in the report, are dramatic, and include the following:

- Open unemployment has been persistently high and average duration is long, though recent trends suggest improved performance.

- There is significant segmentation – two relatively privileged sectors in the public and formal private sectors, a massive informal sector and a large stock of unemployed. Individual transitions across these states have increased over time, but remain relatively limited.

- Formal sector employment in urban areas is dominated by the state and manufacturing sector employment remains among the lowest in the world.
• The majority of those who are working in urban areas are engaged in informal sector activity, typically as a last resort but also as a persistent state.

• Average wages are low, especially for the unskilled and in the informal sector – but productivity is also very low.

• Women are especially disadvantaged in the labor market – and typically face worse outcomes with higher levels of unemployment, lower wages, and a greater concentration in the informal sector.

• Many youth seem to enter the labor market through low quality jobs in the informal sector or into unemployment.

• The challenges are growing, as the urban labor supply is growing fast even with falling fertility rates.

1.13 In this context, a much better understanding of the functioning in urban labor markets, key constraints and implications for policy makers, is a priority. This report contributes to the agenda in several key respects. We establish basic metrics, by exploiting the rich data sources that are available, looking at individual decisions (like labor force participation), firm data, and sectoral and aggregate outcomes. We explore where and what types of jobs have been created, what has been driving those dynamics, and how labor market outcomes have responded to changes in the policy agenda, such as economic restructuring and privatization.

1.14 Throughout, this report seeks to highlight the policy dimensions of our findings. The discussion is significantly shaped by the need to accelerate the structural transformation of the Ethiopian economy, both in terms of the traditional-rural to modern-urban transition, and the transition from a socialist to a market-based economy. The centrality of the private sector to a buoyant labor market entails a close focus on constraining factors and options for more proactive policies, especially relating to informal operators.

1.15 The structure of this report is as follows. Volume I synthesizes the emerging findings and policy implications while Volume II presents a series of thematic chapters which summarize the underlying background work. In this volume the next chapter sets the stage for the analysis by clarifying the metrics of the key labor market indicators. Chapter 3 looks at the structure of urban labor markets and what has hindered their ability to generate jobs despite the acceleration of growth in the last few years. Chapter 4 focuses on the challenge of urban unemployment, while Chapter 5 looks at the effects of migration on urban labor markets. The final chapter in this volume reviews the emerging policy agenda.
2. SETTING THE STAGE – BASIC INDICATORS AND TRENDS

2.1 The Government’s poverty reduction strategy identifies urban development and employment creation as strategic priorities, and this chapter attempts to set the stage for this challenge by providing both a snapshot and recent trends in urban labour markets in Ethiopia. Establishing the basic metrics of the labour market is a major contribution of this report. Significant efforts have been made to reconcile the variety of data sets, definitions and other measurement issues. A series of stylized facts are developed to help characterize the functioning of labour markets. A more detailed analysis of the data is provided in vol. II, Chapter 1.

A Snapshot of Urban Labour Markets

2.2 How well are labour markets working in Ethiopia? People and policymakers typically look at employment opportunities and wages to reflect the health of the labour market and indeed of the economy overall. A GOE inter-ministerial technical committee has identified a list of 14 indicators to be monitored to inform policy making, and work is underway to design a labour market information system (see vol. II, Chapter 7).
Box 1: Key Definitions

In this report we adopt the KILM (Key Indicators of the Labour Market) definitions developed by the ILO to identify the main labour market indicators, unless otherwise specified. There are different names for each indicator, which we use interchangeably:

**Activity rate or Labour Force Participation Rate or Participation rate** – the share of the population aged 15+ either engaged in, or available to undertake, productive activities. It thus captures the idea of labour supply for all productive activities according to the 1993 UN System of National Accounts, though to the extent that some sectors (e.g. informal activity or where women predominate) are not fully reflected in employment data, labour supply is underestimated.

**Employment rate** - the share of the employed over the total population aged over 15 years. The employed are defined as all persons 15+ who were either in paid employment (including apprentices), or in self-employment including those working as employers of others, own-account workers, members of producers’ cooperatives, and those temporarily not at work but with a formal job attachment over the last week. Such measure captures the ability of an economy to create jobs. The definition adopted focuses on the population 15+ (rather than 10+ as adopted by the CSA) in order to derive a clearly monitorable indicator which can be a policy target. Including the age-group 10-15 creates an implicit conflict between employment and education policy objectives.

**Unemployment rate** – the share of the unemployed over the labour force (employed + unemployed) population aged over 15 years. According to ILO conventions this means, during the reference period, being: (a) "without work", i.e. not in paid employment or self-employment, (b) "currently available for work"; and (c) "seeking work", i.e. had taken specific steps to seek such employment. Relevant to Ethiopia is the recognition that “in situations where the labour market is largely unorganized or of limited scope, where labour absorption is, at the time, inadequate, or where the labour force is largely self-employed, the criterion of seeking work” may be relaxed. The CSA definition is based on a "relaxed definition" which leads to higher unemployment rates. However in this study we adopt the internationally comparable definition based on all three criteria.

2.3 Key labour market indicators – activity rates, employment and unemployment rates, wages – help to take the pulse in urban areas. Throughout this study and with a more disaggregated analysis (see vol. II, Chapter 1) we will complement the insights that these basic indicators offer, particularly concerning the quality of employment (we will look at wages and dynamism of various sectors, and the inability of many of the existing jobs to support urban livelihoods, in line with worldwide evidence on the working poor). Our approach is designed to resonate with national policy makers, while using international definitions as far as possible (Box 1). While a range of data is available (see Box 2) we focus here on the two LFS surveys to identify trends over time, in order to maximize comparability across sources.

**Activity rates**

2.4 At about 65 percent, economic activity rates in Ethiopia are low compared to some other African countries (for example, 85 percent in Kenya and 79 percent in Uganda; Leibbrandt and Mlatsheni 2004). In general, participation is higher among men than women and among adults than youth, and increases with educational acquisition. Male participation is roughly in line with other African countries (which have strikingly similar rates in general) and female participation is below average. This reflects the
economically marginalized position of Ethiopia’s women, who have extremely heavy domestic work burdens and often little education.

2.5 Recent trends show a decline in the activity rate of male youth, but an increase among young and adult women; at the same time there has been a decline in activity among those at the higher end of the educational distribution (with the exception of the most educated—those with at least some tertiary education). The decline among young males reflects the positive effects of rising school enrollment. Meanwhile, activity rates rose significantly among women aged 20-24 years and 40-49 years, which may reflect better economic conditions in 2005 than in 1999 (the two data points).

2.6 Analysis of the determinants of activity reveals that women in general (when controlling for other characteristics) are not more likely than men to be inactive, though this is the case for the age group 25+. This effect has become less marked between 1999 and 2005. As female inactivity is likely to be at least partly driven by traditional gender roles in the households, the role of family composition has been explored in the analysis. Individuals living in households with more adults are more likely to include inactive adults – in 1999 this effect was stronger in urban areas outside of Addis, while in 2005 the reverse was true. Women living with children less than 15 are more likely to be inactive, an effect which is not significant in Addis but is in other urban areas.

2.7 Education, as shown also by the descriptive analysis, is correlated with patterns of inactivity with the more highly educated less likely to be inactive. Our analysis confirms this finding – for example, holding all else constant, in 2005 those in the “completed general education” category were 17 percent more likely to be active than all other education groups. Interestingly, however, in 1999, having completed general education had also a significant impact in reducing inactivity among adults, an effect which in 2005 was not significant.

**Employment rates**

2.8 Partly as a reflection of low activity rates, measured employment rates are low particularly for women. The average employment rate is 56 percent. About 41 percent of youth are employed. Fewer than 40 percent of the employed are women, albeit with significantly smaller employment gaps for younger age groups than for older ones. Welcome new evidence suggests that female employment outcomes may be improving: since 1999 employment rates have been steady overall, but have risen both for young and adult women.

**Unemployment rates**

2.9 The official rate of urban unemployment in 2005 was 21 percent (this is based on the population age 10+, while this study looks at those age 15+). Using the international definition, measured unemployment is lower than official numbers but still high at 14 percent. Standard international definition requires *active* job search, while Ethiopia relaxes the active job criterion on the ground that long durations of unemployment discourage workers from actively searching (see Box 5 in Chapter 4, this volume). That Ethiopia, together with South Africa, are the only countries in Sub-Saharan Africa...
officially reporting unemployment at more than 20 percent)\(^5\) which is partly due to the national definition of unemployment.

2.10 Urban unemployment rates have been consistently high and duration is protracted, with distinctive patterns by age cohort, gender and education. Adult male unemployment fell by one percentage point (from 9.1 to 8.1 percent) from 1999 to 2005, and stagnated around 13 percent for adult women. The gender unemployment gap therefore increased slightly over the period for the adult cohort. The median duration of unemployment fell dramatically, from 24 months in 1999 to 10 months in 2005, providing very encouraging evidence of dynamism. Decreasing duration notwithstanding, the persistence of high urban unemployment remains a major policy challenge; Chapter 4 is devoted to examining these issues.

### Table 1: Trends in Urban Activity Rates, by Age Group and Gender (percent)

<table>
<thead>
<tr>
<th>Age group 15+</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>64.8</td>
<td>65.3</td>
</tr>
<tr>
<td>Male</td>
<td>76</td>
<td>73.3*</td>
</tr>
<tr>
<td>Female</td>
<td>55.7</td>
<td>58.5*</td>
</tr>
<tr>
<td>Age group 15-24</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total sample</td>
<td>51.3</td>
<td>50.7</td>
</tr>
<tr>
<td>Male</td>
<td>56.2</td>
<td>51.6*</td>
</tr>
<tr>
<td>Female</td>
<td>47.6</td>
<td>49.9*</td>
</tr>
<tr>
<td>Age group 25+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total sample</td>
<td>73.8</td>
<td>75.7*</td>
</tr>
<tr>
<td>Male</td>
<td>88.4</td>
<td>88.7</td>
</tr>
<tr>
<td>Female</td>
<td>61.5</td>
<td>64.6*</td>
</tr>
</tbody>
</table>

**Note:** *Significantly different from 1999 figure at 95 percent, though results should be interpreted with caution.

**Source:** For all tables unless otherwise indicated LFS, & UBEUS 2003 and 2004, own calculations.

---

\(^5\) South Africa previously reported the relaxed definition, but has moved to the internationally comparable one. For 1999 those stood respectively at 36.2 and 23.3 (Kingdon and Knight 2006).
Table 2: Trends in Employment Rates, by Age Group and Gender (percent)

<table>
<thead>
<tr>
<th>Age group 15+</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>55.4</td>
<td>56.4</td>
</tr>
<tr>
<td>Male</td>
<td>66.9</td>
<td>65.4</td>
</tr>
<tr>
<td>Female</td>
<td>46.1</td>
<td>48.8*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Age group 15-24</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>39.4</td>
<td>40.7</td>
</tr>
<tr>
<td>Male</td>
<td>44.9</td>
<td>42.9</td>
</tr>
<tr>
<td>Female</td>
<td>35.3</td>
<td>38.8*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Age group 25+</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>66.1</td>
<td>67.7*</td>
</tr>
<tr>
<td>Male</td>
<td>80.7</td>
<td>81.5</td>
</tr>
<tr>
<td>Female</td>
<td>53.8</td>
<td>55.9*</td>
</tr>
</tbody>
</table>

Note: *Significantly different from 1999 figure at 95 percent, though results should be interpreted with caution.

Table 3: Trends in Unemployment Rates by Age and Gender (percent)

<table>
<thead>
<tr>
<th>Age group 15+</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>14.8</td>
<td>13.5*</td>
</tr>
<tr>
<td>Male</td>
<td>12.3</td>
<td>10.7*</td>
</tr>
<tr>
<td>Female</td>
<td>17.7</td>
<td>16.6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Age group 15-24</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>23.4</td>
<td>19.8*</td>
</tr>
<tr>
<td>Male</td>
<td>20.3</td>
<td>16.9*</td>
</tr>
<tr>
<td>Female</td>
<td>26.2</td>
<td>22.3*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Age group 25+</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total sample</td>
<td>10.9</td>
<td>10.6</td>
</tr>
<tr>
<td>Male</td>
<td>9.1</td>
<td>8.1*</td>
</tr>
<tr>
<td>Female</td>
<td>13.0</td>
<td>13.5</td>
</tr>
</tbody>
</table>

Note: *Significantly different from 1999 figure at 95 percent, though results should be interpreted with caution

Earnings

2.11 While finding a job is a challenge, even having a job does not guarantee the means to escape poverty. Median wages\(^6\) for urban paid employees are generally low (Br 300 a month, or US$34 in 2005), although significant differences are found across type of employer, sector and worker characteristics. The employers that pay higher median

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\(^6\) Gross earnings from main occupation and including bonuses, overtime, allowances and other benefits (UBEUS 2003). Earnings are reported only by “paid employees” (48 percent of urban employed). As most informal establishments are self employed (not “paid employees”), reported informal wages likely overstate the average.
wages are the parastatals and the government (Figure 2). In terms of industrial sectors, median wages are highest for workers in the financial, real estate, and transport sectors, and for service providers and government workers; wages are lowest for domestic employees (Figure 3).

**Figure 2: Median Earnings by Employer, 2005**

**Figure 3: Median Earnings by Sector, 2005**

*Source:* For all figures unless otherwise indicated, LFS 1999 and 2005, own calculations.
2.12 Those with little education face particularly low wages. An illiterate person earns only 4 birr per day compared with 34 for someone with at least some higher education. Multivariate analysis confirms that earnings rise with education: having some primary education is associated with wages 16 percent higher than those of illiterate workers, and higher education with 90 percent increases over illiterate workers (although there is a puzzling drop in the premium from non-complete general education—70 percent—to general complete—58 percent). The skills premium is particularly strong in the case of higher education for men, while for women the biggest increase is for those with more than general education.\(^7\)

2.13 Skills gaps partly explain gender differences. At the national level, the average male adult has completed 1.8 grades, the average female less than one grade. Even among economically active young women about a quarter are illiterate (compared to 9 percent for men) and therefore only able to access low pay jobs. Thus workers with less than four years of education are likely to be living in poverty. Figure 4 compares monthly earnings against urban poverty lines (upper and lower). This comparison is likely to underestimate the incidence of working poor in urban areas as these refer to individual consumption needs at an austere level – Br 150 or USD$20 per month – obviously breadwinners with dependents find the challenge of sustaining themselves and their families much more difficult.

**Figure 4: Average Monthly Earnings Relative to the Poverty Line, 2005**

![Graph showing average monthly earnings relative to the poverty line for different levels of education.](image)


*Note:* The dashed line indicates the lower (Br 110); the dotted the upper poverty line (Br 163). These are unweighted averages from World Bank, 2005a.

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\(^7\) As expected, returns to education are higher for women once marital status control for selectivity, since women are generally less likely to be employed, even at high levels of education.
2.14 Low wages are associated with underemployment, particularly in the informal sector. Figure 5 shows that the percent of workers who are “available and ready to work more hours” is highest among youth and prime-age adults, and higher for males than females.

Figure 5: Underemployment by Gender, 2005 (percent)

2.15 To sum up, urban areas in Ethiopia are characterized by persistently high unemployment (although the typical duration is decreasing), and substantial wage differentials between the formal and informal sector, and across types of jobs. Significant heterogeneity characterizes the performance of different groups, with women and the youth facing particular challenges. The following sections describe recent trends, to set the stage for possible explanations in the next chapter.

Recent Trends in Job Creation

2.16 Over the decade to 2004 the urban economy grew at an annual rate of approximately 2 percent per capita. Within services the highest rates of growth were registered in banking and insurance (9 percent), health and education (8 and 7 percent respectively) and in transport and communication (7 percent). Within industry, construction grew at 8 percent while manufacturing growth was limited to 3 percent.

2.17 Both the public and private services have been driving net employment creation in urban areas with “public administration, social, cultural, recreational, personal and household services” growing by an estimated 42 percent between 1999 and 2005, against

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8 For detailed analyses on the economic performance of the country as a whole and sectoral trends in employment creation see also two recent ILO studies by Demekel et al (2005) and De Gobbi (2005), as well as the World Bank Country Economic Memorandum (2007).
9 This estimate is obtained comparing the real growth in industry and services and assuming only “natural” population growth (at 2.5 percent) and no migration.
9 percent of the 1994-1999 period. It is possible to disaggregate these trends only from 1999 – this reveals strong growth in the “public administration” and all subsectors of “other household services”. Manufacturing has continued to add jobs, albeit at a reduced pace, growing by 30 percent versus 37 percent in the previous period (Figure 6). Within the services category financial services grew spectacularly by more than 300 percent since 1994, albeit from a very low base.

**Figure 6:** Trends in Urban Employment by Industrial Sector, 1984-2004

Note: *social, cultural, recreational, personal and household services.

Sources: 1984, 1994 Demeke, Guta Ferede 2003 (based on Census sources), 1999, 2005 Own calculations based on LFS.

2.18 By analyzing jointly national accounts and employment data it is possible to disaggregate the productivity and employment components underlying sectoral growth. In aggregate terms it appears that the 1.9 percent per year growth in value added in agriculture and allied activities has been driven almost entirely by growth in employment with insignificant growth in productivity. In contrast, in industry the effects of the almost 3 percent annual growth in employment have been eroded by productivity falling by 0.6 percent per annum. In services, the 2 percent annual growth registered has been mostly driven by increases in productivity.

2.19 Disaggregated analysis shows that in most sectors which experienced more than a 3 percent annual growth between 1999 and 2005 productivity declined while employment rose significantly. Among the high growth sectors, the exceptions are the transport and communication, where the annual growth in employment was negligible and the health sector, where employment actually shrunk while productivity increased significantly.

2.20 Between 1999 and 2004, the public sector and self-employment contributed similar amounts to urban employment, growing respectively by 7 and 8 percent in total. The net public sector contribution, which was almost half of total net job creation,
reflects offsetting trends – a strong increase in the number of government employees and a fall in the number of parastatal employees.

2.21 The significant expansion of the civil service by over 60 percent during the 1990s was driven by decentralization. Growth was especially rapid at local levels, doubling since 1992 (Figure 7).

![Figure 7: Civil Service Growth, Federal and Regional, 1975-2003](image)

Some Stylized Facts

Some stylized facts are presented here to help to put the functioning of the labour market in context before proceeding to explaining observed trends in the next chapter.

**1. The size and quality of labour supply has been increasing**

2.22 Ethiopia’s urban labour supply has been growing at a sustained annual pace of 3.5 percent, partly due to internal migration. In the absence of a recent census it is hard to quantify, but there are concerns about absorption into the urban economy, and downward pressures on wages of the local unskilled population (see vol. I, Chapter 5.).

2.23 The education profile of the labour force has rapidly risen, but the averages remain low. Between 1996 to 2004 urban adult literacy rose from 66 to 74 percent. Still, in 2005 only about one in five in the urban workforce had secondary or higher education and average levels of schooling of urban labour force participants are still fairly low (about 8-9 years of schooling for males, and about a year less for females, with a larger gender gap among older cohorts—but these averages exclude those who have not had any formal schooling). Sectoral studies reveal evidence of specific skills gaps which create bottlenecks for job creation and rising productivity.
2. Education pays, particularly for women and in urban areas outside Addis

2.24 Returns to education in Ethiopia are high and increase at higher levels. Taking illiterates as the reference group, the impact of education on earnings ranges from 26 percent for those with grade 1-4 to 130 percent for the highest skilled. Women, who on average are paid 22 percent less than men with the same individual characteristics, obtain much higher returns to education than men at the upper end of the educational spectrum. Although returns are about the same for primary education, returns to completed general education are 95 percent for women (to 77 percent for men), and returns to higher education are 147 percent for women (132 percent for men)\(^{10}\).

2.25 Differences in returns also emerge when splitting the sample between Addis and other urban areas. In other urban areas, returns to education are significant and higher than in Addis for all levels of education—for example, returns to grade 5-8 are 32 percent in Addis and 49 percent elsewhere. Interestingly, returns from non-formal and grade 1-4 education are not statistically different from illiterate in Addis: suggesting that more than minimal education is needed to make a difference to earnings. Regional differences between Addis and other regions are statistically significant and of the order of 10-20 percent for most regions. Somali and Gambella enjoy higher earnings, while SNNP, Amhara, Oromia, Tigray and Benishangul have lower earnings.

2.26 Using the wage regressions to control for education, other important drivers of differences in earnings emerge—in particular, employment status is significant for nearly all categories. Relative to civil servants, parastatal workers earn about 8 percent less, private sector workers 34 percent less, and domestic workers 88 percent less.

3. Supply trends pose major challenges

2.27 Supply trends are likely to increase labour market participation as better educated people are more likely to be active in the labour market: in 2005, 95 percent of over 25 year olds with higher education were active compared to 62 percent of the illiterate. Likewise, average years of schooling are higher for the active population in the older age groups, suggesting that highly skilled workers have longer productive lives.

2.28 The educational profile of younger generations in urban areas is changing (Figure 8). Currently, the data show that gender participation gaps narrow significantly at higher education levels. Rising education will help promote female participation, though obstacles remain.

\(^{10}\) Another distinguishing feature is that women are more likely than men to self-select into the workforce according to their personal characteristics and those women that would earn low wages (because of the skill profile, the marital status, the age, number of children) chose not to work.
Increased labour force skill and female participation are positive developments which also raise challenges, particularly in terms of the expectations of youth. The 1994 labour proclamation abolished the job guarantee for university graduates. There was evidence that in the 1990s skilled youth were willing to queue and remain unemployed until they got “good jobs” particularly in the public sector (Serneels 2004). More recent evidence suggests that individuals are more willing to take any job available (vol. I, Chapter 4). Panel evidence of high durations of unemployment also suggests that queuing is not likely to be a successful strategy to access good jobs.

4. Youth, women and the disabled face specific challenges

Youth employment rates have fallen significantly, and many youth seem to enter the labour market via low quality jobs or unemployment. Only about half of Ethiopia’s 2.4 million urban youth were employed in 2005. About 80 percent of employed youth work in the informal sector, many of whom are unpaid family workers. The better skilled have better access to paid employment: in 2005, only 27 percent of illiterate youth were in paid employment against 61 percent of the high skilled.

Skills mismatch is another problem facing youth. Although this generation is the most highly educated in Ethiopia’s history, if they can not put their skills to use, the private and social returns expected to follow the government’s massive investment in education will fail to materialize. It will also come with a risk of frustration among the increasing numbers of educated urban youth. In this context, the change between 1999 and 2005 is very encouraging. In the first LFS, about two-thirds of highly skilled young workers were in non-professional jobs; by 2005, the share had fallen to just over one third (Table 4). Highly skilled adults were also much more likely to be in professional jobs in 2005 than they were in 1999. In 2005, 36 percent of highly skilled 15-24 year olds were in non-professional jobs (compared to 26 percent of their adult counterparts) (Table 4).
Table 4: Share of High Skilled Workers in non-Professional Occupations (percent)

<table>
<thead>
<tr>
<th>Age</th>
<th>1999</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age 15+</td>
<td>39.8</td>
<td>27.8</td>
</tr>
<tr>
<td>Age 15-24</td>
<td>67.8</td>
<td>36.0</td>
</tr>
<tr>
<td>Age 25+</td>
<td>35.7</td>
<td>26.4</td>
</tr>
</tbody>
</table>

Note: NON-PROFESSIONALS="Clerks" + "Service, Shop and Market Sales workers" + "Skilled agricultural and fishery" + "Crafts and related trades" + "Plant, machine operators and assemblers" + "Elementary occupations" + "Armed forces". PROFESSIONALS="Legislators, Senior Officials, managers" + "Professionals" + "Technicians and Associate Professionals".

2.32 Labour market outcomes are heavily affected by traditional gender roles. Analysis of the determinants of employment suggest that in urban Ethiopia as elsewhere, household responsibilities and particularly child care are significant obstacles to labour market participation. Women are underrepresented among white collar workers – while they represent almost half of total employment their combined share in “technicians and associate professionals”, “professionals” and “legislator senior officials and managers” does not exceed 30 percent.

2.33 Women earn less than men: given the same observable characteristics, women are likely to be paid 22 percent less. At the same time, decompositions of inequality of earnings across gender and educational levels show greater heterogeneity among women, which means that some women do better, others do much worse.

2.34 In Ethiopia as elsewhere, the disabled faces special challenges because of discrimination and reduced capacity for work. For example, the PPA finds that in urban and rural areas the disabled, being unable to secure jobs, are likely to face downward trajectories in wellbeing. Disability in itself is difficult to define and census and survey data often provide very different estimates of prevalence. For Ethiopia, the latest CSA estimate (2003) is of a prevalence of 7.6 percent (some 5 million people), compared to Uganda, for example, where 5 percent of the urban household heads were identified in the census as disabled. International estimates often report higher prevalence rates (10-15 percent), of whom typically about one third face serious disability.

5. **There are significant differences across urban labour markets**

2.35 Urban areas as defined in Ethiopia are heterogeneous. “Urban” includes "localities with 2000 or more inhabitants” but also (i) all administrative capitals (regional, zonal and wereda capitals), (ii) localities with urban dweller’s associations not included in (i) and (iii) all localities not included in either (i) or (ii) whose inhabitants are primarily not engaged in non-agricultural activities. Ongoing work is analyzing the differences in the economic roles between urban areas of different types.

2.36 Distinctions are generally drawn between primary cities (with more than 1 million people) and secondary cities (between 100,000 and 1 million). The distribution of the
urban population in Ethiopia is skewed: there is only one primary city, Addis Ababa, with the next largest city, i.e. Dire Dawa having an estimated 300,000 residents. For analytical purposes here we distinguish between larger towns – that is the three largest cities – and other urban areas. Addis Ababa, Dire Dawa and Harar together account for about one-third of the total urban labour supply.

2.37 Compared to small towns, large towns are characterized by lower employment rates and higher unemployment for all age groups. For example, in small towns, employment rates for 20-24 year olds are 10 percentage points higher than in large towns (57 percent vs. 47 percent). Employment rates are higher among prime-age workers than among youth regardless of location, but the gap between small and large towns remains (e.g. the employment rate for 40-44 year olds is 82 percent in small towns, vs. 70 percent in large towns). Employment in smaller urban areas shrank between 1999 and 2005, as did activity rates, while unemployment increased.

2.38 Employment in smaller cities is more oriented towards primary activities, as well as to the hotel and restaurants sector. An upcoming World Bank study on urbanization in Ethiopia will shed more light on these issues and the role of cities of different types in fostering growth and poverty reduction.

2.39 Different regional economic structures are reflected in pronounced labour market differences. Employment rates range from 44 percent in Gambella to 69 percent in Benishangul, and unemployment from 24 percent in Addis to 5 percent in Benishangul. The incidence of informal employment also varies significantly across regions. However further analysis is needed to understand the underlying determinants.

A Note on Data Sources and Comparability

2.40 In analyzing labour markets in Ethiopia we are in the fortunate position of benefiting from a variety of data sources, mainly collected by the CSA (Box 2), but the analysis also faces significant comparability issues. These issues inevitably arise when drawing on different surveys, particularly if survey instruments are modified over time, if new instruments are introduced, and/or if different surveys have different geographical coverage.
Box 2: Primary Labour Market Data Sources Used for this Study

1999 National Labour Force Survey (LFS) conducted in March 1999 by the CSA. The survey was nationally representative and covers all zones except 6 in the Somali region and 2 in Afar. The data are representative at the national, urban, rural and regional level. The survey covers the population aged 10 and over, recording their labour market status as well as a variety of socio-demographic variables such as age, gender, migration status and education. The survey did not collect wage data. The survey covers 31,859 households in urban areas, 2,518 of which in Addis.

2005 National Labour Force Survey (LFS) conducted in March 2005 by the CSA. The survey was nationally representative and covers all zones except Gambella region (with the exception of Gambella town) and 6 zones in the Somali region and 3 in Afar, mostly inhabited by pastoralists. The data are representative at the national, urban, rural and regional level. The survey covers the population aged 10 and over, recording their labour market status as well as a variety of socio-demographic variables such as age, gender, migration status and education. The survey instrument has been updated with respect to the 1999 version, the most notable change being that it includes wage data. Other changes, including an updating of the statistical sampling frame and a more precise characterization of urban areas which allows a break down of major urban and other urban areas have also been made. The survey covers 29,623 households in urban areas, 21,420 in major urban areas.

Ethiopia Urban Household Socio economic Survey, a joint program of the Addis Ababa University and the University of Gothenburg, Sweden. Started in 1994, with four waves, in 1995, 1997, 2000 and 2004. Some 9,000 to 10,000 individuals in 1500 to 1600 households are covered. More than 40 percent of individuals in the first wave were tracked by all subsequent waves, while a much higher proportion were covered by at least three waves. A sub-sample of the panel in Addis was re-interviewed in April-May 2006 to provide additional information on informal activities and unemployment – see Box 6.

Urban Informal Sector Survey (ISS) conducted in 2003 by the CSA. The definition of informal sector adopted is the one of home-based or individual establishment/activity operated by the owner with a few or no employees. The survey covers urban centers only, and 15,035 operators were interviewed. The sample was derived by sampling enumeration areas, compiling a roster of informal operators by inspecting all households living in the given area and finally randomly drawing statistical units from those rosters.

2.41 Some of the challenges faced in this analysis include:

- Difficulties in reconciling evidence from different survey series – this report uses as main sources of information the LFS surveys. The trends identified by these surveys differ somewhat with those of the Urban Employment and Unemployment Survey (UBEUS) series by the CSA, a smaller biannual survey. Difficulties include possible seasonality effects, and the different sampling frames adopted. To the extent that the UBEUS becomes a regular annual or biannual survey, more analysis is needed to understand how it can be made more comparable with the LFS.

- Difficulties in reconciling some of the panel with the cross-sectional evidence. The availability of a panel is essential to understand labour markets, yet trends might not be comparable with those of the LFS. The panel is limited to the seven
largest cities in Ethiopia, which together with differences in the survey instrument makes indicators hard to compare.\footnote{For example, in the 2000 wave of the Urban Socio-Economic Survey Sample the share of the 15-64 age group who were in employment was 38 percent against 48 percent in the 1999 LFS; similarly, the share of those unemployed was 17 percent against 16 percent of the LFS.}

- Difficulties in reconciling administrative and survey data, particularly for the civil service. Administrative data exclude contract and temporary work while providing details on some jobs which – because infrequent – are less likely to be covered by the surveys.

2.42 Further work in triangulating different sources and refining survey instruments is needed, ideally by conducting purposefully designed surveys to test some of the features of the instruments now in use. As an example, a module of the ALMS survey (Box 6) suggests that wages from secondary jobs might not be an important element of overall earnings. If confirmed, this suggests that the quality of wage data currently collected is higher than expected.
3. WHY SO LITTLE JOB CREATION?

3.1 The performance of urban labour markets in Ethiopia has been disappointing, even with the acceleration in growth in recent years. Jobs growth has been slow, and way below what is needed to productively employ urban residents looking for work; unemployment is thus high. Even for those who have income earning opportunities, these are typically in the informal sector and very low paid. Compounding the challenges of sluggish job creation and low pay are the particular disadvantages faced by women and youth.

3.2 Our hypothesis is that these dismal outcomes can be traced back, at least in part, to segmentation of the labour market. In effect what we see is an urban economy that is to a large extent cut into three segments – the relatively privileged public sector; the private formal, and the large informal economy, which is mainly small scale and more ‘survival’ than entrepreneurial. To explore this hypothesis, this chapter seeks to explain the scale and pattern of job creation in Ethiopia and examine the policy and other factors which are generating the observed outcomes.

3.3 The chapter begins by reviewing the expected evolution of an economy transiting from state domination to the market. To understand better the Ethiopian experience, we bring insights from a mix of data sets, including firm level data and a household panel consisting of four waves spanning 1994 to 2004. This panel offers a unique opportunity to monitor and understand the evolution of the labour markets in the 7 largest cities in the country.12 We then turn to review more specific policy related and other constraints associated with employment in the civil service, parastatals, private and informal sectors in turn. A series of policy implications emerge which are discussed more fully in the final chapter.

The Transition Process: Expectations Versus Reality

3.4 Ethiopia’s transition agenda raises expectations of a gradual reallocation of resources from low-productivity sectors to more dynamic activities leading over time a series of observed labour market outcomes including:

- a decrease in unemployment, particularly of the high skilled;
- a reduced role of the public sector, and in particular of parastatals, in the economy; and
- a progressive shrinking of the informal sector.

12 Addis Ababa, Awasa, Bahir Dar, Dessie, Dire Dawa, Jimma, Mekele.
The pace of these reallocations should have increased as reforms gained momentum, so that individual mobility would increase over the period, in terms of flows into, but especially out of unemployment, and from parastatals.

3.5 We turn now to see what has happened in practice in Ethiopia, both at the aggregate and sectoral levels, as well as from individual worker perspectives.

3.6 Growth in private employment appears to have accelerated. While the public sector continues to account for the bulk of urban formal employment, the private sector has registered strong growth in recent years. However it is difficult to fully reconcile available data on trends. The panel (see Box 2 above) shows that the private sector accounted for nearly half of employment by 2004.13 However care is needed in using the panel to capture overall trends since as we saw in the last chapter, the aggregate data show that the share of public employment has risen.

3.7 Insights are provided by the ICA sample for 2000/01 – 1999/00 (Box 3), focusing on the accession rate14 and the separation rate15 in 2000/01. We find that the overall accession rate was about 16.7 percent, whereas the separation rate was 10.5 percent.

**Box 3: The 2001 Investment Climate Assessment Survey, and the Labour Market**

| The ICA firm level survey conducted by the World Bank in 2001 with data for 1998/99-2000/2001 provides empirical insight into: |
| Scale, ownership & performance of firms  |
| • Link from these attributes to business & financing environment, including the impact of labour regulation  |
| • Identification of characteristics of firms performing well/poorly  |
| • Labour market dimensions of performance, including gross flows  |
| • Disaggregated skill composition of employment over time by sector, ownership, size & other dimensions  |
| • Relative returns to skills, education, tenure & other worker characteristics  |
| • Relative wages by ownership, sector, size & other firm attributes  |

The individual worker data (n>2500) also permit estimation of simple wage functions, and estimates of the extent of job mobility; returns to training, unemployment incidence & duration. The caveats include the relatively small sample size of firms (n=427), and the partial coverage of economy (limited to manufacturing and the formal sector).

3.8 These levels of gross flows are small relative to OECD and many transition economies. There is significant variation across industries disaggregated by skill type, with state firms having markedly smaller gross flows (Table 5). The pattern is different among the highly skilled, however, with government-owned firms having a higher accession rate of managers and professionals.

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13 Unless otherwise noted, results on labor market transitions and other findings from the panel are drawn from Mengistae, Shimeles, and Bigsten 2006; see vol. II, Chapter 5.
14 The accession rate is defined as the number of new employees hired in one year divided by the number of workers at the end of the previous year.
15 The separation rate is the number of employees who left employment (because of retirement, dismissal or resignation) relative to the number of workers at the end of the previous year.
3.9 The story is quite similar when looking at separation rates in the ICA. Managers at government-owned firms had a separation rate about twice as high as those at domestic private firms (15 percent vs. 7 percent), which is indicative of restructuring (see below). However, unskilled production workers had a separation rate of only 4 percent from government-owned firms, compared to 17 percent from domestic privately-owned firms.

<table>
<thead>
<tr>
<th></th>
<th>Domestic Ownership</th>
<th>Foreign Ownership</th>
<th>Central Government Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managers</td>
<td>0.06</td>
<td>0.09</td>
<td>0.12</td>
</tr>
<tr>
<td>Professionals</td>
<td>0.15</td>
<td>0.21</td>
<td>0.2</td>
</tr>
<tr>
<td>Skilled production</td>
<td>0.18</td>
<td>0.19</td>
<td>0.06</td>
</tr>
<tr>
<td>workers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unskilled production</td>
<td>0.23</td>
<td>0.33</td>
<td>0.02</td>
</tr>
<tr>
<td>workers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-production workers</td>
<td>0.08</td>
<td>0.08</td>
<td>0.06</td>
</tr>
</tbody>
</table>

Source: ICA, 2001 (see Box 3).

The Pace of Reallocation: Individual Worker Mobility

3.10 An initial impression of the situation in the late 1990s can be gleaned from the analysis of individual worker experience in the ICA dataset, where the evidence points to low turnover rates. Based on retrospective reporting, we find that over the three years to 2001, about half of workers stayed in same job and one-third changed either once or twice. At the same time, about 23 percent of workers who had public sector work experience (including the army) moved to the private sector. Very few (0.8 percent) of workers had shifted from private to public sector.

3.11 Evidence from the panel provides complementary and updated insights on the extent of economic change and restructuring through the analysis of the experiences of individual workers over the decade. What emerges is an overall picture of change in appropriate directions, but from an extremely low base, and to an extent that has been very limited to date.\(^{16}\)

3.12 There has been extensive mobility out of the public sector, from both the civil service and parastatals (Figure 9). Over the decade as a whole, there was significant outward mobility from the civil service – less than half of those who had been working for the government were still doing so at the end of the decade. About one in five had moved out of the labour force, and a further 10 percent were unemployed (some due to retrenchment). Fewer than one-in-five had made a successful transition to the private sector however, of whom almost half were relying on informal work.

\(^{16}\) There are several labor market states that we can explore using the panel – i.e. employment in the public sector, employment in the private sector (of which informal), unemployed, and inactive. The latter group may either have retired over the period, re-entered education, or withdrawn from the labor force, discouraged.
3.13 The experiences of parastatal workers over the decade are suggestive of significant restructuring since, by 2004, fewer than one in five were in the same state as 1994. They also had a much higher probability of leaving the labour force altogether (35 percent rather than 21 percent for civil servants), coupled with another 10 percent who reported themselves as unemployed in 2004. It is notable, however, that very few – only one in ten – found work in the private sector, and about twice as many joined the civil service.

Figure 9: Transitions for Selected Workers 1994-2004 (percentage of group in 2004)


3.14 The experience of the unemployed over the decade of the panel is clear and worrying. A very significant proportion – 30 percent – of those unemployed in 1994 were still jobless a decade later – and an additional 22 percent had withdrawn from the labour market altogether. This means that fewer than half managed to find work over the entire ten year period. For those who did find jobs, the dominant path was informal work – which we know tends to be an option of last resort - only 17 percent got formal private sector jobs, and 12 percent found a public sector position.

3.15 It is interesting to contrast the Ethiopian experience with Hungary’s (Table 6). Hungary has been a successful reformer which has faced similar challenges to Ethiopia on the state enterprise front, although higher income levels allow extensive welfare provision. Unemployment in this case has been even higher: over almost a decade 80 percent of the unemployed remain unemployed, and overall less than 11 percent managed to obtain a job.
Table 6: Transition Rates in Hungary: 1994 - 2003

<table>
<thead>
<tr>
<th>Origin</th>
<th>Self-employed</th>
<th>State employee</th>
<th>Private employee</th>
<th>Unemployed</th>
<th>OLF</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self-employed</td>
<td>97.25</td>
<td>0.17</td>
<td>1.26</td>
<td>0.27</td>
<td>1.06</td>
<td>100</td>
</tr>
<tr>
<td>State employee</td>
<td>0.10</td>
<td>96.54</td>
<td>1.30</td>
<td>0.56</td>
<td>1.50</td>
<td>100</td>
</tr>
<tr>
<td>Private employee</td>
<td>0.39</td>
<td>0.52</td>
<td>96.94</td>
<td>0.82</td>
<td>1.33</td>
<td>100</td>
</tr>
<tr>
<td>Unemployed</td>
<td>0.74</td>
<td>3.13</td>
<td>7.29</td>
<td>80.14</td>
<td>8.69</td>
<td>100</td>
</tr>
<tr>
<td>OLF</td>
<td>0.27</td>
<td>0.67</td>
<td>1.03</td>
<td>0.93</td>
<td>97.11</td>
<td>100</td>
</tr>
<tr>
<td>Total</td>
<td>7.58</td>
<td>20.30</td>
<td>31.42</td>
<td>4.52</td>
<td>36.18</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Commander 2006, 1.8 million observations.

3.16 In Ethiopian, the fact that few of the unemployed obtained government jobs over the ten year period casts doubt on whether a significant part of unemployment reflected individuals prepared to wait for a public sector position as was found for the mid-1990s (Sermeels, 2002). The odds of actually securing such a job are so limited that this would not be a rational or sustainable option for individuals to pursue. And as we learn in Chapter 4 of this volume, a follow-up survey of the unemployed in Addis in May, 2006 found that three-fourths would accept “any job”.

3.17 Informal sector activity also tends to be a persistent state for the vast majority. The survey and qualitative evidence suggests that individuals remain active in the informal sector only in the absence of other options. The panel shows very few informal sector workers managing to transit to the formal private sector or other jobs (Figure 9). A small but noteworthy share (10 percent), however, moved from informal to public sector jobs.

3.18 The transition matrices show that mobility has increased significantly since 1997. This can be seen across the different states – for example while fewer than 7 percent of those who were unemployed in 1994 had some form of employment in 1997, over the next three years, transitions into employment picked up at a dramatic rate so that by 2000, the probability that someone reporting unemployment in 1997 had some form of employment was about 37 percent. In other words, the probability of transition from unemployment to employment was five times higher between 1997 and 2000 than it was between the initial waves. These relatively high rates of transition out of unemployment during the period 1997-2000 were more than sustained through 2004, at 41 percent.

3.19 While the higher flows out of unemployment into employment are compatible with significant rates of job creation, relatively few (only 13 percent) found jobs in the formal private sector. The informal sector was the largest single source of jobs for those unemployed who found jobs. However, flows out of unemployment into the public sector rose over the period, mainly into the civil service (Table 7).
Table 7: Rate of Absorption from Unemployment into Different Sectors
(percentage of Initial Unemployment)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal sector</td>
<td>2</td>
<td>18</td>
<td>24</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formal private</td>
<td>2</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Informal sector</td>
<td>4</td>
<td>19</td>
<td>17</td>
</tr>
<tr>
<td>Public sector</td>
<td>1</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Civil service</td>
<td>0.6</td>
<td>5.6</td>
<td>8.5</td>
</tr>
<tr>
<td>Parastatals</td>
<td>0.3</td>
<td>2.0</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Source: vol. II, Chapter 5.

3.20 The significant flows into unemployment are consistent with economic restructuring and transition. While only 2 percent of those who were in formal employment in 1994 found themselves unemployed in 1997, 18 percent of those in formal employment in 1997 were unemployed in 2000, and movements of this magnitude continued over the next four years (Table 8).

Table 8: Rate of Entry into Unemployment (as a share of group at beginning of period)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal sector</td>
<td>2</td>
<td>18</td>
<td>22</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private</td>
<td>2</td>
<td>13</td>
<td>14</td>
</tr>
<tr>
<td>Public</td>
<td>0</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Civil service</td>
<td>0.5</td>
<td>4.4</td>
<td>7.3</td>
</tr>
<tr>
<td>Parastatals</td>
<td>0</td>
<td>4.7</td>
<td>8.2</td>
</tr>
<tr>
<td>Informal sector</td>
<td>4</td>
<td>21</td>
<td>26</td>
</tr>
</tbody>
</table>

Source: vol. II, Chapter 5.

3.21 The rate of job destruction has increased over time. Job loss rates were much higher for all sectors during 1997-2000 and 2000-2004 than for the preceding period, as measured by the likelihood of transitioning from any job category into unemployment.

3.22 Consistent also with the restructuring story is the finding that, in the second and third periods, job loss rates doubled in state owned enterprise and nearly did so in government agencies, albeit from initially very low levels. While in the first period not a single public enterprise worker became unemployed, 5 percent (8 percent) of those who were working in a parastatal in 1997 (2000) were unemployed by 2000 (2004). Likewise we can observe that flows into parastatal employment declined over time, as discussed below.

3.23 The experiences of those in the informal sector prospects have been disappointing. A significant share transited into unemployment and relatively few moved to formal jobs. The probability of transition from informal to formal sector jobs nonetheless did rise, from the negligible base of less than one per cent (1994-7) to 15
percent in 1997-2000.\textsuperscript{17} At the same time, the probability of transition from informal to formal private sector jobs exceeds that of public sector jobs.

3.24 That the informal sector is one of last resort is consistent with the panel finding that flows into the informal sector are largely from the ranks of the unemployed or new entrants. Consistent with the hypothesis that informal activities are typically pursued in the absence of other options, we note that:

- More than one in ten people who were out of the labour force in 2000 entered the informal sector or self-employment by 2004, and about 20 percent of those unemployed in 2000 were self employed or in informal wage work by 2004.

- The probability that a formal sector worker in 2000 would be found in self employment or in informal paid jobs in 2004 was low: 6 percent for a government worker, 8 percent for a public enterprise employee, and 12 percent for an employee of a private firm.

3.25 The overall impression is that the policy reforms over the past decade have had some impact. This is evident in employment restructuring and hence the nature and extent of individual transitions, consistent with a shift towards a more market-based economy. Yet the evidence on stagnant unemployment and large inactivity rates, as well as low-productivity and low-growth prospects in informal activities, suggest that the reform agenda remains unfinished. In the following sections we will focus on different segments of the labour market to understand constraints faced to help inform a revitalized policy agenda.

3.26 These outcomes reflect individual preferences in the labour market, but also powerful influences of government policy which have shaped both the size and structure of the public sector as an employer, and the business climate for recruitment, pay and firing decisions and the prospects of smaller operators. Structural conditions, geography and institutions also matter. The focus here is on the key policy determinants of the observed outcomes, to set up the discussion and conclusions in the final chapter.

**The Impact of Public Sector Employment and Remuneration Policies**

3.27 The policy motivation for our review of public sector employment and pay policies in this chapter is grounded in its relative size, and the effects of public sector employment and pay policy on urban labour market trends. A somewhat distinct issue, which is the need for Government to be able to recruit and sustain the staff needed to deliver on its development agenda, is addressed in the concluding chapter. The basic questions explored here are whether the public sector is a good place for individuals to work, and whether the wages and terms of employment in the public sector push up costs in private sectors.

\textsuperscript{17}Indeed the contrast between the corresponding transition probabilities for the periods 1994-1997 and 1994-2004 largely reflects this increase.
3.28 Accounting for almost one in five of urban workers, and almost two-thirds of those with formal sector jobs, the public sector has a major influence on urban labour markets.\(^{18}\) It is a major player in the skilled segment of the market, accounting for about 68 percent of employment among those with higher education. And with nearly three-fourths of civil servants having at least completed general education, according to the LFS the skills profile of the civil service is much higher than that of other employment categories.

3.29 The Ethiopian civil service has expanded significantly over the past decade as part of the decentralization policy. As a result of this big push, the share of the public sector in total wage employment is high relative to regional comparators. The expansion was concentrated at decentralized (regional and local) levels, so that by 2004, only 11 percent of civil servants were Federal rather than regional employees.

3.30 Compared to other employees, civil servants enjoy relatively high remuneration. An index of average public sector pay shows a steady rise since the devaluation of the early 1990s, aside from temporary dips in 1995 and 2003. Real wages in 2005 were more than double the 1998 level, which in part reflects increases at the top end of the wage scale.

3.31 Traditionally, the civil service pay structure in Ethiopia was compressed – reflecting the influence of minimum pay for the unskilled, and constraints at the upper end. Looking at more recent trends we can see:

- Internal pay relativities were stable in the latter part of the 1990s, then became more compressed in the first half of the present decade. A comparison between 1994/95 – 2001/02 and 2001/02 – 2004/05 shows that the salary relatives of the professionals and administration staff and the sub-professionals and professionals were similar. During the recent period, the ratio of average base salaries between manual and professionals, declined from 1:7.2 to 1:5.

- Internal wage compression has been circumvented to the extent that the expansion in the civil service was accompanied by an expansion in numbers employed in the higher brackets. The Remuneration and Conditions of Service Commission\(^{19}\) highlighted the reclassification of positions as a response to lack of wage competitiveness at higher levels. At the same time, frequent reorganizations, allowances, manipulation of performance appraisal and transfers policies, have arguably distorted the civil service pay-scale.

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\(^{18}\) Unless otherwise specified, ‘Government’ here refers jointly to service delivery workers and the civil service proper. The wage data provided by surveys does not allow disaggregation. It is noted that social service delivery institutions are allowed to implement different pay scales.

\(^{19}\) Civil Service Remuneration Task Force Report (2005)
3.32 Wage relativities – mean and median – by skill category and type of employer (Figure 10 and detailed in Table 9) show that:

- For most key categories of skills – with the exception of professionals and managers—average Government pay is significantly higher than what is offered by the private sector.

- Parastatal wages are more favourable than those offered by the private sector – for technicians, clerks and also the unskilled, which may in turn put private firms at a disadvantage in seeking to attract needed employees.

- Neither the public nor private sectors offer better pay than NGOs, although the overall impact of NGO conditions on the market is unlikely to be large, given the relatively very small number of jobs in the sector (only 2 percent of total employment in 2003).

Figure 10: Median Wage by Educational Level and Type of Employer, 2005

Source: Own calculations, LFS 2005.

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20 The “NGO” category includes international organizations.
Table 9: Average Monthly Earnings, by Type of Employer and Broad Occupation

<table>
<thead>
<tr>
<th>Employee Government</th>
<th>Mean</th>
<th>1052</th>
<th>905</th>
<th>706</th>
<th>578</th>
<th>410</th>
<th>397</th>
<th>490</th>
<th>526</th>
<th>527</th>
<th>410</th>
<th>227</th>
<th>616</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Median</td>
<td>975</td>
<td>805</td>
<td>672</td>
<td>500</td>
<td>420</td>
<td>192</td>
<td>399</td>
<td>480</td>
<td>222</td>
<td>530</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee Parastatal</td>
<td>Mean</td>
<td>1168</td>
<td>1182</td>
<td>627</td>
<td>595</td>
<td>332</td>
<td>128</td>
<td>460</td>
<td>535</td>
<td>230</td>
<td>503</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>1000</td>
<td>1072</td>
<td>530</td>
<td>540</td>
<td>375</td>
<td>60</td>
<td>400</td>
<td>446</td>
<td>210</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee private</td>
<td>Mean</td>
<td>1156</td>
<td>1064</td>
<td>585</td>
<td>400</td>
<td>170</td>
<td>211</td>
<td>316</td>
<td>443</td>
<td>181</td>
<td>309</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>900</td>
<td>900</td>
<td>403</td>
<td>320</td>
<td>120</td>
<td>160</td>
<td>240</td>
<td>350</td>
<td>150</td>
<td>200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee NGO</td>
<td>Mean</td>
<td>1673</td>
<td>1332</td>
<td>739</td>
<td>918</td>
<td>280</td>
<td>159</td>
<td>434</td>
<td>874</td>
<td>321</td>
<td>758</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>1350</td>
<td>1000</td>
<td>513</td>
<td>600</td>
<td>200</td>
<td>132</td>
<td>381</td>
<td>630</td>
<td>250</td>
<td>470</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee domestic</td>
<td>Mean</td>
<td>733</td>
<td>231</td>
<td>266</td>
<td>279</td>
<td>81</td>
<td>121</td>
<td>122</td>
<td>343</td>
<td>74</td>
<td>86</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>262</td>
<td>65</td>
<td>150</td>
<td>320</td>
<td>60</td>
<td>150</td>
<td>50</td>
<td>300</td>
<td>60</td>
<td>60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employee other</td>
<td>Mean</td>
<td>767</td>
<td>773</td>
<td>301</td>
<td>324</td>
<td>162</td>
<td>70</td>
<td>148</td>
<td>334</td>
<td>151</td>
<td>240</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>500</td>
<td>710</td>
<td>300</td>
<td>200</td>
<td>150</td>
<td>70</td>
<td>84</td>
<td>200</td>
<td>150</td>
<td>150</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>Mean</td>
<td>1104</td>
<td>954</td>
<td>673</td>
<td>552</td>
<td>234</td>
<td>228</td>
<td>328</td>
<td>480</td>
<td>157</td>
<td>419</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>980</td>
<td>830</td>
<td>623</td>
<td>470</td>
<td>150</td>
<td>150</td>
<td>250</td>
<td>400</td>
<td>120</td>
<td>300</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


3.33 Yet the attractiveness of an employer and job quality is clearly multi-dimensional. This goes beyond wages, and includes hours worked, and job attributes, including occupational health and safety, non-wage benefits, employer’s adherence to core labour standards, employer/worker affiliation to statutory social security schemes, commuting distance, employment and earnings stability and career development prospects.

3.34 In the case of civil servants, both pecuniary and non-pecuniary non-wage benefits contribute to the attractiveness of their jobs. Foremost under the former are the statutory provisions which assure social security coverage to civil servants, employees in public enterprises and workers employed in the military and police forces. Public pension schemes are financed 60 per cent by the employer (the State) and 40 per cent by workers. Besides an old age pension, benefits for invalidity, incapacity and survivors are provided. The retirement age is fixed at 60 years, with some exceptions, and the basic pension is 30 percent of the salary, and cannot exceed 70 percent.

3.35 The key non-pecuniary benefit for civil servants is job security. There are legislative constraints on dismissal decisions, which are larger in the case of dismissal of a public sector employee. Prior to dismissal of a civil servant on the ground of unsatisfactory performance, training and job transfers should be offered to improve a

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21 See ILO studies by Yehenew Tsegaye's report and Chapter 3 of the paper by Tassew Woldehanna, Fantu Guta, Taddele Ferede (2005).
civil servant's performance. Moreover lawful dismissal requires a notice period of between one to three months, depending on the number of years of service. Remedies against unlawful contract termination are the reinstatement and the payment of due wages, or compensation in addition to severance payment.

3.36 The attractiveness and security of federal civil service jobs staff is indicated by overall turnover rates. At an annual average of about 4 percent the rate of separation from the civil service does not appear high by international standards (Figure 11).

**Figure 11: Annual Rate of Separation from Ethiopian Federal Civil Service**

![Annual Rate of Separation from Ethiopian Federal Civil Service](image)

*Source: Ethiopia Civil Service Commission.*

3.37 The basic upshot appears that for the less skilled, the public sector offers attractive opportunities. For an illiterate job seeker, for example, who account for almost one in five of those looking for work, a government job is a better option than a parastatal, private or informal sector job, due to better enforcement of minimum wages and non-wage benefits.

3.38 Some key policy implications, which are explored further in the final chapter, arise because the bulk of the civil service enjoys better conditions than would be offered by the formal private sector, and certainly than informal sector activity. This in turn can have adverse implications for private sector competitiveness. This should be borne in mind when attempting to redress the brain drain issue at the top end (see Chapter 6).

3.39 Turning more specifically to the labour market aspects of parastatals, we observe the following:

- First, the relative size of parastatal employment, while not large overall – about 2 percent of total employment – is a significant share of manufacturing employment. In terms of profiles emerging from the ICA dataset, it is also notable that the larger firms in the sample are mostly public sector and it is these firms that also have older machinery and equipment on average, and hence report low productivity.
• Second, with the privatization process, the significance of parastatals in the economy and as employers has diminished over time.

• Third, the structure of wages is relatively compressed. A basic picture can be drawn from the ICA dataset, based on firm data from 2001. When the rates are examined by type of ownership, we observe lower wage inequality for unskilled production workers in state firms, as well as overall less wage inequality in state owned enterprises.

3.40 Relative to private enterprises, parastatals report higher wages and more job security. Comparisons of private and public sector enterprises\textsuperscript{22} show that labour is on average twice as productive in the former, which is consistent with private firms using more capital per worker. Public enterprises tend to be larger, employing on average about six times as many workers as private firms, which may also reflect overstaffing. When restricting the comparison to firms that are similar in output, public enterprises employ about 25 percent more workers than do the private firms.

3.41 In this context, recent trends are welcome. As we saw from the panel data, transition rates for parastatal workers were the highest across any type of employer. However as noted recently (World Bank 2007, vol. II, Chapter 3), the privatization agenda ran out of steam after 2002 and is in the process of being revived.

3.42 In conclusion, the Ethiopian labour market suffers not just from segmentation but also from an inappropriate structure. The Government sector remains too large and this has negative consequences for the growth of the private sector, not least in terms of its composition between formal and informal components.

**Constraints on Jobs Growth in the Private Sector**

3.43 The formal private sector has not yet made a major contribution to job creation in Ethiopia. Various barriers have affected its dynamism as a source of jobs, some of which can be traced to inappropriate policies. We focus here on those aspects of the investment climate which are more directly amenable to government policy influences – firstly, those instruments which affect labour demand, namely employment protection and payroll taxes and other costs associated with hiring labour; and second, the business environment more generally, including governance issues and problems associated with what appears to be public enterprises’ preferential access to factor markets and government services.

3.44 Before proceeding however, we review the determinants of firm performance in terms of employment and wage decisions. We utilise the ICA to examine a three year period (1998/99 – 2000/01), which reveals that while the sample experienced small improvements in real sales, median employment change was zero (Table 10).

\textsuperscript{22} Given that public enterprises are larger than private, we focus on sub-samples of comparable firms based on size, output and profits.
Table 10: Changes in Key Indicators at Firm Level, 1998/9 – 2000/1

<table>
<thead>
<tr>
<th>Indicator</th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>Standard Deviation</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Sales</td>
<td>353</td>
<td>0.91</td>
<td>0.14</td>
<td>6.14</td>
<td>-0.93</td>
<td>108.65</td>
</tr>
<tr>
<td>Average Real Wage</td>
<td>147</td>
<td>-0.22</td>
<td>-0.18</td>
<td>214.17</td>
<td>-0.91</td>
<td>0.23*</td>
</tr>
<tr>
<td>Total Employment</td>
<td>367</td>
<td>0.26</td>
<td>0.00</td>
<td>1.04</td>
<td>-0.92</td>
<td>15</td>
</tr>
<tr>
<td>Permanent Employment</td>
<td>327</td>
<td>0.21</td>
<td>0.00</td>
<td>1.05</td>
<td>-0.89</td>
<td>15.00</td>
</tr>
</tbody>
</table>


3.45 Regression analysis of the ICA data shows that there are, as expected, clear links between sales and employment. Our analysis showed that between 1998/9-2000/1, an increase in real sales of 1 percent was associated with an employment change of 0.09 percent. This result is robust to the introduction of industry and city dummies, and is true for public as well as private firms.

3.46 Turning now to examine potential influences on firm profitability and labour demand, we begin with taxation. In other transition economies, the additional costs which create a wedge between take-home pay and labour costs have been found to either discourage recruitment and/or dampen wages. It is also possible that the administration of taxes is unduly burdensome (time taken and so on). If these factors are important in Ethiopia, then a review and possibly reform of key taxes with an eye to enabling labour demand, and private sector growth more generally, would be warranted. The available evidence is reviewed below.

3.47 According to recent IMF reviews there do not appear to be major shortcomings in Ethiopia’s tax system. Rates of personal income tax (which are withheld by the employer) are not excessive by international standards (with a top marginal rate of 35 percent kicking in at Br 5,001 and a tax free threshold up to Br 150). Likewise corporate tax was not found to be too high by international standards (top marginal rate of 35 percent), although limited carry-over of losses could be an issue, especially for new firms. There are no payroll taxes. A tax reform program has been underway for some time. In 2002 measures were taken to broaden the tax base and improve administrative efficiency, including new legislation on value-added and income taxes and the introduction of a taxpayer identification number.

3.48 One part of the tax code, the presumptive tax, is especially relevant for small businesses. The presumptive tax is paid by small business traders and professionals whose annual turnover is less than Br 100,000 (about US$11,000). These taxpayers are not required to maintain accounting records and the income of the taxpayers is estimated (“presumed”) by Tax Authority. The presumptive taxpayers are divided into two categories: business and transport and attorney services. We focus here on the former. Under the business service sector category, the presumed Average Annual Profitability Rate had 22 rates ranging up to 70 percent depending upon the nature of business. In July 2005, presumptive taxation was reformed, and in particular the maximum profitable rate was reduced from 70 to 10 percent, and the number of rates was reduced to 4.
3.49 On the other hand, while a 35 percent corporate tax rate is not high relative to international norms, it is significantly above the regional average of 30 percent. And looking at the factors reported as among the three “most serious” obstacles to expansion by firms in the ICA sample (Table 11), tax rates are cited the most frequently (74 percent) and tax administration the second most frequently (60 percent). However firms (and people) everywhere complain about taxation, so it is important to put these findings in perspective by comparing the results to those of other countries that have conducted an ICA. The comparison suggests that taxes are more of an issue in Ethiopia: the share of firms considering tax rates a “major” or “very severe” obstacle is 45 percent in Madagascar; 48 percent in Uganda; 50 percent in Senegal; and 68 percent in Kenya, relative to 72 percent in Ethiopia. Also, Ethiopia ranks third worst out of 62 countries (behind Tanzania and China) on the number of days firms report that they spend in meetings with tax officials.

Table 11: Share of Firms Reporting Constraint as Severe or very Severe

<table>
<thead>
<tr>
<th>Constraint</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rates</td>
<td>74</td>
</tr>
<tr>
<td>Tax administration</td>
<td>60</td>
</tr>
<tr>
<td>Access to land</td>
<td>57</td>
</tr>
<tr>
<td>Access to foreign credit</td>
<td>55</td>
</tr>
<tr>
<td>Access to domestic credit</td>
<td>43</td>
</tr>
<tr>
<td>Electricity</td>
<td>43</td>
</tr>
<tr>
<td>Economic policy uncertainty</td>
<td>39</td>
</tr>
<tr>
<td>Corruption</td>
<td>39</td>
</tr>
<tr>
<td>Cost of financing (e.g. interest rates)</td>
<td>38</td>
</tr>
<tr>
<td>Customs and trade regulation and administration</td>
<td>37</td>
</tr>
<tr>
<td>Macroeconomic instability</td>
<td>35</td>
</tr>
<tr>
<td>Crime, theft and disorder</td>
<td>32</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>29</td>
</tr>
<tr>
<td>Skills and education of workers</td>
<td>18</td>
</tr>
<tr>
<td>Transportation</td>
<td>15</td>
</tr>
<tr>
<td>Anti-competitive practices</td>
<td>10</td>
</tr>
<tr>
<td>Business licensing and registration</td>
<td>9</td>
</tr>
<tr>
<td>Labour regulations</td>
<td>5</td>
</tr>
</tbody>
</table>


3.50 The ICA covers medium and large enterprises. For small and informal firms, taxes may also be an issue. While there is a tax free threshold on business and profits tax of 1,800 (annually) for unincorporated businesses, there are also VAT and turnover taxes with the latter applying to all goods and services sold by taxpayers who are not obliged to register for VAT.

3.51 A recent survey (May 2006) found that avoiding taxation is often a reason to avoid formal status. A small but significant percentage of firms in the ALMS (12 percent) agreed with the statement “I don’t want my business to grow too much because
then I will have to pay taxes”. This suggests that avoiding taxation could indeed play a role in the decision of some firms not to formalize.

3.52 The concluding chapter picks up the implications of this mixed picture on taxation as an obstacle to growth and employment, and suggests possible next steps in terms of analysis and follow-up.

**The institutional framework for the labour market**

3.53 Ethiopia’s labour law framework – now governed for the private sector by Proclamation No. 377/2003 – ostensibly does provide a series of protections for workers. These include procedures and payments in the event of dismissal (e.g. what is lawful, and severance and notice requirements).

3.54 Social partners in Ethiopia are weak in terms both of membership and in experience (ILO 2005). For example, the Confederation of Ethiopian Trade Unions (CETU) membership of 181,647 workers (and 445 basic unions), represents less than one percent of the total labour force. Unionisation of the Ethiopian labour force has been constrained by the largely agricultural and informal nature of the economy.

3.55 In general, information from the 2002 ICA suggests that labour regulations and labour relations are not seen by firms as significant impediments to doing business, it seems largely because these provisions are not generally enforced outside of the public sector. We do nonetheless find that labour laws and regulations are important in some sectors, and matter most

- to employment decisions in food, beverages, textiles, and garments; where 40 – 75 percent of firms cite laws and regulations regarding firing as reason for labour hoarding, and
- in terms of union pressure, which appear as an important determinant of employment level in some industries, particularly in food and beverages (37 – 41 percent of respondents).

3.56 Fear of social sanctions is an important employment determinant for about half of the firms in most industries. While labour regulations are not acknowledged as a major constraint, this factor may well be more important than it might initially appear. For example, the ICA data show that there is labour hoarding in most firms. The bulk report of firms report over-staffing in the range 1-10 percent (viz employment is between 1-10 percent greater than desired) but over 20 percent of firms reported over-staffing as being greater than 10 percent.

**The impact of the business climate**

3.57 We turn now to the broader business climate agenda, as this relates to jobs growth. The most obvious point at the outset is that Ethiopian enterprises and workers are not internationally competitive. Low productivity makes Ethiopian firms uncompetitive against Asia, for example. An international comparison with other African countries as
well as India and China, shows value added per worker in Ethiopia to compare unfavourably (Figure 12).

3.58 The question, of course, is why this should be the case. Since this is, in a very fundamental sense, the core development question facing Ethiopia which has eluded policy makers and advisers for decades, the answer is well beyond the scope of this report. At the same time it is possible to map at least some of the causal policy factors which appear to contribute to the observed disappointing outcomes.

3.59 A focus group exercise in 2004 reconfirmed the findings of the earlier ICA. The importance of accessing land for building and the overall tax regime were confirmed as the two issues deemed as by far the most severe problems (Figure 13). The focus group results are drawn from discussions with Integrated Value Chain Analysis Groups (IVCAGs) covering five sectors: leather, textiles, floriculture, tourism and construction. There were 12-15 members in each IVCAG, drawn from sectoral associations, with priority given to the leading private enterprises. Hence the results are not representative either of the sectoral or size distribution of private sector firms in Ethiopia, and cannot be regarded as definitive – however the findings are at least illustrative, including of perceptions of change over time.

**Figure 12: Comparisons of Value Added per worker (US$, by firm size)**

![Figure 12: Comparisons of Value Added per worker (US$, by firm size)](image)

*Source: Eifert and Ramachandran (2004).*
The focus groups also explored perceptions of change among business owners. In the past three years, some substantial improvements had been made in the business environment, although more recently there has been larger uncertainty. Among the key improvements were, for example, simplifications to the business registration process so that the days required fell from 44 to 32, and the cost of registration fell from a massive 422 times average income, to 65, between 2002 and 2005. The focus groups confirmed that administrative improvements have been made, though significant barriers remain (see Table 12).

Table 12: Private Sector Focus Group Results: Perceptions of Progress

<table>
<thead>
<tr>
<th>Clear improvement</th>
<th>Mixed progress</th>
<th>Insufficient progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business licensing/ permits</td>
<td>Construction permits</td>
<td>Access to land</td>
</tr>
<tr>
<td>Telecom services</td>
<td>Availability of skilled labour</td>
<td>Overall tax regime</td>
</tr>
<tr>
<td>Customs for exports</td>
<td>Low demand for goods</td>
<td>Access to credit</td>
</tr>
<tr>
<td>Labour regulations</td>
<td>Customs for imports</td>
<td>Infrastructure services</td>
</tr>
<tr>
<td>Business regulations</td>
<td>Municipal services</td>
<td>Privatization</td>
</tr>
<tr>
<td>Business facilitation for priority</td>
<td>Certification of goods &amp; services</td>
<td></td>
</tr>
<tr>
<td>sectors</td>
<td>Environmental regulations</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inspections (fire, sanitary etc)</td>
<td></td>
</tr>
</tbody>
</table>

More general constraints which affect firms’ growth are related to the need to support competitive market structures, and to avoid monopoly and rent seeking. The establishment of the Competition Commission is an important step in the right direction, and significant cases are now in the pipeline, though this remains to be effectively operationalized. Thus among the serious barriers which remain, the highlights are:

- Tax administration, particularly for smaller firms;
• Regulatory and administrative issues, such as difficulties in enforcing contracts (as many as 420 days and 15 procedures are required to enforce a contract) and property registration (Ethiopia ranks among ten worst countries worldwide with 15 procedures to register land);

• Progress in staffing the Competition Commission seem to have stalled (no private or civil society Commissioners have been named), and capacity building activities of the Secretariat are behind schedule.

3.62 This picture of the constraints facing the formal private sector points to the need to build on the reforms to date. The playing field remains uneven with respect to the generally larger and often dominant public sector enterprises, and significant problems in input, output and factor markets are hampering dynamism even of sectors which are experiencing robust growth. A policy agenda to revitalize the private sector is set out in the final chapter.

The Functioning of the Informal Sector

3.63 The informal sector is a tremendously important component of urban labour markets in Ethiopia—not only because of its sheer size relative to alternative opportunities, but also because of its distinct characteristics and its importance as a source of livelihood for the poor. Its significance from individual perspectives is underlined by its evident persistence as a labour market state.

3.64 The Ethiopian policy regime since 1992 has been more hospitable to entrepreneurship, including for small and informal businesses. Whereas Derg policies were “openly aimed at curtailing (if not eliminating) the private sector,” there has been liberalization alongside some proactive measures. The latter include the 2002 National Micro and Small Enterprise Development Strategy, and the waiving of license requirements for firms with capital under Br 5,000. Still some observers have noted that the legacy of previous policies (such as the one-man, one-license rule), if not the policies themselves, likely persists to some degree (Ageba and Amha 2004, p. 4).

3.65 The informal sector accounts for the majority of employment in Ethiopia—according to the 2005 LFS, it represented 71 percent of urban employment overall and 81 percent of youth employment. Several sectors are almost exclusively informal (at least as measured by the number of employees in the sector). These include domestic work, wholesale and retail trade, hotels and restaurants, and primary production (Table 13). Overall, manufacturing accounts for about 45 percent and trade/hotels/restaurants for about 38 percent of informal firms. Some activities appear to be strongly gendered: typically female sectors include food manufactures, services (hotel and restaurants) and trade. Typically male sectors include real estate, transport, and construction.
### Table 13: Share of Informal Employment by Sector (percent of total employment in sector)

<table>
<thead>
<tr>
<th>Sector</th>
<th>Male</th>
<th>Female</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informal – total</td>
<td>64.2</td>
<td>78.2</td>
<td>70.7</td>
</tr>
<tr>
<td>Private Households with Employed Persons</td>
<td>98.9</td>
<td>100</td>
<td>99.8</td>
</tr>
<tr>
<td>Wholesale and Retail Trade, Repair of Vehicles, Personal &amp; Household Goods</td>
<td>91.7</td>
<td>93.3</td>
<td>92.5</td>
</tr>
<tr>
<td>Hotel and restaurants</td>
<td>76.5</td>
<td>94</td>
<td>91.1</td>
</tr>
<tr>
<td>Primary Production Activity</td>
<td>89.5</td>
<td>91.5</td>
<td>90.2</td>
</tr>
<tr>
<td>Manufacture of Food, Tobacco and Beverage</td>
<td>66.5</td>
<td>90.1</td>
<td>82.6</td>
</tr>
<tr>
<td>Manufacture of Textiles, Leather &amp; Wood</td>
<td>82.1</td>
<td>81.8</td>
<td>82</td>
</tr>
<tr>
<td>Other Social, Cultural, Personal &amp; Household Activities</td>
<td>82.5</td>
<td>75.9</td>
<td>80.6</td>
</tr>
<tr>
<td>Transport, Storage &amp; Communications</td>
<td>65.8</td>
<td>15.8</td>
<td>60.9</td>
</tr>
<tr>
<td>Manufacture of other Secondary Products</td>
<td>58.1</td>
<td>62.1</td>
<td>59.4</td>
</tr>
<tr>
<td>Construction</td>
<td>53.9</td>
<td>36.4</td>
<td>50.7</td>
</tr>
<tr>
<td>Real Estate Renting &amp; Business Activities</td>
<td>46</td>
<td>33.5</td>
<td>42.1</td>
</tr>
<tr>
<td>Electricity, Gas &amp; Water Supply</td>
<td>13.8</td>
<td>14.4</td>
<td>13.9</td>
</tr>
<tr>
<td>Education, Health &amp; Social Work</td>
<td>8.5</td>
<td>6.1</td>
<td>7.5</td>
</tr>
<tr>
<td>Public Administration &amp; Defence, Compulsory Social Security</td>
<td>3.6</td>
<td>12.3</td>
<td>6.4</td>
</tr>
<tr>
<td>Other Activities</td>
<td>1.6</td>
<td>6.2</td>
<td>3</td>
</tr>
<tr>
<td>Financial Inter-Mediation</td>
<td>1.9</td>
<td>2.9</td>
<td>2.4</td>
</tr>
</tbody>
</table>

**Source:** LFS, 2005.

3.66 Informal sector firms share many common features. Most (60 percent) of informal operators are women, and their educational profile is low but increasing (Figure 14); the proportion of illiterates in total informal employment fell from 50 percent in 1999 to 37 percent in 2005 (with the respective figures for women being even more dramatic, from 64 to 51 percent).

3.67 Informal enterprises tend to employ only the operator, or one or two additional employees (only 10 percent of whom are permanent employees, with the rest unpaid family members or temporary workers). Virtually all (99 percent) are sole proprietorships, and most keep no book of accounts, sell on cash terms, and operate about 11 months of the year; more than half are home-based. Informal firms sell nearly exclusively to the domestic market, for the most part directly to consumers who know the operator or hear about the firm via word of mouth (ALMS 2006).
Figure 14: Trends in the Education Level of Informal Sector Workers

Note: LFS includes all informal sector workers; ISS includes only operators.

3.68 Ethiopia’s informal sector is predominantly employment of last resort, rather than a preferred breeding ground for entrepreneurs. There are several key pieces of supporting evidence for this claim:

- when asked why they chose their current activity, more than three-quarters of respondents to the Informal Sector Survey (2003) reported an “involuntary” rationale—that they had no alternative or because a small investment was needed (with women more likely than men to be involuntary).

- evidence from the Informal Sector Survey and another MSE Survey (Ageba and Amha 2004) indicate that older firms are about the same size or even smaller than newer firms, based on average sales/number of employees, meaning that most firms do not grow substantially over time. In fact, according to the MSE Survey, “the additional jobs created by the MSEs that added workers [between 2000-2003] were almost fully offset by reduction of workers by others, such that net job creation by the sample MSEs over the past three years was almost zero” (Ageba and Amha 2004, p. 18).

- cluster analysis to assess the degree of correlation among characteristics associated with more entrepreneurial firms (e.g. keeping some accounts, having a permanent location, higher sales, etc.) showed that the “upper” tier of more entrepreneurial firms comprised only about 5-20 percent of firms, with level of sales being the main driver. This contrasts strongly with evidence from Mexico, where there is a much larger dynamic group (Maloney 2004). Thus, although Ethiopia’s informal sector is certainly heterogeneous, as in other countries—and many success stories do exist—it seems that for the vast majority it provides a means of survival rather than upward mobility.

3.69 The share of the informal sector with more dynamic activities and prospects, has some specific characteristics:
• higher proportion of male operators;

• greater skills (both in terms of schooling and vocational training);

• greater likelihood of keeping some accounts, selling on credit, working outside the home, and operating 12 months of the year;

• greater likelihood of choosing the place of work for a business reason (e.g. close to customers or competitors), rather than due to childcare or affordability considerations; and

• larger proportion of (trade/hotels/restaurants) activities firms and a smaller proportion of manufacturers, and relatively more transport firms.

3.70 While having a family based set of firms is not a problem per se, as the experience of Italy among others illustrates, it is a concern that no significant part of the informal economy is populated by individuals/firms that are using the lack of regulation and tax as a form of experimentation ground. Evidence from other countries suggests that absence of taxation and the like can helpfully serve as a quasi-subsidy to new start-ups. Why this is not the case in Ethiopia is not clear. Lack of effective demand may have been an issue but the economy was growing strongly since the early 2000s, so the explanation may partly be the harassment and other obstacles associated with government, as described below. Some features of the sector associated with its low productivity and lack of dynamism – such as the personal nature of contractual relationships and the importance of social networks – are responses to market failures, particularly in factor markets and inputs. These mechanisms can help firms survive at least at some minimal level, but are inherently limiting in terms of growth potential.

3.71 Informal activities take place in a very constrained environment. For initial capital, informal sector entrepreneurs rely almost exclusively on their own savings, and on help from friends and relatives, which is often a gift rather than a loan. Very few enterprises access startup capital through official channels. Lack of market or demand is the other major constraint that informal operators report – their concerns about domestic price competition likely reflect the low barriers to entry. About a third of operators are price takers, in that they charge the going rate for their goods/services, which supports the conventional wisdom of a low degree of product differentiation (ALMS 2006). EBDSN (2006) notes market saturation by similar products, and that gains by firms that attempt to innovate are quickly erased as others imitate their success. Female-owned businesses are significantly more likely to cite “lack of market” as a major issue, as are the less educated and those who chose their activity because of low barriers to entry.

3.72 While entry barriers appear to be low and obviously some would-be entrepreneurs overcome these constraints, others remain stuck in unemployment. According to the 2003 UBEUS, by far the most important barrier faced by the unemployed wanting to establish a business was shortage of finance (roughly 60 percent of respondents cited this reason). Next in importance was lack or problems of working place/land (over 15 percent). No other single problem—including lack of skills—comes close in importance
to these two factors. These results are also consistent with messages emerging from other survey data on constraints in access to finance. More than two-thirds of unemployed ALMS respondents said that they did not attempt to start a business because of lack of capital followed by those who cited education/training.

3.73 There may be a negative signaling effect in the labour market associated with working in the informal sector. If this diminishes future formal jobs prospects it would limit resort to the informal sector to those who feel better prospects to be remote. A non-trivial share (13 percent) of unemployed respondents—and a higher share of the better educated indicated that they would only be willing to take up wage employment in the public or private sector, rather than self employment (ALMS 2006).

3.74 Several investment climate issues have been reported by informal operators as obstacles to expansion, which presumably also limit the transition to formality. In the Informal Sector Survey, larger operators and those working in the hotel/restaurant business were more likely to report “harassment by government bodies” and the regulatory environment as major problems. Moreover, nearly 40 percent of ALMS respondents agreed or strongly agreed with the statement that “government and local administration officials make it difficult for me to conduct my business activities.” Qualitative research and anecdotal evidence also suggest that some government policies, or the interpretation thereof by local officials, can dampen informal activity. For example, according to one study, “it is commonplace to witness police harassment of informal sector operators, including women” (Zewde and Associates 2002). On a related note, lack of policy predictability appears to be a major issue. In the MSE Survey, about a third of microenterprises reported that they have to deal with ‘unexpected changes in rules, laws or policies which materially affect their enterprise,’ and about 40 percent “do not believe that the Government adheres to its announced policies and rules” (Ageba and Amha p. 60-1).

3.75 Problems in access to land and working premises were reported to be an obstacle to both start-up and expansion by many firms, especially in Addis Ababa (Informal Sector Survey). Evidence from other survey data provides ample confirmation of these constraints. Recent migrants to a given area are disproportionately likely to report a problem with access to premises, suggesting that their needs may require special policy attention.

3.76 Respondents to the 2003 MSE Survey were most likely to cite “high taxes” as the biggest regulatory obstacle to expansion, while inefficient/arbitrary tax administration was the third most common complaint. Like larger firms, these enterprises do not consider labour regulations per se to be a significant problem, but they do mention problems related to limited infrastructure, especially lack of telephone, electricity, and water access. In general, the concerns of MSEs reflect those of large firms cited earlier, though with differences in prioritization. Only about a third had noticed improvements in the policy environment resulting from the reforms of the 1990s (Ageba and Amha 2004).

3.77 A major question is why informal firms do not formalize and whether this decision affects their performance. Individuals and firms weigh the costs of becoming
formal against the benefits they expect to enjoy, including access to public goods such as contract enforcement. To the extent that the associated costs are high, or the benefits limited (e.g. small firms in Ethiopia rarely resort to the formal judicial system even if they are formal), operators would be less likely to formalize. In Ethiopia there are two key steps to being an officially recognized entity: registering a firm with the authorities, and obtaining a license. All firms must do the former (though in practice it may be that many informal firms do not), and firms with at least Birr 5,000 in paid-up capital must do the latter as well (see Box 4). The waiving of the license requirement for very small firms means that this is now irrelevant for many informal sector operators.

**Box 4: Costs of Formalization**

Under the official GOE definition, informal firms are those with fewer than 10 employees, that do not keep a full book of accounts, and that do not have a license. While the number of employees is presumably driven by factors other than the choice to formalize, the second two criteria clearly involve tradeoffs in costs vs. benefits.

Keeping a book of accounts enables compliance with the tax code; Table 14 shows marginal tax rates for business income above the exempt threshold of Br 1,800. According to ECC & EBDSN (2004), firms generally perceive the exemption threshold to be too low. Many MSEs also believe that the official assessment of tax liability tends to be subjective, so that many firms are over-taxed, particularly since small firms frequently lack a complete understanding of tax laws. On a more positive note, firms do generally believe that the recent tax reforms have led to improvements in the process.

<table>
<thead>
<tr>
<th>Annual Taxable Income (br)</th>
<th>Marginal Tax Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,801 - 7,800</td>
<td>10</td>
</tr>
<tr>
<td>7,801 - 16,800</td>
<td>15</td>
</tr>
<tr>
<td>16,801 - 28,200</td>
<td>20</td>
</tr>
<tr>
<td>28,201 - 42,600</td>
<td>25</td>
</tr>
<tr>
<td>42,601 - 60,000</td>
<td>30</td>
</tr>
<tr>
<td>60,001 and above</td>
<td>35</td>
</tr>
</tbody>
</table>


In order to register and license a business, the World Bank Doing Business Database reports that one must follow 7 procedures (which take about 32 days), and spend the equivalent of 65 percent of annual per capita income. Remaining formal also entails significant costs, since licenses must be renewed periodically. However, businesses with capital of less than Br 5,000, though required to register, are not obliged to obtain a license. These procedures represent a major improvement; in fact, Ethiopia was one of the “top ten reformers in startup procedures” in the world in 2004, according to the Doing Business Indicators.

3.78 In sum, the incentives for very small firms to formalize are weak. Three-fourths of unlicensed firm operators surveyed by the ALMS said that they did not have a license because they “don’t need a license” or it is “easier to operate without a license.” Moreover taxes serve as a major deterrent to formalization. The 2002 Investment Climate Assessment found that the tax burden and high rents were the main reasons cited by the 2,200 businesses that cancelled their licenses in 2001/02.
Yet there are benefits to formalization, especially as firms graduate from micro into small enterprises. Although about 36 percent of micro-enterprises in the MSE survey saw no benefit to registering/obtaining a license (compared to 24 percent of small enterprises), nearly half said that they “would not have to hide from/give bribe to government officials” (Ageba and Amha 2004 p. 64). Other potential benefits recognized by operators include being able to apply for credit and working premises.

Our analysis of the informal sector implies significant challenges for Ethiopian policymakers, particularly as the effects of repressive policies can be long lasting (Bigsten and Makonnen, 1999). The policy agenda on this front is laid out more explicitly in the concluding chapter. Another dimension that needs to be understood is the relation between the informal sector and the unemployed. Which are the barriers preventing the unemployed from starting up an informal sector activity or taking up informal jobs while continuing their search? These issues are explored further in the next chapter.
4. UNEMPLOYMENT

4.1 The high level and duration of urban unemployment in Ethiopia raises a number of questions about measurement, drivers and policy implications. The high incidence and depth of urban poverty, and lack of unemployment benefits, would *a priori* suggest that unemployment is simply not an option for most Ethiopians. This would seem to hold even if available employment opportunities offer only subsistence earnings, since relatively few families can afford to subsidize their unemployed children for extended periods. Perhaps, then, the reported extent of unemployment is a measurement issue.

4.2 This chapter attempts to address these issues by using the best available quantitative data, complemented in particular by a very recent follow-up survey to create a profile of the unemployed. We are especially interested in identifying the factors that explain the status and persistence of unemployment, and how the unemployed survive. We also put Ethiopia in a comparative perspective, and conclude by drawing out some policy messages for the final chapter.

Levels and Trends

4.3 The prevalence and protracted duration of unemployment is striking. It appears to be structural rather than cyclical in nature, given its persistently high level despite recent robust economic growth—although this may now be changing. Unemployment remained in the double digits from the 1999 to the 2005 LFS, whether a broad or narrow definition is used (Box 5). However, while adult female unemployment rates were essentially stagnant, youth and male adult unemployment fell. Open unemployment in Ethiopia is several percentage points higher than the African average for youth, and a couple of points higher than the adult average as well (Figure 15).

4.4 Most African countries have relatively low unemployment and large informal sectors that absorb unskilled labour (Kingdon, Sandefur, and Teal 2004). In Ghana, Uganda, and Tanzania, the formal - informal wage differential for unskilled workers is fairly low and suggests that “informal wages have fallen to clear the market,” such that low wages and underemployment rather than open unemployment are the policy concerns (p. 22). In Ethiopia however, the high public sector wage premium (for parastatals as well as the civil service) probably drives up formal private wages as well. This limits labour demand overall, meaning that the informal sector is the default option for a large segment of the population. Yet many low productivity informal sector activities are saturated such that expected earnings are low enough that many remain unemployed or become discouraged workers.
Box 5: Measuring Unemployment Rates and Trends Using Different Definitions

According to international conventions, two definitions of unemployment are possible. They vary in the way they classify those who are jobless and available for work, but not taking active steps to find a job. Their appropriate classification depends on whether these individuals prefer not to work, in which case they would be better classified as inactive, or rather whether they can be considered “discouraged workers”, i.e. workers who would like to have a job but believe that an active job search would be fruitless. International practice generally followed the first categorization and adopts a “narrow” definition, which considers those jobless who do not actively search out of the labour force (i.e. inactive). The CSA in contrast adopts the second approach and uses a “broad” definition which treats “passive unemployed” workers as unemployed.

While our study uses the more common international definition to allow for comparability, insights might be lost by excluding discouraged workers. Following Kingdom and Knight (2006) we estimate the change in unemployment between the two labour market surveys using the two definitions. Including the non-searching jobless means a higher rate of unemployment overall (they are included in both the numerator and the denominator when calculating the unemployment rate, but excluded from both in the narrow definition). The unemployment rate was 14 percent in 2005 using the narrow definition, and 21 percent using the broad definition. Figure 16 below, decomposes the total population into four categories based on labour market status: inactive; employed; passive unemployed; and active unemployed. The active unemployed group, on the far right of the graph, represents the narrow definition of unemployment; adding the passive unemployed group shows the total unemployed population per the broad definition. It is clear from the graph that the key change between 1999 and 2005 was a decrease in the share of passively unemployed, and a corresponding increase in inactivity (much of which can be attributed to male youth).
4.5 The lack of jobs makes it easier to become discouraged about the prospects of an active search. Looking at South Africa, Kingdom and Knight (2006) propose three tests to assess whether the profile of the “searching” unemployed differs significantly from that of the “non-searching” unemployed. The results indicate that the non-searching unemployed are no better off (and are financially worse off) than the searching unemployed, suggesting inter alia that their decision not to search may reflect a lack of resources (given low expected returns to searching) rather than lack of motivation.

4.6 Long-term unemployment is common, though average duration has shortened considerably. The urban panel supports the finding that it is becoming more likely that the unemployed in a given year will have found employment by the time of the subsequent survey wave. As shown in Table 15, a massive 93 percent of the unemployed in 1994 were also unemployed in 1997; However, the likelihood of transiting from unemployment to inactivity—i.e. dropping out of the labour market—increased from essentially zero between 1994 and 1997 to 23 percent between the final two waves. Still, the total likelihood of remaining in unemployment or becoming inactive has fallen, and a clear picture of greater mobility out of unemployment emerges.  

<table>
<thead>
<tr>
<th>Initial Status</th>
<th>Self-Employ</th>
<th>Gov’t Worker</th>
<th>Public Enterprise</th>
<th>Formal Private</th>
<th>Other Private</th>
<th>Unemployed</th>
<th>Inactive</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Status in 1997</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployed in 1994</td>
<td>1.47</td>
<td>0.56</td>
<td>0.34</td>
<td>1.69</td>
<td>2.37</td>
<td>93.22</td>
<td>0.34</td>
</tr>
<tr>
<td><strong>Status in 2000</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployed in 1997</td>
<td>7.78</td>
<td>5.56</td>
<td>2</td>
<td>10.22</td>
<td>11.56</td>
<td>51.33</td>
<td>11.56</td>
</tr>
<tr>
<td><strong>Status in 2004</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unemployed in 2000</td>
<td>6.82</td>
<td>8.47</td>
<td>2.89</td>
<td>12.6</td>
<td>10.54</td>
<td>35.74</td>
<td>22.93</td>
</tr>
</tbody>
</table>


23 While this suggests that unemployment duration is typically long, the survey waves are snapshots in time; it is possible that a given respondent had one or more jobs between survey waves, but happened to be unemployed at the time of the survey. We attempt to minimize this complication by comparing the waves against each other, rather than comparing unequal periods in time.
4.7 The median duration of unemployment fell substantially from 1999 to 2005, from more than 1.5 years to less than 1 year. According to the LFS, the share of unemployed experiencing a spell of six months or less increased by 65 percent, while the share having spells exceeding 3 years fell by about half (Table 16). The pattern is essentially the same for men and women, though unemployment tends to last longer for women—about 22 percent of unemployed women in 2005 had been out of work for more than 2 years, compared to 16 percent of men. However, the gender difference narrowed over the six year period.

<table>
<thead>
<tr>
<th>Table 16: Distribution of Unemployed by Duration (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
</tr>
<tr>
<td>&lt; 1 month</td>
</tr>
<tr>
<td>1-6 months</td>
</tr>
<tr>
<td>7-12 months</td>
</tr>
<tr>
<td>13-18</td>
</tr>
<tr>
<td>19-24</td>
</tr>
<tr>
<td>25-30</td>
</tr>
<tr>
<td>31-36</td>
</tr>
<tr>
<td>37-42</td>
</tr>
<tr>
<td>43-48</td>
</tr>
<tr>
<td>49-54</td>
</tr>
<tr>
<td>55-60</td>
</tr>
<tr>
<td>60+</td>
</tr>
</tbody>
</table>

4.8 The private sector absorbs most of those unemployed who manage to find job opportunities. We find from the panel that the informal sector provides the single most important avenue to employment, with 42 percent either becoming self-employed or joining “other private sector” activities. The formal private sector absorbs another 30 percent, and the Government the remainder (20 percent become government workers, and 7 percent join public enterprises).

4.9 New entrants to the labour force constitute the main source of the newly unemployed, followed by job losses in the private sector. According to the panel analysis, 17 percent of the inactive population in 2000 had joined the unemployed by 2004. The probability of losing a job in the formal private sector was 14 percent, or 17 percent in the informal sector. Job security was higher in the public sector, with only a 7-8 percent likelihood of job loss.

**Profile of the Unemployed**

4.10 The unemployment rate varies substantially by observable characteristics. Unemployment among youth is roughly double that of adults, with young women aged 20-24 having the single highest unemployment rate in 2005 at 26 percent. In relative
terms, however, the gender unemployment gap is smaller among youth. Male youth were 76 percent as likely to be unemployed as their female counterparts in 2005, while adult men were 60 percent as likely as adult women to be unemployed. Those with significant formal but less than higher education are most likely to be unemployed, and geographical factors appear important. These factors are explored below in turn.

4.11 The unemployment rate by age group for 2005 shows a spike in the 20-24 year age group (Figure 17). It declines fairly steadily thereafter, with the female rate dipping below the male rate for older groups. The crossover of the male and female rates after age 50 is interesting. Although unemployment is lower among the oldest age groups, it remains significant at 8 percent for those aged over 60. Thus labour market participation is still common for this age group (the activity rate for males aged 60+ is 60 percent, though for women it is only 26 percent).

4.12 Education plays a significant role in explaining the incidence of unemployment. Ethiopian students begin with 8 years of primary education (subdivided into basic primary, Grades 1-4, and general primary, Grades 5-8), then proceed to the first cycle of secondary education (Grades 9-10), the completion of which is considered “General Education”—or they have the option of applying to a Junior TVET program. Students who pass an exam at the end of Grade 10 are eligible for preparatory secondary (Grades 11-12), and then can compete for a place in a tertiary institution. Those completing Grade 10 who are not admitted to preparatory secondary, or who prefer, can compete to enroll in a medium-level TVET program (World Bank 2005c).

4.13 Unemployment peaks among those in the middle of the spectrum of educational attainment, as shown in Figure 18 and 19, which compare the educational profile of unemployment by age (youth vs. adults). For youth, female unemployment peaks among those with General Education—for young males, those in the Beyond General category are most likely to be unemployed. Among youth even the most skilled have a very high
unemployment rate (for women, those with higher education are about as likely as those with Beyond General to be unemployed). However, the picture changes somewhat for adults, in that those with higher education become the least likely to be unemployed, suggesting that in the long run education pays. The fact that those in the middle of the spectrum—beyond primary but with no more than General Education—have the highest rates even for adults is cause for concern. It may signal a mismatch between the educational curriculum and the skills demanded in the labour market. Among the illiterate population, who can perhaps least afford not to work, unemployment was about 7-8 percent over the period.

**Figure 18: Youth unemployment by education level (percent)**

**Figure 19: Adult unemployment by education level (percent)**

Source: LFS (2005), own calculations.

**Youth Unemployment**

4.14 Ethiopia is not alone in Africa in confronting a high level of youth unemployment (Figure 20). The demographic transition from high fertility-high mortality to low-fertility and longer life expectancies implies a spike in the dependency ratio. Young entrants to the labour market, who are generally better educated than their parents and have higher expectations for employment, face difficulty securing jobs in many parts of the world. Ethiopia has not yet entered its demographic transition, and the fertility rate is so high that the population continues to grow at a rapid pace. Particularly as land degradation and scarcity act as push factors for migration from rural to urban areas, urban youth unemployment is becoming an increasingly major concern.

4.15 For youth, who comprise almost one-fourth of the urban population, unemployment rates range from 16 percent for 15-19 year olds to 23 percent for 20-24 year olds. This reflects much lower activity rates for the younger group (38 percent versus 69 percent labour market participation). Disaggregating by gender reveals even larger differences: males in the younger group have a 14 percent unemployment rate, while the rate for females in the older group is 12 percentage points higher. Of course, the unemployment rate alone does not fully capture the challenges youth face in securing productive employment, in particular the quality of jobs held.
Regional Perspectives

4.16 Regional variation in unemployment is significant (Figure 21). The large cities—Addis Ababa and Dire Dawa—have the highest rates. Smaller urban centers have a profile more similar to that of rural areas, where underemployment rather than unemployment is a key feature. Also striking is the variance in differentials between youth and adult unemployment—in Tigray, the youth unemployment rate is about 2.5 times the adult rate, while the relative gap in Afar is fairly small. These differentials suggest that unemployment may be more cyclical in nature in some regions, and more structural in others, but determining these drivers is beyond the scope of this report. Statistically significant increases in youth unemployment between 1999 and 2005 were observed in Tigray, Gambella, and Harari, while there was a significant fall in Addis Ababa (from 39 to 34 percent).

Determinants of Unemployment

4.17 Multivariate analysis confirm the descriptive results. The regressions (see details in Vol. II, Chapter 1) include variables for age, gender, educational attainment, household characteristics (number of children and adults), and regional dummies using the 2005 data.

- As expected, the effect of being female, all else being equal, is highly significant and associated with a 37 percent higher probability of unemployment.
• Having completed General Education also stands out as an important correlate of unemployment; restricting the sample to 15-24 year olds, General Education is associated with a 78 percent higher likelihood of being unemployed. The effect is more pronounced in Addis Ababa than other parts of the country.

• Many of the other education variables are also significant. Interestingly, having had some form of training is correlated with a 25 percent lower likelihood of unemployment in Addis Ababa, while it is not significant in other parts of the country. This is consistent with the expectation that there are relatively good opportunities for semi-skilled workers in Addis Ababa, and that training may help ease initial entry into the job market for young people.

**Figure 21: Unemployment by Region and Age, 2005**

![Unemployment by Region and Age, 2005](image)

*Source: LFS (2005), own calculations.*

4.18 Household composition also helps explain unemployment: adding a child under age 10 to a household is associated with an 11 percent lower likelihood of adult unemployment (though looking only at women shows that it is linked to a higher likelihood of unemployment, presumably because women with young children are less likely to find a job that they can balance with childcare responsibilities). Interestingly, increasing the number of adults in the household is associated with a higher rate of unemployment of the adult household members. This seems to imply that there may be some kind of job rationing within the household, though the effect is somewhat smaller for youth.

**Results from Addis Labour Market Survey (ALMS)**

4.19 This section briefly highlights key results of the Addis Labour Market Study (ALMS) commissioned in 2006 for this report. It attempts to shed additional light on some of the qualitative questions that could not be answered with the standard labour market surveys (see Box 6 for details).
In April and May 2006 the World Bank commissioned a small survey to probe further into some of the peculiarities of the Ethiopian urban labour market, such as the high levels of unemployment and the low levels of informality. In particular the survey wanted to probe whether some of these results might be driven by the characteristics of the statistical instruments used, such as the definition of work captured (as opposed to productive activities more generally) or the practice of relying on a key informant at the household level (rather than each of the individuals on which information is being gathered).

The survey was run on 282 households drawn from the Addis subsample of the Urban Panel (see Box 2) for a total of 1,982 individuals. The modules included in the survey covered: individual labour market behavior including information on primary and secondary jobs; type of activities undertaken during the week and whether they included any form of direct compensation; unemployment with an emphasis on means of support of the unemployed, search strategies and desired characteristics of jobs individuals would like to hold; self-employment and characteristics of the businesses run, including whether they ever tried to formalize their activities and the support networks that facilitate business activities; social capital, including questions on reciprocity networks and organizations/institutions individuals rely onto; and subjective well-being. Other household characteristics, such as their welfare status in 2004 were also used in the analysis as background information.

### 4.20 Is unemployment really as high as the reported figures?

The ALMS module on time use asked the unemployed respondents to choose the three activities (from a list) that they had spent the most time doing in the previous week. The list had 22 choices, including inter alia productive activities—several examples are “selling products produced by household business,” “construction in the community,” and “buying/selling inputs, running errands for businesses/productive activities of friends or relatives.” The survey thus intended to capture forms of employment that labour force survey respondents might not consider “proper” jobs. Table 17 shows the results, omitting activities that fewer than 10 percent of men and women selected. Household duties and work for own consumption, and social/education activities, dominate the list. A negligible share indicated that productive activities were one of their three main activities; moreover, almost none of the unemployed indicated that they received some form of compensation for the activities they selected. These results reinforce the high measurement of open unemployment.
Table 17: Primary Activities of the Unemployed in the Past Week (percent)

<table>
<thead>
<tr>
<th>Activity</th>
<th>Male</th>
<th>Female</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household chores</td>
<td>14%</td>
<td>85%</td>
</tr>
<tr>
<td>Taking care of HH members</td>
<td>4%</td>
<td>24%</td>
</tr>
<tr>
<td>Running errands for HH consumption</td>
<td>2%</td>
<td>10%</td>
</tr>
<tr>
<td>Fetching water, wood for HH consumption</td>
<td>5%</td>
<td>18%</td>
</tr>
<tr>
<td>Family and social obligations</td>
<td>8%</td>
<td>16%</td>
</tr>
<tr>
<td>Meeting up with friends</td>
<td>64%</td>
<td>25%</td>
</tr>
<tr>
<td>Looking for work</td>
<td>43%</td>
<td>13%</td>
</tr>
<tr>
<td>Going to church/mosque/other meetings</td>
<td>38%</td>
<td>45%</td>
</tr>
<tr>
<td>Recreational activities</td>
<td>74%</td>
<td>30%</td>
</tr>
<tr>
<td>Education/training</td>
<td>12%</td>
<td>15%</td>
</tr>
<tr>
<td>Traveling</td>
<td>17%</td>
<td>7%</td>
</tr>
</tbody>
</table>

Source: ALMS 2006.

4.21 The gender distribution of activities reveals several stylized facts. Not surprisingly, women spend much more time on household work, though the magnitude of the gender difference is still striking. Unemployed men tend to spend much more time on social activities, and also on looking for work. In general, women are more likely than men to be among the “non-searching” as opposed to “searching” unemployed. These results are related to another question that asked what traits the unemployed desired in a job. While a plurality of the searching employed (who are disproportionately male) said that a good income was the most important feature, the non-searching were more likely to desire independent work that is close to home. This may be because women need to balance any employment with their household responsibilities. While they may claim to be “available” for work, the fact that they are not actively seeking it suggests that their true availability may be limited. This characterization is slightly different than that of “discouraged workers” who also undoubtedly make up a component of the non-searching unemployed.

4.22 Given the extent of urban poverty, how do the unemployed support themselves? If the unemployed are not spending a significant amount of time on “odd jobs” to earn income, we must ask how they are surviving. In short, it appears that families take care of their unemployed members. The vast majority (85 percent) of the unemployed report that living with family is their primary means of support, followed by “monetary gifts/help/inheritance/loan from relatives/friends”—and most of these (84 percent) do not expect to be repaid. Although their families provide for them, 13 percent of the unemployed say their families think “I should wait until I find a good job.” Perhaps this is part of a household livelihood strategy (e.g. if a member secures formal wage employment, it could substantially lessen the entire household’s vulnerability). Not surprisingly, a higher percentage of the searching unemployed (64 percent) than the non-searching unemployed (21 percent) say that their families want them to “get a job as quickly as possible.”

4.23 Almost three-quarters of the unemployed (73 percent) report that they would be willing to accept “any available job.” This varies by education level, with skilled workers more likely to indicate that they would only be willing to take wage employment in a public or private organization (with just a small percentage distinguishing between
the two). Duration of unemployment does have a statistically significant positive effect on the likelihood of wanting “any available job,” so it does seem that jobseekers become less particular as unemployment becomes more protracted. On indicators of subjective well-being there were statistically significant differences between the employed and the unemployed, with the latter faring worse on all. This undermines any argument for considering unemployment a result of “luxury” or a preference for leisure. Perceptions of the main obstacle to finding employment vary widely, from lack of education or experience to lack of information and contacts, reinforcing the notion that there is no magic bullet to solve the problem.

**Key Implications**

4.24 International experience has shown that there are no easy answers for tackling high unemployment, especially for youth. Much more is known about effective early childhood interventions, for example, than best practice interventions aimed at boosting youth employment—though more attention is being focused in this area, including via the creation of the global Youth Employment Network by the UN, World Bank, and ILO. The World Bank’s 2007 World Development Report—entitled *Development and the Next Generation*—covers the multiple transitions youth face as they become adults.

4.25 In Ethiopia, median unemployment duration is nearly two years, and for many much longer, especially for women. Some literature argues that the truly harmful effects of unemployment (on human capital and individual/societal welfare) come from long-term unemployment, rather than unemployment incidence per se. This implies that policy design should take the heterogeneity of the unemployed population into account.

4.26 The entrenched youth unemployment in the Middle East and North Africa region provides a cautionary tale about what can happen with a growing youth labour force and insufficient job creation. The relatively undiversified economies of many countries in the region, patronage-based governance, and weak private sector mean that despite dramatic improvements in human capital a large segment of society is unable to find productive work. Depending on guaranteed public sector jobs to generate employment for new graduates—a strategy followed by Ethiopia under the Derg but since abandoned—is clearly unsustainable. Yet much of the employment generated in Ethiopia in the last decade has still been in the public sector as part of decentralization, rather than in the private sector. Some of the evidence presented in the preceding chapter provides welcome signs of new dynamism, which needs to be nonetheless significantly expanded. The task for the government, then, will be to boost private sector confidence and empower economic agents through improvements in the investment climate and send credible signals that political risk is at an acceptable level (discussion of these issues is beyond the scope of this report; see the forthcoming World Bank CEM).

4.27 The empowerment of women writ large will be critical to reducing the dramatic differential between male and female unemployment. Women are disadvantaged on every measure of labour market outcomes, to say nothing of welfare more generally. They are constrained in the types of jobs they pursue by social norms regarding acceptable female behaviour, and lower asset ownership and household and childcare
responsibilities may make it more difficult to become self-employed. While a comprehensive treatment of policy interventions to raise the status of women in society is well beyond our scope here, it is important to underscore that any employment-related program should be designed with the distributional impact by gender in mind.
5. MIGRATION, URBAN LABOUR MARKETS AND POLICIES

5.1 Limited rural-urban migration over the past three decades has contributed to the low urbanization rate of Ethiopia. According to the most recent national data, 14 percent of the population (aged 10+) was living in urban areas, and of those 18 percent had moved there over the four years up to 2005 (LFS 2005).

5.2 Migratory pressures are bound to increase. While the lack of recent census data does not allow an assessment of current flows of internal migration there is anecdotal evidence supporting the view that migration is increasing. Further increases can be expected due to population pressures on land and environmental degradation in rural areas and the momentum of the development process itself. Longer term determinants such as “regional imbalances in employment opportunity, improved communications, road and transport networks and changing aspirations of the younger generation” (Deshingkar 2003, p. 25) are also likely to play a role.

5.3 There are reasons to be concerned about the transformation that increased internal migration flows brings about. To the extent that urban labour markets are segmented, a large influx of migrants to urban areas would result in increased competition in the low-barrier low-productivity sectors, typically the informal sector, further bringing down wages and increasing underemployment, increasing urban poverty and putting pressures on the provision of basic services and infrastructure.

5.4 There are elements supporting some of those concerns, but they need to be evaluated more closely. In urban areas there are signs of increasing pressures on access to basic services (World Bank 2005a), and the most recent data show that over the period 1995/96-1999/2000 while poverty decreased in rural areas, it stagnated in urban areas. From the point of view of the labour market, it appears that migrants are more likely that non-migrants to be self-employed, suggesting that increased migration might lead to a swelling of the informal sector.

5.5 This chapter will build on quantitative and qualitative data sources to scrutinize more closely the evidence on the impact of migration on the labour market. It will also look at international evidence to highlight the need to create a supportive policy environment to reap the potential benefits of migration on growth and poverty reduction. These policy conclusions will be explored further in chapter 6 below.

A Snapshot of Internal Migration

5.6 In Ethiopia overall migratory flows appear limited though there are signs growing migratory pressures. Between 1999 and 2005 the pace of migration grew significantly,
albeit from a very low base (the share of migrants who had spent one year or less in their current community almost doubled, going from 1.8 to 3.5). Comparisons based on a sample of DHS surveys recording information for female migrants offer a comparative perspective (Figure 22).

**Figure 22: A Comparison of Migration Rates (Percentage of Urban Women of Reproductive Age who are Recent Migrants, by Region)**

![Bar chart showing migration rates by region](chart)


5.7 The most common move is within rural areas, and smaller cities play an important part in the process of “step-migration”. About 40 percent of recent migrants were living in urban areas in 2005 of whom about 40 percent had moved from another urban areas. Among recent migrants living in rural areas intra-area migration was almost double at 79 percent. As the population is overwhelmingly found in rural areas, the most common type of move was within rural areas (46 percent), while recent migrants represent a larger share of the urban than of the rural population (18 percent rather than 4 percent). Smaller cities play an important role in migration, a pattern common to Northern and Sub-Saharan Africa (Figure 23, 24), consistent with qualitative evidence that much of migration, particularly within rural areas, is short distance.

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24 While the overall share of urban respondents is stable between the 1999 and the 2005 LFS (13.5 and 14.2 respectively), the share of recent migrants in urban areas rose from 15 to 18 percent.
5.8 Migrants tend to be young and concentrated in the most productive age groups. Stark gender patterns in migration behavior are closely associated with different reasons to migrate are visible. Migration rates are highest in the 15-29 age group. Disaggregation by gender shows that women are more likely to be found in the age group 15-25, while the opposite applies to migrants 25+.

5.9 Migrants move for a variety of reasons with work related such as searching for a job and having a job transfer more prevalent for men than for women, as are education and returning home. When disaggregated by intended duration of migration, however, gender differences for temporary migration disappear, with job related temporary moves just as likely for women as for men. Women typically migrate permanently for reasons related to marriage arrangement and dissolution (particularly within rural areas) and, though to a lesser degree, moving along with family. Reasons related to distress migration, such as displacement, war, drought and living with relatives (which qualitative evidence shows is a common coping strategy) are equally likely for men as for women.

5.10 Job related transfers are mostly to urban areas. This is the case for “contracted moves” – i.e. moves part of an agreement with an employer – though also “speculative moves” – i.e. searching for jobs – are slightly more directed towards urban areas. Not surprisingly, education related migration is overwhelmingly directed towards urban areas.

5.11 Economic migration to urban areas has been traditionally analysed by economists in terms of the Harris Todaro model, which identifies wage differentials as the key drivers of the migration decision. The lack of rural wages prevents us at this stage from running such type of models. We resort therefore to reduced form models.

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Two conceptual problems complicate the empirical analysis. One is that while in an aggregate analysis of flows we can describe wage differentials between recipient and sending areas, we cannot assume that those differences are motivating migration, as migration decisions per se can affect relative wages. Secondly, if we try to explain the determinants of migration at the individual level, it is difficult to arrive at the “individual specific wage gap” needed in a Harris Todaro model. As migrants self-select into migration we cannot impute their wage in the zone of origin, as by migrating they reveal that there is something
5.12 The common perceptions of migrants are of individuals who are unskilled and with limited training. Further, particularly for women, they are associated with prostitution and begging in urban areas. The data reveal that while migrants are mostly unskilled, they tend to be more educated than non migrants. In 1999, 58 percent of recent migrants had no education which compared very favorably with 79 percent of those who have never migrated. Recent migrants have noticeably higher incidences of grade 5-8 and grade 9-12 than the population who has never migrated, partly of course because requiring an education beyond basic primary might have required them to move. Educated migrants are more likely to be men.

5.13 Econometric analysis of the determinants of migration points to the heterogeneity of migrants, with education a key variable in differentiating flows. The likelihood of being a recent migrant is “bipolar”: taking as base case having no education, individuals who have grades 1-12 appear less likely to migrate. Those with more than 12 years of education, in contrast, appear just as likely to be migrants as those without any education. Non-recent migrants show a different pattern, with those with grades 1-4 showing a higher likelihood of migration than the non-educated, while those with higher levels of schooling display lower probabilities. Among the other individual characteristics, gender does not play a significant role.  

5.14 Network effects are important drivers of migration. The share of migrants living in the community very significantly affects the probability of being a migrant.

5.15 Qualitative evidence helps to understand the mechanisms which lead to these characteristics of the migrants (Box 7). Cultural and institutional factors, such as informal rights to land, agricultural practices, marriage practices, affect the migration opportunities of different types of individuals. Gender and ethnicity are important dimensions along which migration is segmented. Further, at variance with economic models that focus on expected wage differentials as the main drivers of migration, migration is rarely based on a single motivation. Of the 25 or so reasons for migration to urban areas put forward by the ETPPA respondents “some are individual (for example, being stood-down from the army), but most involve family interactions or events that place the individual in a weak position for making a living in rural areas (divorce, loss of land access, death of a spouse and so on)” (MOFED 2005 pp. 60-61).

intrinsic to them that makes them different from those who stayed. It would be possible to tackle econometrically these problems if individual panel data tracking individuals across the migration experience, or at least different cross-sections providing wage information over given geographical areas were available. Among the data constraints the lack of disaggregated cost of living information for different settings (and for different groups) and the difficulties at arriving at estimates of the direct costs of migration should also be noted.

26 This finding is at odds with those of previous studies of migration in Ethiopia which find that women are more likely to migrate. Our inability to distinguish permanent migrants from seasonal or circular migrants might help explain this difference (with women more likely to be permanent migrants).

27 Ideally one should focus on the time of migration, whereas in practice the surveys have ex post data (i.e. after migration). A focus on recent migrants goes some way towards addressing this problem, which is the strategy adopted in this report for quantitative analysis. Unless otherwise specified what follows refers to recent migrants only.
5.16 Overall, the employment outcomes of migrants are better than for non-migrants, though there is much variation in their employment due to their different characteristics and reasons to move. The employment rate of recent migrants is 70 percent, against 65 percent for non-migrants. Such difference is due to migrant men high employment rate (85 percent versus 77 percent for non migrants), while women’s employment rate at 55 percent is the same across groups. In general, migrants who moved for work related reasons exhibit the highest employment rates. Breaking down women’s employment performance, it appears that recent migrants who moved for work related reasons have employment rates not very different from men’s.

5.17 As migrants are relatively better educated, one can expect them on average to have higher probabilities of being employed than non migrants. Our analysis shows, in contrast, that it is not only the difference in observable characteristics such as years of education that drives their employment performance. Among recent migrants this positive effect of being a migrant is stronger for women, while the opposite is true for those who migrated more than 4 years before. Disaggregating the model by education groups shows that for recent migrants the “premium” on being a migrant in terms of employment probability is stronger for the low skilled and the high skilled (those with 1-4 years of schooling and those with more than 12 years of schooling). For non recent migrants, this “premium” is significant for the high skilled women and lower skilled men (up to 8 years of schooling).²²

Box 7: Push and Pull Factors in Rural and Urban Areas – Qualitative Evidence

For analytical purposes, reasons for migration are generally classified as push – i.e. factors in sending areas that provide incentives for mobility – and pull – i.e. factors in receiving areas that provide incentives for mobility. The WED study (Tadele et al. 2005) and the Participatory Poverty Assessment (MOFED 2005) provide insights on these, and highlights the complex motivations driving migration. Such motivations go well beyond the simple differentials in expected wages at the centre of economic modeling of migration.

The rural push factors associated with male migration are shortage of land, landlessness, destitution, the need to raise cash to pay the land tax and debts incurred in paying for agricultural inputs. Urban areas are associated with the pull of perceptions of better employment opportunities, particularly in the informal sector and in construction, information on jobs from informal sources suggesting that there is demand for urban workers and better pay than in rural areas, and social support by long term migrants are identified as important pull factors.

Women are overwhelmingly reported to migrate to urban areas to join their spouses, though a distinct stream of women looking for work can also be identified. The former groups participates in the urban economy by working outside the house and undertaking petty trading activities to a varying degree, depending on cultural factors linked to their ethnicity and origin. The latter group is constituted by young single, or divorced or widowed women moving to look for work. Their migration is related to institutional and cultural factors, such as the plough-based agriculture of the north which prevents women from performing key tasks even when they have access to land. Further, the need to move away from the social norms typical of rural areas or from negative perceptions of women working outside the house are closely associated with the choice of migrating to urban areas.

²² The other results are in line with other evidence for Ethiopia (see Volume II).
In rural areas, there is significant mobility, though only in minimal part is it long term and related to labour market behaviors. Much mobility to rural areas is seasonal. For example, urban daily labourers who usually work in peri-urban areas in agricultural tasks travel seasonally to rural areas to take advantage of the various cropping seasons and to perform other agricultural tasks. Permanent migration in rural areas, both voluntary and involuntary, is driven by land availability and the existence of previous migrants. Women migrate a lot upon marriage but such migration tends to be short distance. Migration by women to work in towns is seen as shameful, and risky, though perceptions of female migrants (or commuters to nearby areas) by rural inhabitants can improve if their earnings allow them to support their families.

Qualitative evidence highlights how migrants rely heavily on contacts and relatives in their area of destination, who often are the ones who helped them migrating in the first place. Migrants who follow “circular” patterns, by which they go with some regularity to their home communities often convince young men, unmarried women and children, to follow them to urban areas where they can help them find a job. Ethnic based *iddirs* burial associations and self-help groups are the key institutions migrants set up to provide mutual assistance for various purposes, including facing unexpected events (funerals, need to provide help to relative in rural areas) or planned ones (organizing joint trips to go back to areas of origin for the Meskel holiday).

An important element affecting migration decisions is the cost, though we have only indirect evidence on effects. The PPA notes that the cost of travel is relatively high in comparison to the ability of farm households to generate cash. Similarly, evidence from the WED study shows that location decision for migrants to urban areas are influenced by the closeness to home origin. Rising transport costs are also noted as factors hindering contacts with home communities, which are particularly important for those migrants who have left their households in rural areas and move back seasonally to continue to work their land.

5.18 While the local concentration of migrants is strongly correlated with the decision to migrate, the employment rate of migrants (rather than their concentration) is associated with probability of employment.\(^{29}\) This finding is in line with qualitative evidence suggesting the importance of networks and personal connections to obtain jobs, as well as of the characteristics of the local economy, and in particular the existence locally of jobs that migrants can access (e.g. a growing construction sector).\(^{30}\)

5.19 Analysis by gender shows that women migrants are less likely to work than men, and that the effect is particularly strong for non-recent migrants. The positive effect of age on employment is similarly more contained for women. For women the highest probability of working is associated with no education and with more than 12 grade (effect of grade12+ particularly high for non recent migrants), while for men with less than 5 years of primary (also with more than 12 years for non recent migrants). In terms of life-events, for women marriage is associated with a lower probability of working (the

\(^{29}\) Note, these variables referring to migrants in the local area exclude the individual observation in question.

\(^{30}\) This finding could otherwise reflect the characteristics of the area – i.e. that it is an area where everybody has a high employment rate, migrants and non-migrants alike, and where the probability of being employed is thus high. This is not supported by the data, however, as the employment rate for non-migrants should be equally significant in affecting the probability for a migrant to work, which is not the case. Furthermore, the employment rates for migrants and non-migrants in a given area show little correlation.
opposite holds for men). Marriage dissolution is generally associated with a higher probability of working. For women who have not migrated recently, the negative effects of marriage are less pronounced and those of marriage dissolution are more positive.

5.20 The positive performance that migrants have in the labour market is partly reflected also in their wages, at least for men. Migration is associated on average with a 14 percentage points premium for male migrants. Disaggregated analysis by educational group reveals that such premium applies to recent male migrants who have higher education (more than 12 years of schooling).

5.21 Closer analysis reveals that migrants and non-migrants face a different wage structure. Returns differ systematically for migrants and non-migrants. Gender differences are also very noticeable. On average migrants have higher returns to skills than non-migrants, though the differences decline for higher levels of education. This might reflect the correlation of migration with unobservable individual characteristics which also influence earnings. The pattern differs for women and men. In the case of female migrants, they enjoy higher returns to education than non-migrants at all education levels, and the gap decreases for higher educational levels. In the case of male migrants, for lower educational levels they experience lower returns than non-migrants (for male migrants returns are not significantly different from those of the non-educated up to 8 years of education) and they experience slightly lower returns than non-migrants for levels of education above grade 12.

5.22 The spatial clustering of migrants is also related to lower wages, in turn suggesting competition between migrants in the labour market. While this effect is non-significant on average for the non-migrant population more disaggregated analysis reveals that the individuals with some education (grades 1-4) are those whose wages are negatively correlated with the concentration of migrants.

5.23 Does the competition between migrants extend to non-migrants as well? On average there is a negative but non-significant effect. Disaggregated analysis reveals a negative impact on the wages of those without education.

5.24 In summary therefore the available evidence suggests that from a labour market point of view migration is not a major concern, but that as pressures on land in rural areas increase, new challenges could follow. To date, however, most of migration is relatively short distance, with both step-migration and moves to urban areas directly from adjacent urban areas being quite common. Those who migrate for work related reasons have a better employment performance than the others, possibly because of the importance of network effects in both motivating migration and in favoring access to jobs. While migrants do not seem to “compete” directly with non-migrants and to drive down their wages, except for those with very low skills, they do seem to be in competition with each

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31 The analysis of wages is conducted with the Child Labor Force Survey database, which collects information also on the overall labor market performance of the whole family. Unfortunately this survey does not allow individuals to be identified it is not possible to identify as migrants, as the question is only asked at the household level. Compared with data from the LFS of 1999, the CLFS provides lower estimates of migration.

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other. These findings do indeed raise concerns for a possible scenario of increasing migration due to distress in rural areas, resulting in increasing poverty among migrants and ultimately also among the long term resident population in urban areas.

**The Impact of Migration on Growth and Poverty Reduction**

5.25 It is not possible to correlate these findings on the impact of migration on urban labour market with an estimate of the overall poverty reduction impact of migration. The lack of evidence on wages, returns to capital and underemployment in rural areas makes it difficult to arrive at an overall assessment of the effects of internal migration on growth and poverty reduction.

5.26 Qualitative data, however, suggests a positive role of migration in alleviating poverty. Qualitative evidence from the WED study in line with other (see Box 8) suggests that while the economic opportunities opened to migrants might not allow them to escape poverty, they are often able to significantly contribute to improvements in the livelihoods of sending households and of sending areas. Migrants who keep contacts with their rural areas of origin have been found to channel resources directly to the rural areas, through remittances, but also contributing to *iddirs* in their home area, or contributing to efforts such as fund raising for local roads.

5.27 The same qualitative evidence, however, suggests that things might be becoming more difficult for migrants. This raises concerns for the future if migratory flows increase as expected.

**Box 8: The Impact of Migration on Wellbeing in Rural Areas in Ethiopia**

Several studies review the impacts of remittances in Ethiopia. McDowell (1995) argued that the size of remittances for poor households can be very low but it is vital to improve food security since it helps to diversify risks and ensure support in times of harvest. Remittances can also stimulate agricultural intensification where practices allow the head of household (who may be a woman or a less senior man) to employ labour, and remitted earnings are used for purchase of equipment, seeds, fertilizers or draught animals. Worku (1995) in his study of Gurage migration argued that the impacts of migration are not merely economic, but that the interaction brings about cultural change through ideas, skills and attitudes, and that migration makes rural villagers more receptive to change in areas such as technology. He found that Gurage migrants are responsible for a dramatic change in the attitudes, values and beliefs of both migrant and non-migrant households. Negative consequences of migration have also been noted. Worku (1995) argues that migration in Gurage is responsible for greater rates of divorce, higher transmission of STDs/HIV-AIDS and the introduction of new habits such as consumption of locally made alcohol and cigarettes. Migration can also result in a greater work-load for women, and inflation of bridewealth caused by migrants’ income.

5.28 While the evidence for Ethiopia is still limited – though more work is currently planned in the context of the ongoing urbanization study – the international experience offers some key findings on the contribution of migration to growth and poverty reduction. They offer a starting point for the elaboration of policies to enable the urban economy to reap the benefits of migration, while minimizing potential shortfalls. 

*(i) Migration can increase efficiency and growth through improved resource allocations*
5.29 Internal migration has long been recognized as central to the processes of urbanization and structural transformation which cross-country evidence suggests are associated with higher development levels. Indeed, “as economies develop, the share of the agricultural labour in total labour declines and converges to a level of 2-3 percent” (Larson and Mundlak, 1997). While there is significant dispersion in the degree to which countries have urbanized during their development process, a strong negative association can be found in cross-country data between income levels and share of population in rural areas.

5.30 Migration can therefore play a major role in fostering growth and poverty reduction, by reallocating resources more efficiently both geographically and sectorally across the economy. China, offers a spectacular example of the transforming role of migration: an estimate of 16 percent of GDP growth over the period 1987-2005 has been contributed by migration. Part of the growth impact is generated by internal remittances which, given the right condition (an environment supportive to local business development, infrastructure to support communication and growth), can increase demand for agricultural produce and stimulate non-agricultural activities.

(ii) Migration can reduce poverty significantly, but there are new risks of exclusion

5.31 By opening up more productive employment opportunities and allowing a diversification of risks, it can significantly contribute to household income. The benefits are not limited to the migrants – for example, to the extent that a dynamic economy develops in urban areas, the influx of low-wage migrants can prevent a loss of competitiveness due to rising wage costs. The characteristics and skills of migrants and evolution of sectoral demands for labour are important elements of this virtuous circle.

5.32 To the extent that there are strong rural-urban linkages some of the benefits enjoyed by the migrants will filter back to the rural areas. Such linkages include remittances (Box 9), knowledge and ideas that return migrants can bring back, the introduction of new technologies, and the demand that urban migrants can have of rural products.

Box 9: The Importance of Remittances in Rural Portfolios

A comparative review of empirical work on rural household income portfolios in Sub-Saharan Africa by Reardon (1997) found that on average 15 percent of rural incomes are accounted for by remittances. In China, it has been estimated that remittances sent home by urban migrants compensated sending households for the loss of labour due to migration (De Brauw et al. 2001, quoted in Fan et al. 2005). The nature and level of remittances varies widely depending on the accessibility of the home village, employment opportunities, the costs of living, the ease of remitting, and the ‘orientation’ of the migrants (particularly if they intend to return home). Even if income from remittances is small, the limited amounts of additional cash can make huge differences to the options available to people to cope with disaster situations. (Sharp et al., 2003).

5.33 At the same time, migration can reconfigure the profile of poverty and vulnerability in rural and urban areas, posing new policy challenges. Evidence from India shows that internal migration over the 1983-1993 decade contributed to a 2.6 percent decrease in rural poverty, while increasing urban poverty by a smaller amount.
Similar patterns were found for the 1990s – suggesting that rural-urban migration contributed to making poverty more visible by shifting it at least in part from rural to urban areas. It is also possible that those left behind by the migrants might also be more vulnerable, particularly if rural-urban linkages are weak.

(iii) Country characteristics and institutions mediate the impact of migration

5.34 Country characteristics and institutional features affect the nature of migratory flows, the success of the migrants and the linkages that can be kept with home communities. Relevant factors include institutions, geography, transport costs and information, as well as opportunities to integrate in receiving labour markets. For example in Mexico the poor migrate (internationally in this case) and this reduces national poverty (Stark 1991). The geographic contiguity with a labour market characterized by large demand for low cost low skilled work (the US) is clearly part of this poverty reducing outcome. In one study in Western India, seasonal migration was found to be driven as well as amplifying rural inequality as it was directed towards urban rural labour markets strongly segmented by ethnic lines, so that those without access to recruiters’ networks or kin can only access the worst paid forms of jobs. Furthermore, recruitment from villages through networks decreased competition among employers (Mosse et al. 2002). Migration can also be associated with increasing inequality in urban areas, particularly as migratory processes tend to be cumulative, with successive waves of migrants of a certain type (location, ethnicity) attracting more of the same – thereby generating competition and low earnings in sectors where migrants are typically working (e.g. Borjas 2003).

(iv) Increased urbanization is an inevitable aspect of the development process

It is hard to control migratory flows, particularly in a context of urban growth. As the China experience shows, once migratory pressures build up these flows are hard to contain. Such pressures can be both on the “push” and “pull” sides. The former often include population pressures and environmental degradation in rural areas. These key findings are illustrated by China’s evolving approach to migration (Box 10)
Box 10: China: Institutional Reforms Help Reap the Potential of Internal Migration

In China, the *hukuo* (registration) system was introduced in 1958 to prevent urban migration by forbidding work and access to basic services outside the area of official residence. Economic reforms introduced from 1978 provided a more favorable environment for migration. During the period between 1978 and 2004, income per capita rose from US$153 (constant 2000) to US$1162, while the share of the rural population declined from 81 to 60 percent. In 2001 the Government began reforming the *hukuo* introducing new freedoms of movement from rural areas modulated on the basis of the destination, i.e. decreasing from movements to small towns to megacities. Today unregistered migrants continue to play a large part in China’s economy with estimates of those flows ranging from 50 to 120 million.

Internal migration flows are still male dominated owing to both cultural factors and demand in urban areas. In 2000, 37 percent of migrants were employed in manufacturing, followed by construction, services, and restaurant and commerce (14, 12 and 12 percent respectively). Small and middle sized cities are significant destinations, with high shares remaining within their province of birth. As in other Asian countries, increases in female migration reflect growing social acceptance and specific demand in some sectors (domestic work for the uneducated and factory work for women with some education).

Internal remittances have been estimated to contribute as much as agricultural earnings to rural incomes. Circular migration during the year and high return migration drive remittances. Many migrants contribute to non-agricultural activities by returning to townships or small cities in their area rather than to farming. They are also likely to take leadership positions in their home communities.

Labour migration since the late 1990s has been recognized as one of the national poverty reduction policies. The overall net effect of migration is an estimated increase in rural household income per capita of 14-30 percent. There have been several policy initiatives to support the poverty reduction impact of migration. For example in 2004, the Sunshine program which involves a partnership between the central and provincial governments in poor areas and provinces with high rates of outmigration was launched. It aims to provide vocational training to 10 million rural laborers who plan to move out of agriculture or want to move to the cities. After a year of operation 80 percent of the 1.5 million trainees are reported to have found jobs.

New challenges are emerging. While “surplus labour” in rural areas still amounts to 150 million people, some manufacturing areas have started experiencing shortages of manpower, and the increasing sophistication of products means emerging skills mismatches. Concerns on new vulnerable groups are also emerging: in rural areas, the poor and unskilled still face barriers to migration, and women and the elderly can be left behind. Vulnerable groups in urban areas include jobless migrants with no access to social services. Further policy reform is needed in continuing the gradual reform of the *hukuo* system, making more flexible arrangements for land tenure and continuing efforts to increase education, for China to continue reaping the benefits of rural-urban migration in the face of increasing inequality and emerging new forms of poverty.

*Sources:* Huang and Zhan (2005), Deshingkar (2005).

Policy Challenges

5.35 The PASDEP agenda includes as strategic priorities both the strengthening of rural-urban linkages and the rebalancing of the growth strategy. In this context there is a new emphasis on small town development and growth poles and on employment creation, particularly in urban areas. Internal migration is not directly addressed by
PASDEP though increased migration is likely to be spurred by sustained urban growth, as well as being to a certain extent integral to the success of this development agenda.

5.36 Critically assessing the institutional framework within which migration takes place is an important step as Ethiopia’s regulatory environment has inherited an anti-mobility bias. While significant movements of people have accompanied the country’s development over the 19th and 20th century, voluntary movements of people significantly slowed down in the 1970s. The drastic political and economic reform introduced in the Derg period, prevented the consolidation of land in large estates and kept in check internal migration. For example the land reform and subsequent measures limited access to rural land only to registered and permanent members of Peasant Associations. Further, land would be redistributed if someone was absent for more than a year, as was redistributed the land of resettled persons. The effects of these regulations in rural areas were compounded by the requirements of official pass letters to go to the cities, as well as of official registration with the kebele for urban residence.

5.37 Today, while requirements such as local registration and the need for an identity card provide means of formally controlling internal movements, local perceptions on constraints to mobility also limit migration. The perception of risk of land redistribution remains high and can stifle diversification of livelihoods in both rural non-agricultural activities and long term migration. Perhaps equally important for migration decisions are perceptions on the role of Peasant Associations and kebele officials in controlling internal movement (Box 11). The adoption of a model of ethnic-based federalism might have also reduced the extent of interregional mobility, by compounding preferences for migration to areas whose language and culture migrants already share and particularly by affecting perceptions on the fairness of the management and assignation of housing and other assets, children’s education and insecurity. Some discrimination by local authorities in finding jobs and providing business licenses on language or ethnic ground has been reported.

5.38 Sustained flows of migration without reform in the residence requirements will result in the creation of a new underclass of citizens, with limited access to urban services and at risk of losing their livelihoods in rural areas once their land is redistributed. As the experience of East Asian countries such as China and Viet Nam shows, deep pockets of poverty and vulnerability can therefore emerge in urban areas.

5.39 Poverty and vulnerability are likely to pose the greatest policy challenges in smaller urban areas, which might be the least able to face them. Such challenges include the creation of a supportive economic environment for the private sector as well as housing provision and service delivery, which are likely to difficult to provide especially in smaller cities. International experience (National Research Council 2003) points to the difficulties that are generally found by smaller cities in providing appropriate living

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32 The Migration, Gender and Health Survey conducted jointly by the Addis Ababa University and Brown University (2000) with a focus on the five most populated regional states (Afar, Oromia, Amhara, SNNPR and Tigray), indicated that permanent intra-regional migration has become more frequent than permanent inter-regional migration with the exception of temporary migration to Addis Ababa.

33 Tadele et al. 2005
conditions to their inhabitants who are likely to experience the worst forms of poverty in urban areas.

**Box 11: Perception on Constraints to Internal Migration in the PPA**

| The general case is for people to be able to move freely, subject, as might be expected, to social constraints (as pertain to adult women in many places) and to carrying personal ID at all times. There was a sense in some reports that local administration kept a very close eye on people’s movements and activities, although the degree to which this might inhibit individual initiative was difficult to assess. In urban sites it was reported that resident registration with the kebele is compulsory, and movement out of the kebele to go elsewhere requires an official leaving letter. Letters from the kebele are also required to get access to health services for free (or low fee). How uniformly these requirements are pursued in towns, and the penalties for failure to comply with them are not clear from information reported by respondents. In rural areas it was reported that as people’s movements are monitored quite closely by kebele administrations, it is advisable in many circumstances to have cleared any planned travel with the relevant officials before setting out, to avoid trouble. Furthermore, it is widely perceived that migration beyond a certain duration will result in forfeit of the land rights of the person concerned by the kebele administration. In some sites it was also reported that engagement in non-farm activities such as trading in consumer goods would result in forfeit of a person’s rights over land. Limits to migration, therefore, could be seen as part of a widespread perception in rural Ethiopia that engagement in non-farm activities as part of a mixed livelihood strategy is not permitted, so that people must choose in an absolute sense whether to stay wholly in agriculture or to engage wholly in non-farm business. |

*Source: Adapted from MOFED 2005.*

5.40 It will be important to strengthen rural-urban linkages. These include the facilitation of flows of remittances and information (about jobs, technology and economic opportunities) which can support investment in the rural economy and growth by increasing the efficiency of the allocation of resources throughout the country. They also include strengthening of the infrastructure network in rural areas to facilitate the flows of goods and satisfy the expected rise in urban demand.
6. ADDRESSING THE POLICY CHALLENGES

6.1 The generation on a sustained basis of decent income earning opportunities – job creation – is the *sine qua non* of effective economic policy. In the absence of jobs, government policy will be judged as a failure by the population, and economic outcomes will not generate improved welfare over time.

6.2 The focus of this report was on the narrower dimension of urban labour markets. It is nonetheless a central element in the broader challenge, and indeed arguably more visible and politically potent. The newly heightened policy focus on labour markets as a priority is extremely welcome. This is not because labour market distortions are *in themselves* major obstacles for Ethiopia’s growth and poverty reduction, but because a range of policies impact the functioning of the labour market. Employment creation is therefore an additional lens to evaluate the performance of the reform agenda.

6.3 This final chapter briefly summarises the major challenges highlighted by this study and reviews some of the policy options open to the Government of Ethiopia.

**The Urgency of the Labour Market Agenda**

6.4 There have been a number of positive developments in the Ethiopian labour market over the period under review. Among the important findings of this report are the changes in the quality and quantity of labour supply due to the increasing skill levels and the substantial improvements in individual mobility over the decade – trends which are consistent with the development aspirations of Ethiopia.

6.5 However these positive trends are overshadowed by pressing emerging needs. These were documented fairly extensively in the preceding chapters, and can be briefly, if partially, summarized as follows:

- The need to accelerate the pace of job creation in the economy – given the approximately 600,000 people (mainly youth) entering the total labour market each year, and to make inroads into the stock of unemployment: roughly 450,000 are already sitting unemployed in Ethiopia’s towns and cities, of whom about half have been jobless for more than 12 months.

- The need to improve labour productivity so as to enable increases in real earnings, since today even having a job is not necessarily a route out of poverty. Especially for those working informally in self-employment and as unpaid family workers – the need to enable these types of activities to prosper is urgent.
The need to improve the position of women in the labour market. For the same characteristics (education, experience, etc.), women are paid 22 percent less than men and the unemployment rates, including for more educated women, are much higher than for men.

The need for effective programs to cater for youth in the labour market. These are needed to facilitate school-work transitions, as well as to tackle the stock of unemployed.

And all this is in the context of the more general challenge of enabling rapid growth in the economy – which needs to be of the order of 6 percent annually in order to meet the poverty MDG.

6.6 To address the central challenge of increasing the pace of job creation, the Government has a range of potential instruments at its disposal – from the direct creation of positions in the civil service and state owned enterprises on the one hand, through improvements in the business environment and investments in skills and people that are conducive to private sector investment and growth on the other.

6.7 The emphasis of Government policy traditionally tended to focus on the public sector as the route to job creation. Even though the Labour Proclamation of 1975, based on a socialist system, was amended in key respects in 1993, the public sector still dominates the urban labour market in important respects. Reforms such as abolishing recruitment solely through public employment offices and guaranteed employment in the public sector for college and university graduates, easing the conditions allowing temporary employment, and widening the range of cases where dismissal is not unlawful over time have contributed to a better functioning labour market.

6.8 Reducing segmentation, where recent progress needs to be deepened and accelerated – will be key. Segmentation arises where institutional barriers – for example protection of privileged sectors or firms – act as barriers to entry, but can also constrain overall growth of demand (due to e.g. high costs). There is evidence that some parts of the labour market are already well-integrated – in particular at the top end, which is in turn associated with the “brain drain” at senior levels of the civil service – but overall segmentation across labour market states is pervasive.

6.9 In order to develop a quantitative sense of the benefits of reducing labour market restrictions a set of labour-focused simulations has been designed with MAMS (Maquette for MDG Simulations) for the period 2005-2015 (see chapter 6, volume II for more details on the simulations). MAMS is a dynamic CGE (Computable General Equilibrium) model and relative to other CGE models it offers a detailed treatment of government services and of the tax system and other sources of government receipts. The labour market is disaggregated into three segments on the basis of educational achievement (see Box 12).

34 For technical documentation on MAMS see Lofgren and Diaz-Bonilla (2006a). For other applications of MAMS to Ethiopia, see Lofgren and Diaz-Bonilla (2006b) and Sundberg and Lofgren (2006).
6.10 The simulations have been designed to explore the effects of a more efficient allocation of labour across the economy and how those would affect other policies. The experiments include the gradual removal of barriers to mobility between urban and rural areas, and a decrease in the segmentation in urban labour markets. Impacts are analyzed in terms of changes in the composition of GDP and of employment, as well as effects on growth and on welfare.

**Box 12: The MAMS Model**

MAMS is a dynamic CGE (Computable General Equilibrium) model designed for economy-wide analysis of the impact of policies and external shocks on poverty and human development (HD) in developing countries. In the Ethiopian version, production is divided into 11 activities (agriculture, industry, and private services and 8 for different government service functions: education – first primary, second primary, secondary, and tertiary – health, water-sanitation, other public infrastructure, and other government). This classification reflects data limitations and the fact that the key purpose behind the model design was to analyze the impact of government policy and other economic developments on the evolution of selected MDG indicators.

The labour market is disaggregated into three types on the basis of educational achievement – workers with less than completed secondary education (the bulk of the labour force), workers with secondary education but not completed tertiary, and workers with completed tertiary education. The labour market is linked to the educational system. The part of the population that is enrolled in school is not in the labour market. Among those not enrolled in schools, a fixed share enters the labour market at the time when their cohort would have entered the second primary cycle. This group consists of those who either never attended school or had left school before starting the second primary cycle. Others leave the educational system at a higher level, with their educational achievement at the time of their exit determining their labour type.

In the labour market, the default assumption (from which the various simulations deviate) is that the workers are free to move between the different production sectors. For any given labour type, the model captures observed relative wage differences between employment in different production activities. For example, workers at the lowest educational level in agriculture earn considerably less than if they worked in other activities. For each labour type, a flexible economy-wide wage clears the market in each time period, scaling wages in the different production activities up or down in a manner that retains relative wage differences. For each labour type, the unemployment rate is fixed (a fixed share of those in the labour force are not employed). These means that we are implicitly assuming that the unemployment rates do not change.

6.11 We find that the elimination of barriers to the efficient functioning of the labour market, all else equal, could lead in 2015 to national output that is 2.4 percent higher than in the base case, with an increase in average welfare of about 2 percent. A conservative estimate of the poverty impact is a 3 percent decline with respect to the base. Removing such barriers would also accelerate the transition out of agriculture, with the urban economy becoming more dynamic and the expansion of all the non-government urban sectors.

6.12 An interesting aspect of these simulations is that removing barriers in the labour market would result in increasing returns to secondary and tertiary education outside of
agriculture. This is good news in the medium term given plans of accelerating investments in education, suggesting that new cohorts of better educated workers would face more favorable labour market prospects.

6.13 As segmentation and the sluggish pace of job creation result from a variety of barriers, an agenda to tackle these challenges is correspondingly broad. This is laid out below on several fronts: enhancing the private sector contribution to employment, integrating vulnerable groups, creating an effective civil service, and enabling migration to contribute to growth and poverty reduction. Lastly we will focus on monitoring and evaluation of labour market developments.

**Enhancing the Private Sector Contribution to Employment**

**Improvements in the business climate**

6.14 The most important route to reducing unemployment lies in increasing productivity and growth. A much better record on job creation in the private sector is central to improved labour market outcomes in Ethiopia. Our analysis suggests that institutional and investment climate factors are very important in deterring entry into the private formal economy and that unless these are addressed, Ethiopia will make little progress in meeting its jobs challenge.

6.15 There is no single magic bullet here, and nor is the agenda for jobs distinct from the more general policy reforms and measures needed to stimulate the private sector. The priorities which have emerged from empirical analysis, focus group and other qualitative work suggest a renewed private sector strategy needs to be established around three broad themes: building market-supporting institutions, revitalizing sector-level growth strategies, and strengthening economic governance.

6.16 Key elements therein are highlighted here:

- Most important appear to be reducing the regulatory and policy obstacles to competition in key sectors, such as wholesale and retail trade, logistics and in capital markets
- Effectively operationalizing the Trade Practices Commission and Proclamation, including extension of its purview to SOEs, and reviewing mergers and acquisitions that increase the power of existing large firms
- Improving access to finance, so that firms need to rely less on collateral, and a wider range of instruments, notably equity
- Improving property access – through leases and/or ownership – to improve performance on property registration and leasing
- Building on recent administrative reforms which have improved customs, tax administration and foreign direct investment.

6.17 One challenge for the Government is to identify measures to increase tax collections without creating a disincentive to private sector development. Cognizant of

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35 The reader is referred to the CEM 2006 Volume II, Chapter 3 for more.
the existence of outdated and complex tax laws and weak and inefficient tax administration, a tax reform program has been underway for some time, which got renewed momentum in 2001 when the "Revenue Board" was scaled up to become the Ministry of Revenue. The 2005 reforms to the presumptive tax (as mentioned in Chapter 3) have been welcomed by firms. Recent work suggests that higher tax collections could be realized through limiting exemptions on imports and rebalancing incentives to investment to accelerated depreciation.

6.18 There appears to be concrete interest on the part of Government in ensuring positive impacts of the tax system and tax reforms on investment and growth, saving, and the distribution of income. Advice and assistance is already being provided by the IMF. On a complementary front, in order to ground a better understanding of these issues, it may be useful to undertake more detailed empirical micro-analysis on the conduct of individuals and households, and both private and state firms, across different sectors in time periods spanning past reforms; and estimate behavioral responses of economic agents, and calculate associated revenue, efficiency, and distributional effects of alternative options. This would include, for example, calculating effective marginal tax rates on different agents (households, firms, in different locations, etc.) and in different sectors, and other important parameters such as the cost of capital to firms. This would help inform understanding of the distortionary costs of increased revenue mobilization. On this basis, actions could be recommended to improve the efficiency and effectiveness of the tax system vis-à-vis private sector growth and employment objectives.

6.19 While the foregoing has mainly to do with the formal sector, these also have a bearing on the success of informal sector activities. There seem to be two broad sets of constraints holding down wages and productivity growth in the informal sector. The first, “lack of demand,” is obviously related to low average incomes and extensive poverty (lack of purchasing power), but also partly reflects the high degree of competition among relatively undifferentiated goods and services. The second set of constraints comes from government actions and/or regulations.

6.20 Constraints directly related to government actions/regulations are easier to address in the short term. There are three main avenues where action could have a sizable payoff:

- ensuring that informal sector operators can conduct their activities free from official harassment and from arbitrary regulations and/or payments
- expanding access to microfinance by facilitating private sector activity therein
- improving access to workplaces – security of tenure reduces risks and enables informal operators to invest

6.21 We review each of these avenues in turn, bearing in mind the important additional point that emerged from the analysis, that actions and programs responding to these constraints should have a gender-sensitive lens. Further, the role that informal activities have in sustaining the poor and vulnerable should be kept in mind: though frequently low productivity and non-dynamic, these activities in urban areas can at least enable sufficient food intake. Indeed together with low skills, the inability to start-up self-employment
enterprises was identified by the PPA as one of the two defining features of vulnerability in urban areas.

6.22 Based on the size and significance of the informal sector in Ethiopia, it is clear that attempts to repress activity will have adverse impacts on employment prospects in aggregate and at the individual level. The alternative to informal sector activity is not a “proper job” in the formal sector, but unemployment.

6.23 Freedom to operate. On this point there seems to be a disconnect between official government policy, which recognizes the key role of the informal sector and SMEs in the economy, and the actions of some local officials. Results from the UNECA governance study (2004) also report a perception (in this case by a panel of local experts) that the government does not sufficiently support the informal sector. The PPA and anecdotal sources show that petty traders are subject to occasional harassment by officials, although the extent of such practices is unclear. In the survey data, larger and more established informal firms are more likely to report government harassment and regulations as an issue.

6.24 Existing regulations which either deliberately discriminate against informal operators and/or are subject to interpretations which have this impact, are urban zoning regulations. Changes in urban land use and in particular on the location of markets have been reported as adversely affecting the activities of the small scale self-employed whose low margins make them less able to face increasing costs to access inputs. A more general review of existing regulations and practices is needed to inform the design of appropriate reforms. Moreover, Government needs to ensure that officials at all levels are aware of how they should treat informal sector firms, and make sure that they do so.

6.25 Microfinance. Lack of capital surfaces in every survey and in qualitative sources as a major, or even the most important, constraint to would-be and current entrepreneurs. Overall only a small percentage of informal sector operators rely on formal loans for capital; most draw resources from their own savings, or from friends and relatives. However the microfinance industry is rapidly expanding, and seems to be having a positive impact not only in terms of access to credit, but to other financial services (e.g. savings accounts). There are currently a total of 25 licensed microfinance institutions in Ethiopia, operating in all but 3 regions, with funding coming from own as well as donor resources. According to the Association of Ethiopian Micro Finance Institutions (AEMFI), the number of loan clients doubled between 2001 and 2004 to over one million.

6.26 Regulations governing the Ethiopian microfinance industry have been relaxed (including on loan size and interest rates). Yet it does appear that further changes could spark private investment in the sector. According to the National Bank of Ethiopia existing MFIs satisfy less than 10 percent of demand for microfinance. MFIs need to deepen as well as broaden their reach, since many small and growing businesses need slightly larger loans than MFIs typically provide, but cannot access commercial credit. Frequently these borrowers would prefer individual loans to dealing with the time
commitment and risk involved with group-based loans. There are also concerns at the other end of the spectrum, since the very poor may not be able to gain acceptance into a group for group-based lending. Further analysis and evaluation on the impact of existing loans would usefully inform policy development in this area. Moreover, expanding the reach of MFIs in towns could be important, since they operate predominantly in rural areas.

6.27 Access to workplaces. Both the formal and informal components of the private sector have identified the availability of land, and the associated time and cost of land related transactions, as one of the key constraints to growth. With the new Urban Land Lease proclamation issued in 2002, it was expected that there would be significant changes in regional/city level practices with regard to urban land management. However, recent studies indicate that the volume of informal land transactions is high; leased land plots are actually cheaper than “rent” land and buildings; taxation of real estate transactions is high; the allocation of vacant land is made without auction, for low administratively defined prices or free of charge; and there are huge differences in the amounts of payments for similar plots. In this climate, informal sector operators—who have limited capital and at best a weak political voice—would be expected to experience great difficulties. Although there are targeted interventions (e.g. via the Addis Ababa ReMSEDA, see below) that aim to help entrepreneurs find working premises, this is a second-best (and limited) solution—ideally the legal framework would be more conducive to improved access to secure tenure in general. The upcoming World Bank study on urbanization will look further into these issues and provide specific recommendations.

6.28 Finally, there is the question of why informal firms do not obtain a license, and whether they consider being unlicensed a problem. The Addis Labour Market Survey found that most firms that did not have a license cited “easier to operate without a license”, or “did not need a license” as reasons. A minority cited reasons related to the license process itself. Avoiding taxation is often a reason to avoid formal status; indeed, a small but significant percentage of firms in the ALMS (12 percent) agreed with the statement “I don’t want my business to grow too much because then I will have to pay taxes” (2006 survey). However there are benefits to formalization – avoiding harassment, access to credit and so on – that these operators are missing out on.
Business Support Programs

6.29 Beyond removing constraints, governments can also take active steps to promote individual forays into business. Because most Ethiopians who manage to transit out of unemployment find work in the informal sector, programs aimed at supporting entrepreneurship, and in particular access to finance, could have an impact. While not everyone has the personal qualities and aspirations to be a successful entrepreneur, and the overall business climate influences whether new businesses can succeed, there is some international experience about the types of business development schemes (BDS) which work.

6.30 International evidence shows that programs to support business development are more successful when they address multiple facets of the challenge, and not just access to finance. O’Higgins (2001) lists the following typical components of programs intended to enable self-employment, and reports that the best results come from programs which cover all (though not via a single organization—microfinance itself, for example, is best provided by a specialized institution and not by an educational organization):

- Promoting and introducing the self-employment option;
- Training in the necessary skills for self-employment;
- Mentor support;
- Access to finance;
- Access to work space;
- Business expansion support; and
- Access to support networks.

6.31 The Government’s Micro and Small Enterprises Development Strategy, proclaimed in 1997, recognizes that the MSE sector is held back by “various policy, structural, and institutional related problems and bottlenecks,” including the key constraints noted here (marketing problems, lack of capital, lack of working premises, etc.). The strategy led to the creation of the Federal Micro and Small Enterprises Development Agency (FeMSEDA), which also has Regional bureaus (ReMSEDAs), under the Ministry of Trade and Industry umbrella. These are the main public sector providers of training and business development services for MSEs, and there are also numerous private skills/management training institutes and organizations. Services vary widely, with many specialized skills training schools as well as more comprehensive centers. The Addis Ababa ReMSEDA, for example, provides a one-stop shop for entrepreneurs, offering training, microfinance, assistance with registering and accessing workplaces and equipment. Thus far it has served about 200,000 clients and created 150,000 jobs.

6.32 The Ethio-German Micro and Small Enterprises Development Program accounts for much of the impetus and resources behind BDS in recent years, via public, private, and NGO providers. An impact study conducted in 2004 looked at 45 businesses that had participated in a BDS program, and found that 23 had subsequently increased their income and 12 had hired new workers. In particular, BDS seemed to improve
entrepreneurs’ marketing skills, and to help them begin keeping records of business transactions, in addition to facilitating access to credit and workplaces (Zerihun 2004).

6.33 There appears to be significant unmet demand for training and BDS. About three-fourths of informal operators surveyed would be willing to pay for some or all of the cost to attend a training program (Ageba and Amha 2004). The ALMS probed into this issue, and found that about three-fourths of small business operators had never sought help in running their business. The majority said this was because they did not know where to go for help. Likewise, most of the unemployed said they were unaware of any government program in Addis Ababa that could help them find a job or start a business. This suggests that simply better publicizing the services available (as was recognized in the government’s MSE Development Strategy) could make an initial difference.

6.34 Expanding the existing types of interventions also appears to be appropriate, alongside strengthening program monitoring and evaluation. Any significant scale up should be based on careful evaluation of the evidence to identify what works best and what needs to be adapted in extending existing programs. At a minimum, more systematic monitoring and periodic impact evaluations are needed to assess the effectiveness of the Government’s existing programs in order to gauge the value of future scaling-up. An analysis of the employment creation impact of the Addis Ababa Integrated Housing Program, which integrates employment creation through support of SMEs in construction woodwork and metal work, is being undertaken by the World Bank following to this report, to contribute to these efforts.

Integrating Vulnerable Groups

6.35 Women and young people experience relatively greater difficulties in securing productive employment than adult men, which suggests a need for targeted active programs need to be designed. The fact that women have lower levels of educational attainment and lower access to capital and assets than men creates disparities that could be addressed through program design.

6.36 A specific obstacle for women which is more intractable lies in their domestic work burden. This is vividly illustrated by the time-use component of the ALMS, where over two-thirds of unemployed women said their most time consuming activity in the previous week was domestic responsibilities, while only 9 percent of men said this was the case. In contrast, more than half of unemployed men said their primary activity had been social (e.g. meeting up with friends, recreational activities, etc.). Thus women’s employment options appear constrained by the need to keep up with chores and take care of children. Indeed, most female informal sector operators are home-based and with limited prospects for these reasons. Policy and programmatic interventions should be designed with these concerns in mind.

6.37 Targeting women, as MFIs tend to do internationally also serves to combat gender inequity. For example, evidence on female microfinance borrowers in Bangladesh, where MFIs are well established, indicates significant poverty reduction impacts, as well
as better human development outcomes for their children (Littlefield, Morduch, and Hashemi, 2003). In Ethiopia, the percentage of loans held by women varies widely. Some MFIs specifically target women, and women account for 60 percent or more of the lending portfolio, while other MFIs lend well under 40 percent to women. Increasing efforts to reach women in areas where they appear to be underserved could help reduce gender inequality.

6.38 Reaching youth, who have higher levels of educational attainment than their predecessors but obviously less experience, entails a different set of considerations. The consensus in the literature seems to be that preventative interventions (such as keeping children in school longer) are more effective than ex-post interventions such as specific training programs. In the case of Ethiopia, however, where the human capital base is extremely low and a large part of the population has already missed the chance for formal schooling, other programs are likely to be necessary. Ensuring appropriate targeting will partly depend on the availability of relevant labour market information (see vol. II, Chapter 8).

6.39 Though the informal sector provides the main route to employment for most, this often means informal wage work (or unpaid work) rather than self-employment. However, given the limited prospects in the informal sector, programs targeting youth need to be broader than facilitating entrepreneurship, perhaps via joint initiatives with the private sector to increase opportunities for on-the-job training that enable young people to gain workplace-relevant skills.

6.40 Recognizing the need for a multi-sectoral approach to empowering youth and equipping with the tools for success, the government created the Ministry of Youth and Sports, which formulated its guiding National Youth Policy in 2004. Currently the Ministry is working to finalize its strategy to implement this Policy, which includes plans for interventions in improving healthcare for youth, expanding access to business development support and microfinance, creating new training opportunities, and providing care for vulnerable young people, among other objectives. These will be coordinated with existing services for youth, which mainly fall under the Ministry of Education (which administers the formal education system) and Ministry of Trade and Industry (which oversees FeMSEDA).

6.41 Many of the BDS and training providers referenced above serve a relatively young clientele. The Addis Ababa ReMSEDA in particular specifically targets unemployed youth and women, and informal educational opportunities naturally appeal to new or recent entrants to the labour force. According to the FeMSEDA training institute, which mainly enrolls those between 20-30 years, youth are more likely to take courses in specific skills (e.g. woodworking, metalworking, handicrafts), while the older students are more interested in management and business development courses. Assessing patterns of demand for training would be help to inform the expansion of current programs.
6.42 The most visible government effort to improve youth employability lies in the creation of a formal technical and vocational education and training (TVET) program. The TVET program aims to address concerns that many secondary graduates who do not continue to higher education lack practical skills, and a pilot tracer study of TVET is currently underway to determine if the new system is effective. The Government plans to continue its massive expansion of TVET, to eventually accommodate most Grade 10 graduates, while at the same time the size of upcoming cohorts is increasing (nationwide, there were about 30,000 first level TVET students in government and non-government programs in 2004/05, and nearly 300,000 grade 9 students; MOE 2005). The World Bank’s upcoming secondary education study will closely examine issues related to the current program and scaling up.

6.43 In addition to lack of a proper education and lack of experience, youth respondents to the ALMS were more likely than older jobseekers to cite a lack of influential contacts as the main obstacle to getting a desirable job. Policies to strengthen merit-based selection for jobs in the public sector may warrant consideration, and policies aimed at promoting competition in the private sector in general (as discussed above) should indirectly have this effect as well.

Active Employment Programs

6.44 A potential set of tools to tackle unemployment includes job creation and job subsidies, as well as training (Box 13). However the sheer scale of Ethiopia’s unemployment problem, vis-à-vis government budget constraints, means that active labour market programs alone cannot solve the problem, especially given their other limitations. Low demand for labour in general constrains the potential of interventions on the supply side (e.g. training and business development support), although these do have an important role to play. Interventions which specifically create jobs such as public works programs, can usefully temporarily raise incomes, but tend not to increase the long-run employability of the worker.

6.45 Active interventions, while no substitute for dynamic private sector job creation, can help alleviate the negative effects of unemployment for the most vulnerable. In Ethiopia, longer durations of unemployment are found for those who are looking for their first job, which means that individuals (especially youth) risk being lock out of productive opportunities. Most interventions tend to be on the supply side, via literacy and vocational skills training programs, for example, and there is some evidence that such programs may have a greater impact in developing than developed countries (where their effectiveness has been questioned). There are a variety of ways to package this kind of assistance that could be considered for Ethiopia, and tailored to fit the local context. In Kenya, for example, the Jua Kali Voucher Program distributes training vouchers to entrepreneurs or employees of SMEs to allow them to boost their skills. Although the program has not been rigorously evaluated, it is believed to be achieving many of its objectives, including increasing the amount of training accessible to informal sector workers and increasing competition among training providers (Adams 1997). While voucher programs also have critics (see Gagel 2005 for arguments against), at least one
useful lesson can be drawn from the Kenyan program – that such projects are better run by the private sector than the government, and that exit strategies are needed so that subsidies do not have to continue indefinitely (Godfrey 2003).

6.46 Labour market interventions can impact both the labour supply (e.g. training) and demand (e.g. improving the investment climate; business development support; public works programs) sides, ideally in mutually reinforcing ways. For example, training programs work better when there are close links with the private sector, since employers have some knowledge of the kinds of qualifications that are in demand. Especially in light of emerging shortages in specific sectors and for certain profession profiles, it would be important to have an integrated approach to vocational training, starting with a bottom-up approach that links firms’ needs with the type of educational system that would best support the creation of those skills. Singapore offers a very successful example of integrated management of a vocational training system, and after having developed it in collaboration with donors, has graduated from receiving foreign assistance. Today it pursues strategic partnerships whereby private firms outsource part of their production processes to firms in poorer countries such as Viet Nam and help them build up their skills.

6.47 Much of the evidence about the impacts of ALMPs comes from industrial, rather than developing countries. In countries where the informal sector dominates, implementation capacity is low, and demand for labour is relatively weak, the ability of ALMPs to make a major impact on employment and wages is limited. Available program evaluations tend to be less encouraging than those in OECD and transition countries, but the results vary, and there are examples of youth training programs that have been more successful in developing than industrialized countries. This may arise because, for example, such programs are addressing skilled labour constraints (Betcherman, Olivas, and Dar, 2004).

6.48 The factors leading to successful ALMPs tend to apply for all countries (Betcherman, Olivas, and Dar, 2004). Interventions that offer a combination of services, are demand-oriented and relevant to the workplace, and are well-targeted generally work well. However the evaluations underline the fact that program impacts are usually more positive when the economy is growing, and cannot effectively offset lack of growth. It is important to ensure that programs are well targeted, and that vulnerable groups receive special attention (e.g. the disabled and orphaned).

6.49 There may be a role for enhanced employment exchange services to improve the flow of information in Ethiopia, but because most hiring tends to be via informal networks the impact is unlikely to be large. International evidence has suggested that employment services are most beneficial when integrated with career counseling and other support, which is in line with MOLSA’s plans to expand its services. Still, the impact is generally limited, with only a minority of firms listing their job openings and the absolute numbers of job-seekers assisted being very small relative to the stocks of and flows into unemployment.
Better educated job seekers tend to be more likely to register with employment services – this is certainly true in Ethiopia, where according to MOLSA 82 percent of those registered had at least junior secondary education in 2001/02. This suggests employment services are probably not a good tool for reaching the unskilled unemployed. Moreover, MOLSA data suggests a mismatch between the registered jobseekers and the posted jobs, since many vacancies remained unfilled for extended periods of time – this could be related to skills, or perhaps to expectations (e.g. if skilled workers are uninterested in jobs located outside major towns, which is supported by some anecdotal evidence).

Box 13: Are Active Labour Market Policies (ALMPs) Worthwhile?

While the debate over the effectiveness of ALMPs is not conclusive, a recent review of 159 impact evaluation studies in both developing and industrial countries does draw general conclusions about which interventions work better than others, which can be highlighted as follows:

- **Employment services** include counseling, placement assistance, job matching, labour exchanges, and other related services. They generally have positive impacts on the post-program employment and earnings of participants. Costs are relatively low so the cost-benefit ratio is often favorable. However, employment services per se are of limited use in situations where structural unemployment is high and there is a lack of demand for labour. The coverage and effectiveness of these services in developing countries is less in countries where many labour market transactions are informal.
- **Training for the unemployed**. Participants often benefit from these programs in terms of higher employment rates but not in terms of higher earnings. The few evaluations in developing countries paint a less favorable picture. Programs seem to work best with on-the-job training and active employer involvement. Results are more positive for women than men.
- **Retraining for workers in mass layoffs** most often have no positive impacts. The few successful cases typically include a comprehensive package of employment services to accompany the retraining, but these are generally expensive.
- **Training for youth**. In industrial countries, these programs often fail to improve labour market outcomes, and the conclusion has been that earlier investments in the education system to reduce drop-outs and other schooling problems are more effective. While there are few studies in developing countries, evaluations in Latin America do find positive impacts for programs that integrate training with remedial education, job search assistance, and social services.
- **Wage/employment subsidies**. These often do not have a positive impact and have substantial deadweight and substitution costs. Targeting and monitoring may help but at the cost of reducing take-up rates.
- **Public works**. This can be an effective short-term safety net but public works do not improve future labour market prospects for participants.
- **Micro-enterprise development/self-employment assistance**. There is some evidence of positive impacts for older and better-educated workers. However, take-up is low.


Alongside the state employment service, there are also private sector brokers. Each works with a network of 5-10 job dealers who are in charge of recruiting. Some of them also offer shelter to job searchers who don’t have it. They obtain fees from both the employee and the employer, partly depending on wages. It is anecdotally reported that wages can vary a lot by neighbourhood and that wages depend not only on the job description but the employer’s ability to pay. There are concerns for migrants, especially female migrants, who are vulnerable to exploitation in the absence of their own social
and other networks. These operators seem to perform a useful function for those who lack information about the jobs market and/or do not have networks, but might warrant some monitoring and possibly regulation.

6.52 Public works programs can serve as a safety net for the most vulnerable, and alleviate unemployment, even if they do not guarantee better employment outcomes for participants in the long run. They can also support economic growth by building/maintaining community assets. Some of the other advantages of public works programs include their attractiveness to informal sector workers and the relative ease of targeting, fairly low administrative burden (compared to other come support schemes), and ability to provide quick relief after shocks (Vodopivec and Raju 2002).

6.53 One successful public works program in Senegal employed youth in labour-intensive construction and public service provisioning. By sub-contracting the work to SMEs, the program created 80,000 jobs in SMEs in its first phase, including 6,000 permanent jobs (which is atypical for a public works program). The effectiveness of the program was attributed to “clear objectives, strong political support, and assistance from development partners” (Sarr 2000, cited in UNECA 2005, p. 26). By integrating training programs with public works employment schemes, youth-oriented programs in particular might increase the likelihood of having a longer-term impact – one criticism of the Senegal program was the lack of such a component.

6.54 Ethiopia has extensive experience with food-for-work, and more recently broad-based cash-for-work schemes (via the Productive Safety Nets program), but only in rural areas. Adapting and expanding the concept for urban areas should be on the policy agenda, and may be the best mechanism to directly expand opportunities for the unskilled unemployed. It is important to underscore that although unemployment rates are higher among the relatively well-educated, in absolute numbers the unskilled unemployed constitute a very large group (and experience an unemployment rate that is still high relative to other countries). If linked with training programs, public works interventions may have a better chance of improving participants’ employability in the future, rather than simply offering a temporary source of income. Moreover, along with generating employment, public works programs can help expand and maintain critical infrastructure and public assets in large cities as well as towns. This dovetails nicely with the Government’s increasing focus on urban development as a central part of its growth and poverty eradication strategy.

6.55 An analysis of Ethiopia’s existing food security programs by Quisumbing and Yohannes (2004) showed that the programs tend to mirror patterns in the labour market more generally, i.e. with lower female participation and earnings. In order to improve outcomes for women, they recommended careful selection of the type of project (men are more likely to work on infrastructure projects, for example) and allowing flexible schedules/providing day care to enable more female participation. They also emphasize the importance of female involvement in the program planning stages as critical to achieving benefits for women.
Conditions for an Effective Civil Service

6.56 The policy implications of current remuneration and hiring practices are two fold (see chapter 3, this volume):

- that relatively good conditions in the civil service for the low skilled could distort the lower end of the labour market, make private firms less competitive and possibly also encourage “wait” unemployment; and
- the need to respond to a visible brain drain problem at the high end which, while not quantified in extent, appears to be undermining government capacity at the senior policy level.

6.57 Anecdotal evidence suggests that attrition rates are high among skilled personnel and at the high levels of the structure (department head level and above), although aggregate turnover is not high (4 percent annually). There is intense demand for professionals with a masters qualification (plus 5-15 years of experience) in economics, management, public health and others depending on the specific demand of the employers, which constitute about 5 percent of the total civil service employment.

6.58 The data confirm that the inequality in wages across different types of employers is less variable for the high skilled relative to the low skilled. This suggests that the market for relatively scarce high skills is more integrated (there is a “going rate”), which would be expected to encourage individual mobility in response to earnings differentials.

6.59 A recent comparison of civil service salary scales with those of parastatals, the private sector and NGOs though small in sample size and not representative suggested that high skilled workers can find higher earnings outside the civil service. Table 18 summarizes the ranges by qualification. For example, parastatals pay 1.3 to 3.8 times as much as the civil service for social science graduates. The private sector also pays more for similar qualifications and experience. NGOs and international organizations, who generally recruit graduates, offer by far the best pay – although obviously the numbers of jobs in those agencies are limited in both absolute and relative terms.
Table 18: Ratio of Salaries for Selected Professions Relative to Civil Service, 2005

<table>
<thead>
<tr>
<th></th>
<th>Parastatals</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social science</td>
<td>1:1.3</td>
<td>1:2.9</td>
<td></td>
</tr>
<tr>
<td>Law and engineering:</td>
<td>1:2.4</td>
<td>1:3.8</td>
<td></td>
</tr>
<tr>
<td>Private sector</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social science</td>
<td>1:1.6</td>
<td>1:1.7</td>
<td></td>
</tr>
<tr>
<td>Law and engineering:</td>
<td>1:1.6</td>
<td>1:3.3</td>
<td></td>
</tr>
<tr>
<td>Medicine</td>
<td>1:2.6</td>
<td>1:1:42</td>
<td></td>
</tr>
<tr>
<td>Teaching</td>
<td>1:1.9</td>
<td>1:8.3</td>
<td></td>
</tr>
<tr>
<td>National NGOs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social science</td>
<td>1:2.5</td>
<td>1:5.5</td>
<td></td>
</tr>
<tr>
<td>Law and engineering:</td>
<td>1:3.0</td>
<td>1:4.2</td>
<td></td>
</tr>
<tr>
<td>Medicine</td>
<td>1:2.9</td>
<td>1:3.3</td>
<td></td>
</tr>
<tr>
<td>International NGOs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social science</td>
<td>1:5.8</td>
<td>1:10.8</td>
<td></td>
</tr>
<tr>
<td>Law and engineering:</td>
<td>1:5.4</td>
<td>1:9.5</td>
<td></td>
</tr>
<tr>
<td>Medicine</td>
<td>1:9.1</td>
<td>1:9.7</td>
<td></td>
</tr>
</tbody>
</table>


6.60 Somewhat surprisingly, even for non-salary benefits (allowances and medical insurance), civil service conditions for professionals are also relatively poor. Allowances, per diem and medical/insurance coverage are more attractive in the non-public formal sectors than the civil service, at least for professionals. For example, unlike the civil service, some international organizations revise the salary scales to reflect changes in the cost of living.

6.61 Civil service reforms, together with new ways of managing human resources, including performance evaluation and more accurate (and less inflated) definitions of grades and tasks, will be needed to meet the challenges ahead. Some of these reforms cannot be implemented rapidly, but other countries’ experience has shown that disaggregating pay and employment reforms and sequencing over government agencies can be an effective strategy.

6.62 While the situation may seem to call for across-the-board decompression and rationalization strategies, such approaches have been increasingly criticized across Africa. The current trend based on international experience is to disaggregate pay and employment reforms and sequence them sectorally (agency-by-agency reform) and/or by cadre (i.e., creating a senior executive service).

6.63 The stated goal of the Government is to reform more deeply the system and make the civil service performance based – however this is a long term program that will take some years to come to fruition. The current system is based on seniority rather than merit, so that not all those at higher levels warrant higher pay or efforts to retain, and over time younger people need to be attracted and given incentives to excel. As we showed in Chapter 3, it appears difficult to lay off civil servants.

6.64 It is nonetheless possible in the short term to introduce simple, focused measures that could help to retain the key staff who have been identified as essential to senior level
management and policy functions. At the high end, for the GOE to keep up with the private sector/NGOs/donors (PND), the approach could be as follows:

- The subset of GOE senior cadres that are qualified for the PND market should be identified. A simple historical analysis of the qualifications and characteristics of GOE staff recently hired by the PND will reveal precisely the constellation of skills, education and experience that qualify for PND employment (typically be heads of department or equivalent, usually with a Masters degree, and at least ten years of experience).
- An anonymous survey of the terms of employment given to the former GOE employees, to inform the design of a competitive package.
- Develop and introduce a package of incentives for the select group, and monitor implementation.

6.65 Box 14 provides an example of how donors in Tanzania are collaborating with the Government to ensure that over the longer term efforts to retain and build senior cadres are sustained. At the same time, as stressed in Chapter 3, the issue of compensation is broader than pay, and involves life choices, incentives and staff evaluation, training opportunities and location incentives, as well as societal and political factors.

**Box 14: Donors’ Support of the Tanzania Medium Term Pay Reform Strategy: the Selective Acceleration of Salary Enhancement program (SASE)**

SASE is the key intervention introduced by the Government of Tanzania to leverage implementation of its Medium-Term Pay Reform Strategy (MTPRS), adopted in 2000. SASE targets priority-post holders, essentially those in managerial, professional and technical positions and aims to commit, motivate and retain critical personnel to introduce and sustain a results-oriented culture in the public service. Salary scales under SASE are pegged to target levels contained in MTPRS. The intention is that in the medium-term, donor partners will on a declining sliding scale, finance the gap between current and target salary levels.

At the beginning of each year, donor partners disburse the annual amounts pledged to SASE (that are within MTEF), to the Consolidated Fund. Resources are allocated to the various Ministries Departments and Agencies (MDA) based on objective and transparent criteria for the selection of candidates. At the end of each year, individuals benefiting from SASE undergo a rigorous assessment procedure and each Ministry reports (using independent sources of information) on the impact of the scheme, as well as whether those who benefited from the scheme ought to continue being included.

The scheme is at an early stage in its implementation. Currently, just over 1,000 employees in 4 MDAs benefit from SASE. In the medium-term, a tenfold increase in the numbers on SASE is planned, though the total actual numbers will be reviewed once resource ceilings have been agreed with the Ministry of Finance and participating donor partners.

Recent progress reports highlight some difficulties in implementing such a scheme. These have included unrealistic planning horizons, the slow rollout with only 4 out of the 11 MDAs targeted benefiting from the scheme, and the “projectization” of SASE, with some donors targeting particular MDAs. Donors’ willingness to support the scheme has also been weakened by the emergence of gaps between actual pay and target pay (particularly for higher grades), as public employment grew unexpectedly. The scheme is voluntary and despite the availability of systems
and tools provided by the Public Service Commission the management culture within Ministries remains weak. Further, compliance with safeguards procedures is very time consuming for managers.


6.66 Some recent research has focused on turnover of staff in service delivery. Very high turn-over rates have been found among teachers in the first cycle of primary schools, especially in remote areas in which communities contribute not only to school construction, but also to the hiring and paying of teachers. Because community salaries are not guaranteed, teachers, after gaining some experience, look for alternative job opportunities. On the other hand, some anecdotal evidence on health workers now suggests that the private sector may be saturated and “losing its appeal,” and some health professionals may be moving back to the public sector (Serneels and Lindelöw 2004).

6.67 The future policy challenges faced by the Government in a context of scaling up to reach the MDGs are clearly those of increasing demand for staff, and for staff with higher skills, coupled with the competition by the private sectors and donors which raises the premium on those very skills that are so scarce. At the same time, as explored in Chapter 3, it is important to ensure that relative good conditions for the average and unskilled worker do not unduly push up private sector costs and reduce Ethiopia’s competitiveness.

**Education and Training**

6.68 Our study has shown that returns to education in Ethiopia are high and increase at higher levels. Relative to illiterates, men with some higher education earn 132 percent more, and for women the premium is even higher at 147 percent. Interestingly, however, returns from non-formal and grade 1-4 education are not statistically different from illiterate in Addis: suggesting that more than minimal education is needed to make a difference to earnings in the capital.

6.69 Increasing educational attainment of the Ethiopian population and workforce has had important effects on the labour market. On the one hand, it partly explains the lower activity rates of youth (who are still in school), although completed general and tertiary education does tend to make individuals active in the labour market. One welcome trend also is that the high education gaps between men and women have been narrowing over time.

6.70 We also found large returns to training both in terms of earnings, as well as higher activity and employment rates. Only 11 percent of those with training are inactive, and those with training represent about 21 percent of the active population. At the same time, much of the training that we observe has been provided to civil servants – about half of

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36 Note that the data do not allow us to distinguish on the job training (likely to be provided by better employers) from training which preceded the entry into the labor market.
whom have training, against 19 percent of those working for the private sector and only 4 percent of parastatal workers. The distribution of those employed with training by sector (primary, manufacturing etc.) likewise shows a predominance of the public sector (out of the entire workforce that has received training, 20 percent are public sector workers) and the educational sector (26 percent), and a spread across other sectors. At the same time, looking at the occupational distribution, reveals that the groups most likely to have training are those with high skilled occupation (as many as 90 percent of professionals have training, against 6 percent of those in elementary occupations).

6.71 A key question on training relates to relevance to private sector demands. We do find that the private sector laments lack of specific skills (supply chain study). Follow-up work being supported by the World Bank will help to explore how the supply chain from basic education to training can be shaped to respond to private sector needs.

6.72 It should be noted that in our sample most (three out of four) of the individuals who had received training also had at least general education – thus the results here may not be replicated with the expansion of training through people being streamed into TVET much earlier.

**Enabling Migration to Contribute to Growth and Poverty Reduction**

6.73 The contribution of migration to growth and poverty reduction is strengthened by an overall labour market policy that enables dynamism, and by the overall coherence of the policy framework. This involves understanding the diverse and complex strategies that people, especially the poor, use to diversify their income sources and reduce risk. Thinking about migration (as more generally about population) needs to be integrated into the planning of different ministries. Both the rural and the urban development agenda need to consider migration more explicitly.

6.74 In the case of rural development, migration needs to be seen in a context of overall income diversification, favoring at least shorter range migration and connectivity with towns. Several policy elements currently pursued are in line with these objectives including strengthening the management, capacity and planning of rural towns, which play a key role in providing services and access to markets for the rural population; and scaling up the provision of rural infrastructure such as roads and electricity.

6.75 Urban authorities, faced with the prospect of a growing population, need to consider how to create an enabling environment which can turn the challenges posed by increased mobility into opportunities. This involves developing new alternatives for service delivery, providing urban infrastructure and considering access to land and credit by the newcomers.

6.76 Specific policies to be considered with respect to migration include:

- *Facilitating flows of information and people.* Strengthening rural-urban linkages through improved information flows on jobs and skills required, better transport
facilities that can allow easier movement particularly for migrants that maintain links with their areas of origin can have a strong impact on their development. Developing migrant-friendly financial services is an important element in favoring the diffusion of the benefits of migration – this could be done by NGOs but also by the private sector as intermediating remittances can be profitable.

- **Deregulation.** In the short run a priority is addressing the exclusion of migrants from goods and services that require registration – this could involve temporary identifications like those now issued in China. Temporary identification could also help reduce the need for a local guarantor required to access certain jobs (typically jobs that involve dealing with property), which hinders the employment prospects of those migrants who do not possess strong linkages with the non-resident population. Women and children are particularly vulnerable to the denial of service provision and protection, particularly if they do not have strong support networks in the host area.

- **Civil society.** The involvement of NGOs in dealing with migrants has been successful elsewhere (e.g. state of Rajasthan in India) for example in setting up resource centers that provide information on job availability, wage rates and rights, or in providing skills and help in accessing better jobs. In another example, again from India, an NGO has worked closely with local governments of source villages to develop an informal system of identity cards for migrants, which gives them some protection against official harassment (Deshingkar 2005).

- **Urban safety nets.** This is an area still to be explored, but to the extent that those who migrate under duress have no alternatives they will be present in cities and will require targeted measures, particularly if they have nowhere to return to and have no assets.

- **Overall urban policy framework.** Over time a system that facilitates flows to areas whose development is supported by other policies (e.g. secondary cities as part of a rebalancing of the urban structure) can be put in place. Coherence of overall policy framework and appropriate resource flows within a decentralized context are very important in this respect.

**Monitoring and Evaluation**

6.77 Progress on policy actions and developments in the labour markets, particularly in urban areas for which data collection is more frequent, need to be part of the PASDEP monitoring and evaluation framework. Indeed including employment creation as a strategic priority has been an important innovation and an opportunity to enhance the value and policy impact of labour market information. Monitoring and reporting on PASDEP should not substitute but build upon an integrated Labour Market Information System (volume II, chapter 7).

6.78 Collaboration of all the stakeholders interested in labour market policy both within the Government and outside will be needed to optimize the significant efforts in terms of data collection and reporting that Ethiopia undertakes, and to maximize the gains
in feeding into effective policy making. Such collaboration will have to take place at various levels along the spectrum from data production to data analysis and reporting and evaluation of specific program outcomes. It should therefore involve active participation in producer-user consultations through to access to data in its various forms and in consultation and collaboration on the analysis.

6.79 The design and updating of PASDEP’s monitoring matrix and the identification of target indicators provide the starting point for this monitoring process. It will be important that the indicators chosen for the monitoring are clear and of easy interpretation, and that they can be disaggregated by age group and gender to focus on priority groups. Indicators should also be prioritized, to the need to keep the number of indicators manageable.

6.80 The consultation process around this study has highlighted a variety of opinions on appropriate indicators for monitoring the labour market policy side of PASDEP. International evidence suggests two useful criteria to consider in identifying indicators:

- The indicators chosen should offer a clear sense of progress. Current practices of monitoring employment for the age group 10+ might not fulfill this criterion, as enrolment is increasing. Complementing this indicator with an indicator for the age group 15+ would help disentangling the effects of increased enrollments from those of labour market developments such as job creation. 37
- The indicators chosen should be clearly linked to policy. For example, while unemployment figures can steal the headlines, trends in inactivity may be an equally important policy concern that risks neglect.

6.81 Important indicators that fulfill these criteria are the employment rates for the individuals 15 and over and the wage levels of the employed. Reporting regularly on these indicators, in total and disaggregating by gender, age group, skills, and region (including min and max) would provide a good summary of how the country is using its productive potential.

6.82 Reporting on even such a minimal set of indicators could prove however to be a challenge. As part of ongoing efforts at the CSA to develop a strategic plan for its survey activities and to link them more closely with the PASDEP, monitoring issues of data coverage and schedule of collection would need to be addressed. Now that the CSA is planning to undertake the UBEUS survey annually, labour markets urban areas could be regularly monitored. The challenge is to strengthen the quality of wage data (whose inclusion in the survey has been a major step forward), of considering urban domains capable of providing more details on different types of urban areas (larger cities, smaller, secondary cities and for rural towns), and of exploring ways of capturing earnings in the informal sector. Further, as discussed in Chapter 2, issues of comparability with the LFS need to be addressed.

37 Monitoring separately child labor (as an indicator to be reduced) and employment rates will help in distinguishing these different policy outcomes.
6.83 Data coverage for regular monitoring in rural areas remains more problematic. Alternatives ranging from the inclusion of an all purpose nationally representative survey in the statistical survey plan to customization of existing surveys (e.g. agricultural sample survey) to fully include labour market aspects in additional modules/questions might be considered. Learning opportunities such as the ongoing Rural Investment Climate Assessment (ICA) could offer a platform to start a discussion on rural specificities, on the type of instruments which might better capture them and on the appropriate tools for analysis. Similarly, the ongoing work for the new ICA (in urban areas) could offer an opportunity for discussion, collaboration and capacity building on firm level surveys, building on international experience and on the specificities of the Ethiopian statistical program and its multiple firm level surveys.

6.84 Overall, it is important to ensure that the various elements of labour market monitoring aim to reflect closely the informational and analytical needs raised by PASDEP. This should be responsive to emerging demands for more detailed information, such as those related to the scaling up of existing government programs either directly or indirectly supporting firm development (through the provision of infrastructure, for example), and those related to the new urban agenda.
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