Supporting small informal businesses to improve the quality of jobs in Africa

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While the 1980s and 1990s were characterized as lost decades for Africa, the 2000s and 2010s saw the continent enjoying economic growth higher than many other developing parts of the world. A remarkable downside of this growth performance, however, is that poverty did not fall by much, and acute unemployment and job precarity are still prevalent, mostly affecting the largest and most vulnerable population segments: young people, women, and rural populations. In a trickle-down effect, rising labor incomes are normally the primary way economic growth translates into higher living standards and lower poverty rates. The size of an economy's formal private sector is correlated with that economy's ability to generate decent jobs, and the size of the informal sector in Africa sector is symptomatic of a jammed structural transformation.

Factors behind Africa's poor performance in creating decent employment lie on both the supply and demand sides (Golub and Mbaye 2015). On the supply side, a booming population driven by the highest fertility rates in the world led to exponential growth in the working-age population. And job seekers, especially younger ones, face serious obstacles to their employability in most countries due to limited training. On the demand side, economic growth in Africa is driven by commodities—agriculture, oil, and mining—whose carryover to the rest of the economy is small. The productivity of agriculture remains low, and the mining and mineral industries are inherently capital intensive, employ little local labor, and leave behind only a marginal share of the revenues generated. The growth of other formal activities is deterred by an unfriendly business environment with high unit costs and a heavy-handed, often corrupt bureaucracy (Mbaye and Gueye 2018). Consequently, the bulk of employment in Africa is informal, which corresponds to much lower job quality. We argue that the appropriate policy response is to nurture Africa's large number of informal micro- and nano-enterprises, which predominates the labor market, in such way that they can grow and generate better jobs.

THE WEST AFRICAN LABOR MARKET: MAJOR TRENDS AND PATTERNS

Demographics is at the center of Africa's labor market trends. Africa's share of the world's population, about 14 percent in 2007, is projected to increase to 26 percent by 2050, according to World Population Prospects (2017). At the same time, while the world's population growth is slowing, currently to about 1 percent a year, sub-Saharan Africa's remains at 2.5 percent (World Population Prospects 2017). As a consequence, Africa's working-age population is trending upward, contrasting with a stagnant demand for formal jobs. Indeed, the continent is likely to be the reservoir of the world's workforce by 2050.

Unemployment in Africa, at first glance, is not more catastrophic than elsewhere. Rates are more moderate than in many other parts of the world. In fact, the official unemployment rate, calculated using the ILO method, is very low in Africa. For example, in Benin the unemployment rate was only 1.7 percent in 2017 and never above 2.2 percent between 2000 and 2017 (ILO 2014). These numbers mask the underlying problem: The low-quality jobs straddling the border between employment and unemployment or the borderline between labor force participation and inactivity warrant particular attention in interpreting unemployment rates. In this light, the unemployment rate, taken alone, is not an appropriate indicator of labor market performance. Rather, taking both the unemployment rate and the underemployment rate into account may more realistically depict African workers' status (Golub and Hayat 2015). In this case, the total is well above 50 percent in many African countries. Similarly, the total comes close to 90 percent for most African countries when considering vulnerable workers (encompassing own-account and domestic workers) alongside the unemployment rate.

While the employment situation in Africa is very difficult overall, it is even more challenging for three vulnerable groups: youth, women, and rural populations. Indeed, youth employment (ages 15–24) is now a priority political issue (O'Higgins 2017). Youth have lower employment rates than adults by around 20 percentage points, depending on the country. Seldom does a falling official youth unemployment rate reflect reality as it excludes discouraged youth who have left the labor market for studies. The youth unemployment rate also misses those between ages 15 and 24 who are not in education, employment, or training (NEET). A decline in unemployment might just mean that the NEET population is growing. The share of NEET among youth, which averages around 15 percent at the global level, peaks at 30 percent in West Africa, exceeding by far that in developed and middle-income countries (Elder 2015). In West Africa, the NEET phenomenon affects rural populations more than urban ones, and women more than men.

In fact, women are also almost always disadvantaged in the labor market. Their share of total paid employment is very low in most countries. Conversely, the proportion of women in vulnerable employment is very high: In most cases, they constitute over 70 percent of the population in vulnerable employment. Underemployment is similarly a problem: Whether visible or invisible, underemployment affects women more than men, and gender inequality in income remains high. Finally, rural employment patterns differ from national averages. Far more rural than urban activity is informal (Benjamin and Mbaye 2012). Family labor and arrangements such as sharecropping are the rule, and wage labor is an exception (Mbaye, Benjamin, and Gueve 2017). Moreover, invisible underemployment is far more prevalent than visible underemployment in all rural activities, both agricultural and nonagricultural.

DECLINING LABOR DEMAND AND RISING INFORMAL EMPLOYMENT

Supply and demand are imbalanced in Africa's labor market, with high levels of unemployment and underemployment, and few higher-quality formal jobs, that is, better-paid jobs with permanent contracts and social protections. Labor migration from rural areas to cities continues at a steady pace. But low-productivity informal services, rather than formal manufacturing, are absorbing almost all the resulting labor surplus in cities. Informal income in African cities is above subsistence agriculture income but well below formal sector income (Benjamin and Mbaye 2019). Any policy promoting employment in Africa should first aim to trigger sustained inclusive growth that would increase the demand for formal labor.

Africa's labor market has a paradox: The workforce is abundant, but labor costs are high due to a low productivity level relative to comparators. In fact, relative unit cost of labor in Africa is much higher than in comparator countries (Gelb et al. 2017). The wage in dollars relative to productivity—relative unit labor costs—in 2010 was 6.5 in Senegal, for example, compared with 1.1 in China, 0.7 in Malaysia, and 0.8 in Mexico and Colombia (Ceglowski et al. 2015). In addition to labor costs, rigid complex labor regulations such as legal holidays and restrictions on hiring and firing affect the labor market in Africa.

Africa's unfavorable business environment, which impacts both large and small, formal and informal enterprises, then, is the main cause of the atrophy of the formal private sector and the expansion of the informal sector. In particular, high taxes and regulation by a low-quality bureaucracy stifle the private formal sector. Notably, how many taxes a company must pay and how much time it takes to declare and pay them, rather than the tax rates themselves, create a bottleneck for businesses. Fiscal harassment also constrains formal enterprises, as a company may undergo repeated audits, inspections, and tax adjustments once it is identified as a tax payer (Mbaye, Golub, and Gueye, forthcoming). As a consequence, only a tiny number of firms shoulder a disproportionately high share of the tax burden. In Senegal, for example, about 15 companies pay up to 75 percent of the state's tax revenue (Government of Senegal and Millennium Challenge Corporation 2016).

Other factors obstruct formal private entrepreneurship, limit formal employment, and propel informal sector expansion. Access to electricity is low compared with Asian countries at comparable economic stages. The same can be said about bank financing for private investment, which is less available and more costly in Africa than in comparator countries. High transport costs and inefficient transport logistics are also significant obstacles.

Unsurprisingly, entrepreneurs assess the costs and benefits of being informal based on the business environment (Matsongoni and Mutambara 2018). Thus, the worse the business climate in terms of red tape and poor public services, the greater the incentive to go informal. The downside of remaining informal is loss of access to public services and government contracts, as well exposure to crackdowns in which business owners can be fined, closed down, or even imprisoned.

Cronyism is another important driver of informality. For example, Ali and Najman (2019) emphasize the important and numerous privileges enjoyed by firms with connections to either the army or government officials compared to non-connected firms in Egypt. The differential in terms of trade protection, preferential access to finance, energy subsidies, tax advantages, barriers to entry, etc., is such that firms without political clout must become informal to survive. Furthermore, connected firms are sheltered from competition from the informal sector. All these considerations are consistent with Gelb et al.'s (2009) theory according to which limited state enforcement capacity along with a poor business environment is a major driver of informality.

THE INFORMAL SECTOR IS SPRAWLING AND HETEROGENOUS

The informal labor market overwhelms the formal one

Given the complexity and the number of the factors at play, it is no surprise that the informal sector predominates in both GDP and employment in African economies. One of the major challenges facing analysts and policymakers dealing with the informal sector are related to its very heterogeneous nature. According to the 17th International Conference of Labor Statisticians guidelines (ILO 2003; Shehu and Nilsson 2014), informal jobs include:

1. Informally paid employees without social security, paid annual leave, or sick leave.
2. Paid employees in unregistered enterprises with fewer than 5 employees.
3. Self-employees in unregistered enterprises with fewer than 5 employees.
4. Employers in unregistered enterprises with fewer than 5 employees.
5. Family workers.

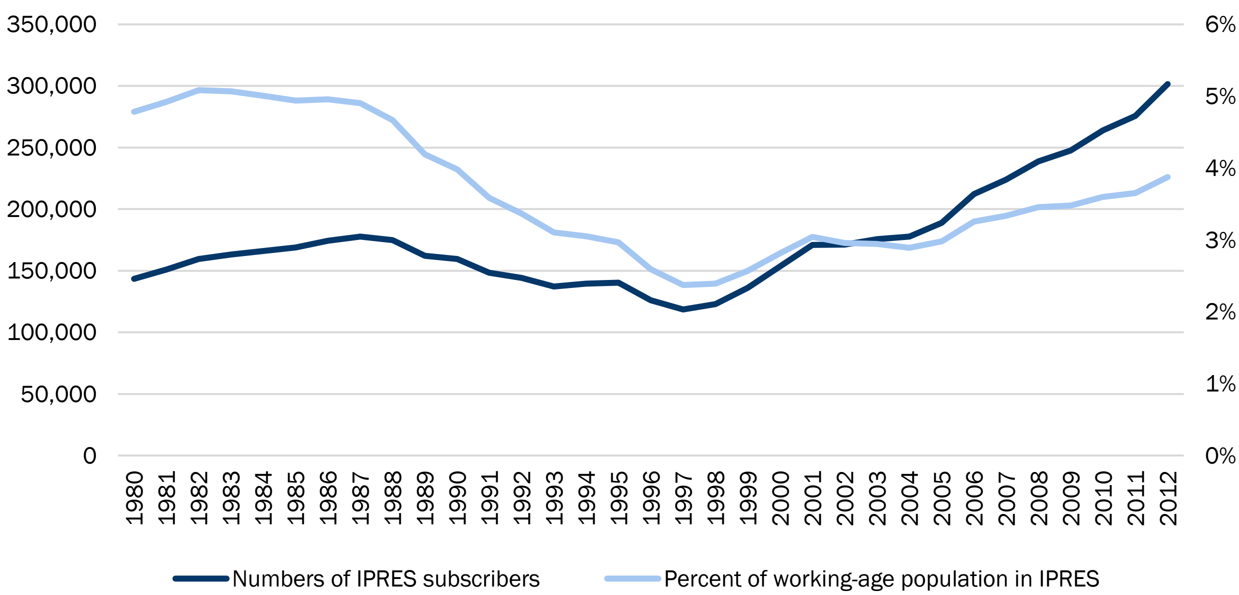
Employees in category 1 mainly refer to informal workers in the formal sector. In some African countries there may be a higher proportion of informal workers in the formal sector than in the informal sector itself. In category 3, many who are considered informal employees are concomitantly small enterprises or microenterprises. A large proportion of employers are thus counted as informal employees in category 4 because they are in informal production units. Thus, over 80 percent of employment is self-employment in most African countries (Mbaye et al. 2015).

Because informal employment includes informal employment in the formal sector, then, policies addressing informal employment will also affect the formal sector. Also, because informal employment includes employers in addition to employees, the informal sector is on the borderline between private sector development and labor market dynamics issues.

The definition of the informal sector varies significantly from one author to another (Benjamin and Mbaye 2012; Fields 2011; Heintz 2012; Fu, Mohnen, and Zanello 2017), most surveys in Africa restrict informal entrepreneurship to firms that are not registered or do not keep accurate accounts: “An informal activity is any activity that is not registered and/or lacks formal written accounting, whether as a primary or secondary job, according to INSEE, AFRISTAT, and DIAL 2005, which conduct the 1.2.3 surveys, one of the most used type of survey on the informal sector in francophone Africa. Their results confirm the sheer size of informality in both jobs and number of firms (Table 6). For example, according to the 2001-2003 1.2.3. survey in Dakar, the city had an estimated 277,000 firms, but only fewer than 10,000 were known to the tax service and so considered formal, according to the official tax directory of the Senegalese Ministry of Finance. This finding is unsurprising: General censuses of companies in Senegal and Cameroon found that almost 97 percent were informal (ANSD 2017). The trends in other countries are just as striking, or even more so. Of particular importance is that estimates of the magnitude of the informal sector, using this 1.2.3 survey, are likely to *underestimate* the numbers of informal jobs and firms. As a matter of fact, they treat all private firms that keep some accounts and/or are registered as formal, but many of these registered firms are still informal by other standards, such as nonpayment of taxes or organizational structure (Mbaye, Golub, and Gueye, forthcoming).

To better estimate informal employment in Senegal, Golub, and Mbaye (2015) took the working-age population, estimated at 9 million, and subtracted the number of people in formal employment (those covered by IPRES, or the *Institution de Prevoyance Retraite du Sénégal,* Senegal’s social security system). According to official sources, there were only about 300,000 formal jobs, which would cover just 3.8 percent of the working-age population (Figure 1), contrasting with estimates often above 20 percent (for example, those by ILO).

Figure 1: Workers in formal employment in Senegal, 1980-2012



Source: Golub and Mbaye, 2015, and author update.

Note: IPRES is the *Institution de Prevoyance Retraite du Sénégal,* Senegal's social security system.

Earnings in the informal labor market are low

Low levels of earnings are a distinctive feature of informal jobs. In francophone Africa, formal private sector salaries and benefits tend to follow public sector standards, while informal wages are often below subsistence. The difference in earnings doesn’t just occur between formal and informal enterprises; the distinction also appears between large informal and small informal enterprise pay too (see Table 7) (Benjamin and Mbaye 2012; Fu et al. 2017; Mbaye et al. 2015). Libreville, Gabon is noteworthy: It has the highest average formal sector earnings of Mbaye, Golub, and Gueye’s (forthcoming) country sample, but also the lowest average informal sector earnings. Relatedly, Libreville also has the highest income inequality in the sample.

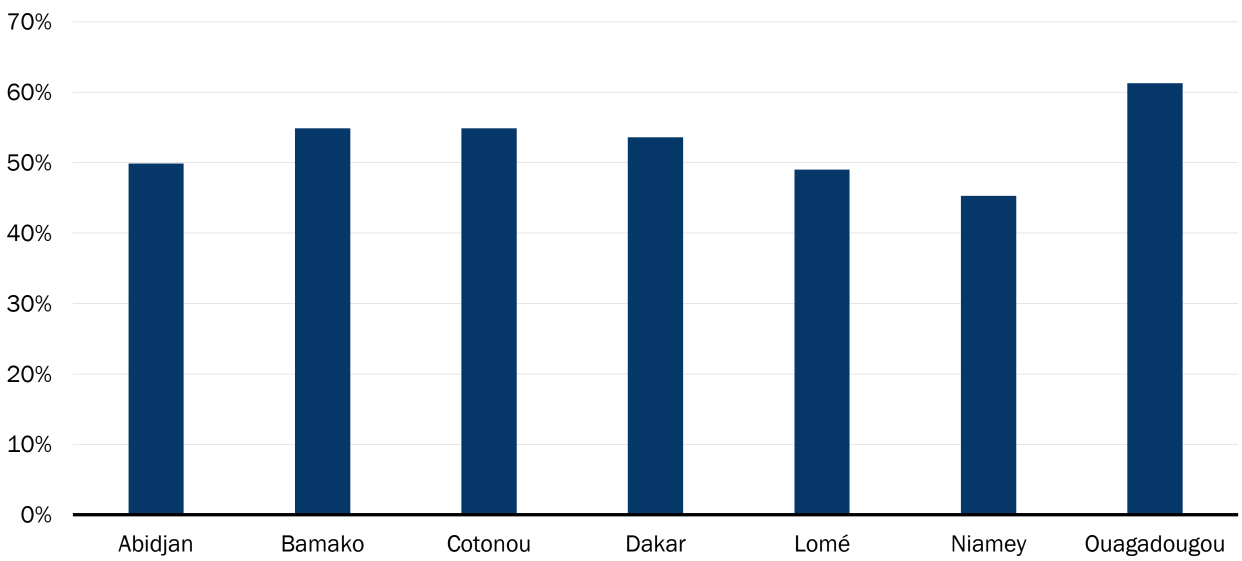
Table 1: Wages of employees, according to firm status (CFA franc)

City	Formal	Large informal	Small informal	Total
Cotonou, Benin	324,802	62155	79340	140468
Dakar, Senegal	467269	265750	182472	264416
Douala, Cameroon	364404	168427	103003	211523
Libreville, Gabon	656310	204810	67455	200453
Ouagadougou, Burkina Faso	326531	319817	134036	216935
Yaoundé, Cameroon	272180	541609	85682	182851

Source: Mbaye et al. 2015.
Note: 1 USD = 586 CFA franc.

The 1.2.3 survey data confirm these trends. In sample countries, over 40 percent of informal sector employees earn less than the official minimum wage, and in Ouagadougou, that proportion reaches 61 percent (Figure 2).

Figure 2: Employees in informal enterprises earning less than minimum wage in seven West African economic capitals (% of total employees)

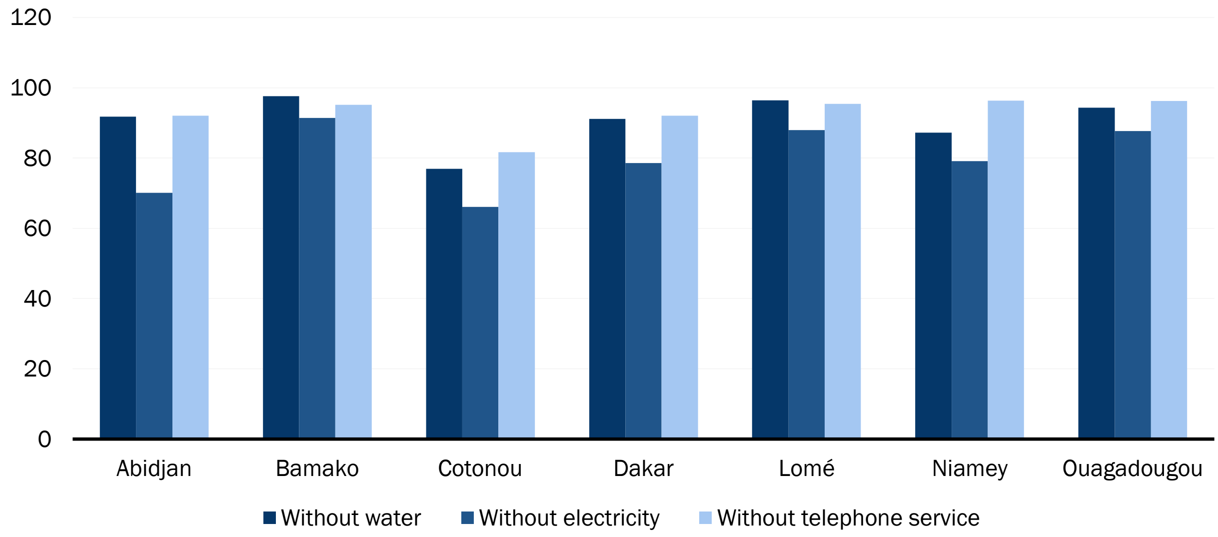


Source: 1.2.3. surveys, 2001-2003, 2015, 2019.
Note: Data covers percent of employees surveyed. Data for Cotonou, Lomé, and Ouagadougou are from 2001. Data from Abidjan are from 2002. Data from Dakar are from 2003. Data from Niamey are from 2015. Data from Niamey are from 2019.

Working conditions in the informal sector are poor

The low quality of informal activities is also reflected in working conditions (Figure 3). More than 80 percent of informal enterprises lack basic services—water, electricity, or telephone. These results confirm previous findings from other authors regarding working conditions in the informal sector (Mbaye, Golub, and Gueye, forthcoming; Perry et al. 2007).

Figure 3: Lack of basic services in informal enterprises in seven West African economic capitals (% of surveyed enterprises)

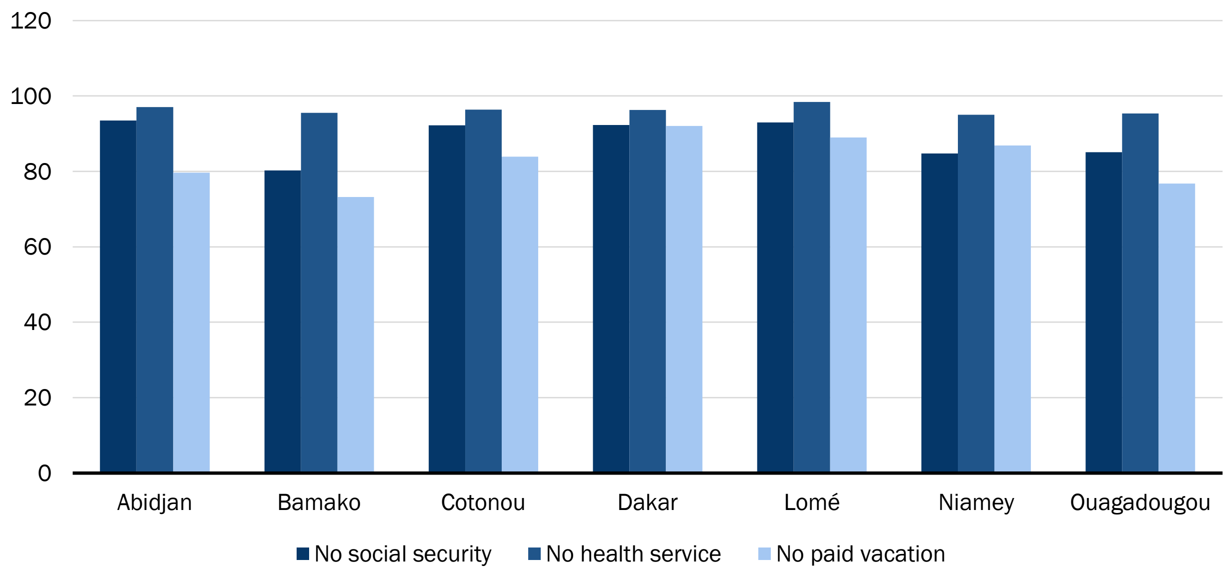


Source: 1.2.3. surveys, 2001-2003, 2015, 2019.

Note: Data covers percent of enterprises surveyed. Data for Cotonou, Lomé, and Ouagadougou are from 2001. Data from Abidjan are from 2002. Data from Dakar are from 2003. Data from Niamey are from 2015. Data from Niamey are from 2019.

Similarly, about 80 percent of informal enterprise employees have no social security nor medical services (Figure 4).

Figure 4: Lack of benefits for informal enterprise employees in seven West African economic capitals (% of total employees)



Source: 1.2.3. surveys, 2001-2003, 2015, 2019.

Note: Data covers percent of employees surveyed. Data for Cotonou, Lomé, and Ouagadougou are from 2001. Data from Abidjan are from 2002. Data from Dakar are from 2003. Data from Niamey are from 2015. Data from Niamey are from 2019.

Another important issue of interest regarding the analysis of the informal sector concerns interactions of formal and informal firms. Generally, formal enterprises tend to be larger than informal ones, which often take the form of micro- or nano-enterprises. Some research confirms that informal firms largely escape tax obligations, labor market regulations, and other government interventions (Mbaye and Gueye 2018: Chapter 3). On the other hand, these enterprises are less likely to have access to public services (e.g., water, electricity) and are ineligible for value-added tax (VAT) deductions (Perry et al. 2007). Thus, there are offsetting competitive advantages favoring one set of firms or the other. In practice, however, the lower costs associated with tax and regulatory avoidance usually outweigh the benefits of access to public services, due to the fact that these services are typically of low quality in African countries. This leads to an unlevel playing field in areas where formal and informal firms compete, which is almost always in favor of informal firms.

POLICY IMPLICATIONS

There is profound disagreement among economists and policymakers on whether the informal sector should be repressed or assisted, as discussed in detail in Mbaye, Golub, and Gueye, forthcoming. Many experts criticize the informal sector's negative effects on the regulatory framework, such as tax evasion and unfair competition with the formal sector. Others point to the role of the informal sector as a provider of employment of last resort. Many of these analyses do not consider the heterogeneous nature of the informal sector, in particular the distinction between large and small informal firms.

Given the overwhelming proportion of small and medium enterprises (SMEs) on the continent, mostly informal in the African private sector, support to private businesses should feature a coherent strategy to support small firms, almost all of which are informal. Throughout the world, on average, more than three out of five SMEs do not survive to their third anniversary (Zogning and Mbaye 2015). The rate of failure is considerably higher in West Africa: For example, Benjamin and Mbaye (2012) report that in Benin only 25 percent of the informal firms sampled in 2007 were still in business two years later. Among the many reasons for this higher failure rate in West Africa, we repeatedly see insufficient financing, a lack of planning, over-indebtedness, poor cash management, a lack of experience, weak customer service, non-compliance with regulations, and a low ability to innovate.

In this way, the high failure rate indicates that most informal entrepreneurs lack the skills and attitudes to develop, operate, and grow their businesses to attain the standards of a modern enterprise. A successful entrepreneurial policy should center on the following points: vocational training adapted to the requisite skills, incubating institutions that nurture business creation, financing in the form of loans and grants at different stages of the business life cycle, and support services.

Training should develop advanced skills, including managerial qualities. In addition to the "hard" skills developed by well-designed vocational training programs, complementary "soft" skill abilities must be fostered. As Fox (2017) similarly argues, in order to be effective, informal education needs to develop both cognitive (reading, numeracy, problem solving) and non-cognitive knowledge that relates to a set of attitudes and behaviors important to business. Among these are perseverance, self-esteem, self-control, motivation, ability to communicate effectively and interact with the rest of society, and ability to engage effectively with business networks.

While vocational training for entrepreneurs addresses the lack of experience and managerial competence of entrepreneurs, it does not answer the perennial questions of financing and high start-up costs. New entrepreneurs start out in an environment in which few factors are under their control, and it usually takes a long time to develop a clientele. During the initial period in which most businesses make little to no income, the unavoidable costs of rent, labor, marketing, and capital can lead to serious cash-flow problems in the absence of an adequate financial plan. Establishing business incubators and accelerators should figure into the strategy. Incubators provide physical facilities, consulting resources, and appropriate development tools to new and emerging businesses, helping them survive and grow during start-up, when they are more vulnerable. Business incubators can have a significant long-term impact on the economy because they enhance entrepreneurial culture, support new businesses with high growth potential, help to establish closer ties with other entrepreneurs in the same sector and transmit knowledge from partner research centers and universities, and thus considerably increase the rate of survival and success of SMEs.

Financing constraints are a significant obstacle to SME development in Africa. Mbaye, Diop, and Gueye (2017) found that in Benin only 15.6 percent of SMEs had access to bank loans, versus 59.5 percent of large enterprises. The corresponding figures are 14.2 percent and 70.6 percent in Senegal, and 17.6 percent and 56.9 percent in Niger. Likewise, small firms are subject to much more onerous collateral requirements than large firms. Moreover, interest rates are high in West and Central Africa, and small, informal enterprises are faced with particularly high rates. Unfortunately, most projects aiming at facilitating the financing constraint weighing on SMEs in general, and on the informal sector in particular are surprisingly ineffective (Fox 2017, Blattman et al. 2018). Blattman et al.'s (2018) evaluation of the effectiveness of microfinance programs in conflict areas find that grant funding is more effective than loans. Fox also recommends cash transfers as a means of funding SMEs instead of credit. From an operational point of view, zero-rate loans could, in our opinion, constitute a more sustainable alternative.

With very high youth inactivity and high active population growth, Africa may have a comparative advantage in sectors relying on unskilled labor, such as light manufacturing (including clothing and hides and skins), as acknowledged by Monga and Lin (2010) and processing agricultural, horticultural, and fishery products (Page and Tarp 2018). However, the business environment's sluggishness and production's poor organization undermine agriculture and industry and discourage exports and foreign investment. West African countries must reduce barriers to private investments, especially in agricultural and manufacturing industries that intensively use unskilled labor, through improved regulation, better enforcement of existing laws, and lower cost but higher quality infrastructure services. Donors, governments, private investors, and local entrepreneurs should work hand-in-hand to identify and address these and other barriers to competitiveness.

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