

Private Sector Development Synthesis Note

Evidence and Debates on Employment Creation

Updated October 2017 (links last updated July 2021)

Key take-aways:

- Labour-intensive light manufacturing industries, supported by a conducive investment climate, can deliver productive jobs for low-skilled workers at scale.
- SMEs contribute a large share of employment in developing countries; however, as many fail, their net job creation rate is likely similar to large firms. Development agencies focused on job creation through SMEs should therefore target small firms that grow.
- Creating wage jobs in the manufacturing and service sectors has great potential in the medium term, but increasing productivity and incomes of the many people in traditional agriculture needs to remain a priority in the short-term.

According to the [ILO World Employment Report 2015](#), over 201 million people were unemployed in 2014. This was expected to increase by 11 million by 2019. [USAID \(2015\)](#) notes that even relatively 'bad' jobs are important as coping strategies against extreme poverty. Job creation is therefore high on the agenda of many agencies; there are however different views on how to boost employment. Some focus on large-scale economic transformation through, for example, the development of more productive industries. Others favour interventions to promote productivity growth of existing firms, typically focusing on traditional but less productive industries. This Note explores the various options and debates, focussed mainly on research in Sub-Saharan Africa. Some insights are inspired by inputs and discussions at the [DCED's 2014 Annual Meeting](#).

1. Promoting structural transformation for long-term growth and job creation

[Tilman Altenburg of DIE](#) argues that economic growth and higher incomes require people to move into activities with higher productivity. Productivity gains may come with the trade-off of reducing demand for labour in the short-run. However, evidence suggests that productivity growth may be achieved at the same time as job creation through the development of labour-intensive, light manufacturing sectors. Both [Basnett and Sen \(2013\)](#) and [Page and Shimeles \(2014\)](#) find that growth in the manufacturing sector is able to create higher productivity jobs quickly, because the skills typically required are quite minimal. Taking specific country examples, an ODI report on [Rural Wages in Asia \(2014\)](#) finds that the number of individuals employed in rural areas has fallen by over 15% in China and Korea over 5% in Malaysia between 1995 and 2010, despite growing populations, because of the strong demand for labour in the countries' manufacturing sectors.

Indeed this phenomenon may offer the potential for 'quick wins' through the relocation of firms from countries such as China – which have already absorbed surplus labour, and are now on a path to developing more capital intensive industries – to countries in Africa where wages are markedly lower ([Lin and Wang \(2014a\)](#)).

One example is the Haujian Shoe Factory, which relocated from China to Ethiopia in 2012 and employed 4,000 people by the end of 2013 (see [Lin and Wang \(2014b\)](#)). Helen Hai, CEO of Haujian,

reports that through one year of intensive training, Ethiopian employees' productivity rose to 70% of that of its employees in China, whilst wages remained at about 30% of the Chinese workforce. This achievement underlines a possible benefit of the relocation of existing firms – on-the-job training programmes may already be well-established. Such manufacturing industries also have the potential to generate spillovers in the nearby economy, boosting incomes for a wide spectrum of the population. [UNU-WIDER \(2014\)](#) describes some of the success factors behind industrial policy in Ethiopia, in this case comparing the metal industry and the floriculture industry, which started with a single pioneering local firm and delivered more than 50,000 jobs ([World Bank, 2012](#)).

One caveat is that such shifts to more productive sectors will provide quick benefits only for a small proportion of the population. It is likely that the majority of relocations will initially take place to poorer areas within China due to lower transaction costs, according to a survey included in ODI's report on [Rural Wages in Asia \(2014\)](#). At the same time, Ethiopia alone has a population of 94 million people: decades may be required until significant economy-wide benefits are realised – as is discussed further below in the section 'Increasing productivity and incomes in agriculture'. In addition, promoting industrial jobs also requires supporting companies in enhancing job quality. A study in Ethiopia ([Blattman and Dercon, 2016](#)) finds that 68% of workers quit their industrial job within one year and the probability of a serious health problem rose by 1% per month of industrial work.

[ODI/ECDPM \(2015\)](#) argue that the movement of workers between sectors has contributed more to growth than has rising sectoral productivity. This positive movement was found to be mainly towards the service sector rather than in manufacturing. However, the study also highlights the primacy of politics in determining employment progress, stressing the need for political solutions alongside technical ones.

Another, more general caveat is the definition and measurement of net job creation is challenging, especially in the informal sector and smallest enterprises; [DCED \(2014\)](#) explores some of the issues.

2. Employment creation through small and medium enterprise support

For some, a focus on developing large manufacturing firms neglects the role of small and medium enterprises (SMEs) as key drivers of job creation. SMEs, with between 5 and 100 employees, contribute on average 48% of formal employment in developing countries, according to a cross country-study of 104 developing countries by [Ayyagari et al. \(2014\)](#). Small firms are also found to have the highest job creation rate – though these results only count firms which survive; given that the failure rate of small start-ups is high, the bias in favour of survivors is likely to give an overly positive impression. Furthermore, the sample was very heterogeneous, with a small number of 'transformational entrepreneurs' being responsible for the bulk of job creation. [Page and Soderbom \(2015\)](#) conclude in Ethiopia that small and large firms create similar numbers of net jobs.

Ayyagari et al. also find that productivity growth of SMEs is lower than that of larger firms, and consider whether access to finance and training would improve the performance of SMEs. A literature review by [Grimm and Paffhausen \(2014\)](#) however finds that the impact of these interventions on firm performance is very modest, again with the exception of a few firms. Moreover, even when gains are achieved, they do not seem to translate into job creation – with the caveat that almost no evidence exists on long term impacts.

[Tilman Altenburg of DIE \(2014\)](#) explains this poor performance by noting that the great majority of SMEs in developing countries concentrate on a few activities in traditional markets, which are characterized by low access barriers and are usually saturated. These SMEs perform an important role in providing a large share of employment, but their potential to reach higher productivity levels, or to

expand, is very limited. Donors seeking to create productive jobs in the SME sector should concentrate on those SMEs which are already growing, and in particular those which are engaging in new sectors or activities by providing finance and infrastructure, rather than training ([Grimm, Knorringer and Lay. 2012](#)).

The development of the manufacturing sector may help to facilitate the skills upgrading of workers – particularly if, as in the case of the Huajian shoe factory, effective on-the-job training is implemented. This can create opportunities not only for the transition to more capital-intensive manufacturing industries but also for local innovation and the creation of new, productive SMEs. However, skills upgrading is unlikely to occur at scale without external support: [Golub and Hayat \(2014\)](#) and [Basnett and Sen \(2013\)](#) argue that education and skills training are important requirements for allowing people to take advantage of the economic opportunities which arise in the process of structural transformation, and for encouraging SMEs to start in new sectors or activities more generally.

More details on the role of SMEs in job productivity growth can be found on the [DCED's Small Enterprises web-page](#); information on skills training can also be found on the [Youth Employment page](#).

3. Reforming the Investment Climate to support job creation

Although cheaper wages in developing countries may encourage the relocation of firms from countries such as China, a poor investment climate can increase both the costs and risks of doing so. As such, a conducive investment climate can be an important factor in encouraging increased foreign direct investment in developing countries. Though donors can play a role in sharing the costs and risks of investments for selected companies – for example through challenge funds or similar development partnerships, as explored on the [DCED's private sector engagement webpage](#) – it is likely that broader changes are also needed, to make it easier for businesses to invest and operate.

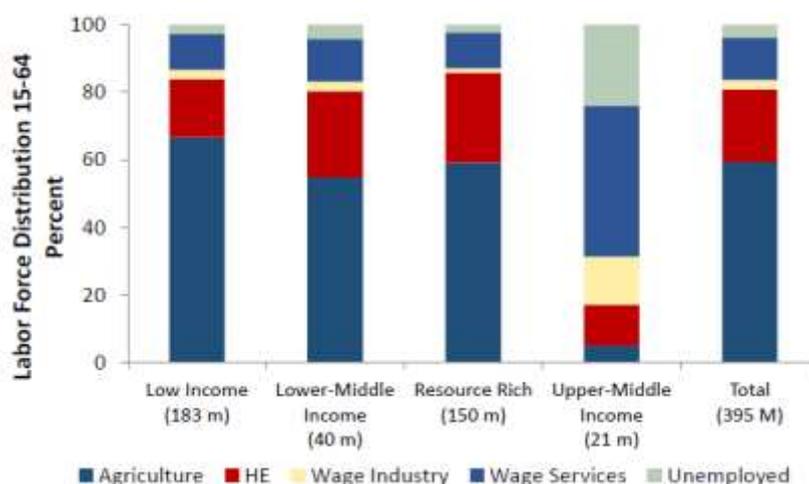
Reforming the Investment Climate is of particular concern for Sub-Saharan African countries, which [Golub and Hayat \(2014\)](#) find compares unfavourably to other developing regions in terms of the quality of infrastructure and public services such as frequency of power outages; time taken to obtain a fixed-line telephone connection; time taken to clear an imported container through customs; and percentage of roads that are paved. Such features of the investment climate are damaging for export-oriented industries, where quality control and timeliness of delivery are paramount.

A conducive investment climate will also be important to support the creation of productive SMEs. Even when the majority of SMEs are unproductive and unlikely to grow significantly, as discussed below, [Iavone, Ramachandran and Schmidt \(2013\)](#) find that the investment climate can explain 40% of the difference between firm sizes in Africa and those in the rest of the world.

4. Increasing productivity and incomes in agriculture

Structural transformation has great potential, but [Louise Fox](#) of UC Berkeley argues that it cannot generate sufficient jobs in the short-term – especially for the many young people entering the labour market in Africa. The same is true of waged employment in the formal sector, which includes SMEs. The only sector that can do that is agriculture, together with related rural household enterprises. As the graph below shows, in 2010 over 80% of Sub-Saharan Africans were employed in these sectors.

Fig 1. [Louise Fox, UC Berkeley, 'What is the private sector challenge in low income countries – An African Perspective'](#)
Presentation at the DCED Annual Meeting 2014



As such, the focus on creating new jobs in higher productivity sectors should be combined with attempts to increase the productivity and incomes of those already employed in traditional

sectors; an agenda focussed solely on the creation of new jobs may in fact be unhelpful. [USAID \(2015\)](#) notes, however, that rural wage labour is systematically under-reported.

The study by [Page and Shimeles \(2014\)](#) of seven African countries finds that improvements in labour productivity in agriculture accounted for 82% of poverty reduction seen since 1995. Movements of labour from agriculture to more productive sectors (manufacturing and services) only contributed 18%. Although the authors stress the importance of further structural transformation for achieving significant economic and job growth, this evidence demonstrates that interventions to increase agricultural productivity can have substantial impacts on poverty through increased incomes. Evidence on the success of agricultural value chain development interventions on job quantity is however limited ([Ingram, Verina and Elsje Oosterkamp, 2014](#)).

[Golub and Hayat \(2014\)](#) further argue for the potential of 'transformational' productivity growth in the agricultural sector. Cash crops share many of the features of manufacturing exports: high labour-intensity; potential for quality improvements through technological transfer; and lucrative but quality-sensitive markets in developed countries. Moreover, the current Asian context provides a particular opportunity for this transformational growth. As more individuals find work in the manufacturing sectors, rural wages have consistently increased, due to the reduction in underemployment.

ODI's report on [Rural Wages in Asia \(2014\)](#) notes that this will have a significant effect on the price of food produced in Asia, with the implication that this may present a significant new market opportunity for Africa, whilst also strengthening Africa's relative competitiveness in global food markets.

5. Conclusion

The debate suggests that employment creation in developing countries, and in particular in Africa, will require a multi-stranded approach. Labour-intensive light manufacturing offers great opportunities for job creation as well as skills upgrading in the future. However, increasing agricultural productivity is critical for improving incomes of workers in the short term, and may also achieve significant economic growth in Africa – particularly as Asian rural wages rise. Development agencies could choose, therefore, to focus not only on the creation of new jobs, but also on improving the productivity of existing ones. Growth in either of these is likely to be significantly enhanced by improvements to the investment climate, which will also have the advantage of enhancing the productivity of SMEs.

Click on this link for the DCED's Employment Creation Knowledge Page, with a range of useful resources on the theme: www.enterprise-development.org/implementing-psd/employment-creation