

Unemployment and self-employment in urban Ethiopia

Determinants and scenarios



In brief

- Urban labour markets in Ethiopia feature very high rates of unemployment and own-account work, with an unemployment rate of 23.5% and a self-employment rate of 25.9% in Addis Ababa, according to the 2016 Urban Employment and Unemployment Survey (UEUS).
- This study documents facts about the labour market situation of workers in Addis Ababa by skill type and uses a quantitative model to study its determinants.
- Low-skilled workers face job finding rates that are very low, at less than 7% per month, and job loss rates that are extremely high by global standards, at over 5% per month. High-skilled workers face similarly low job finding rates and moderate job loss rates.
- The findings of the study suggest that rates of low-skill own-account work are very high since it serves as an important alternative to job search in a situation where jobs are hard to find and do not last long. For the low skilled, reductions in labour market frictions would not only reduce unemployment but would reduce own-account work by even more.
- Reducing costs of job search and improving the quality of matches between workers and firms would reduce both unemployment and low-skill own-account work. Income support to the unemployed would redistribute and provide insurance. Alternatives like subsidised transport for concrete job search activities or other ways of promoting search should be considered seriously.

*This project was funded
by IGC Ethiopia.*

Overview of the research

About half of the labour force in Addis Ababa is self-employed, in casual or temporary employment, or unemployed (2016 Urban Employment and Unemployment Survey (UEUS) of the Ethiopian CSA). These numbers are similar in other sub-Saharan African economies, but much smaller in developed economies. Long-term private sector employment, which is the dominant form of employment in high-income economies, accounts for only about a third of employment in Addis Ababa.

It is clear that elevated levels of unemployment reflect some form of labour market frictions. To understand whether and how policies can affect unemployment, it is necessary to first understand the importance of different frictions. Similarly, understanding the origin and motivation of the high rates of own-account work requires distinguishing among multiple sources.

This study aims to do so, in a quantitative analysis that is tailored to reflect the skill composition and role of different types of employment in Addis Ababa. In a first step, data from the 2016 UEUS and the 2013 National Labor Force Survey (NLFS) is used to document basic facts and estimate flows out of unemployment, into jobs, and separations from jobs. These serve as an input to the second step, the quantitative analysis of a theoretical model.

For this, the study builds a model of frictional labour markets tailored to Ethiopia, building on similar models that are the standard for the analysis of labour markets in developed economies. To this end, the model features not only the employment states of unemployment and private sector wage employment, but also a choice to engage in own-account work or running an employer firm. It also incorporates casual work and public sector employment. The model endogenously generates predictions for the importance of different labour market states, like unemployment and own-account work, as a function of fundamental characteristics of the economy. It is parameterized using UEUS data to replicate the status quo in the labour market in Addis Ababa.

The study then uses counterfactual model simulations to address the following questions:

1. What is the importance of different labour market frictions for unemployment? How does this vary by skill group?
2. What are the determinants of high levels of low-skill own-account work? How important are labour market frictions as a driver of own-account work?
3. What are the aggregate, distributional and welfare effects of income support to the unemployed?

The analysis allows for conclusions on the relative importance of different frictions, for different outcomes, like unemployed and self-employment, and thereby helps guide thinking into which areas are promising targets for further investigation and for possible policy intervention.

Policy motivations for research

High rates of unemployment are a major policy concern. High rates of own-account work are not far behind in importance, given the often low productivity of these activities, and low incomes derived from them. Increasing rates of wage employment is a stated policy objective across developing countries. Therefore, understanding obstacles to progress on this front is important.

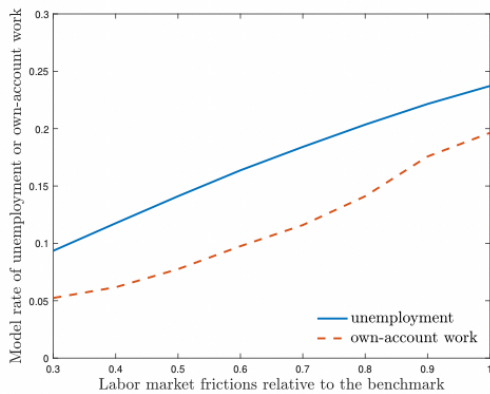
Understanding obstacles is also important because it is a necessary input for correct policy analysis. It helps to both guide attention – which obstacles are important and should be the object of further study and possible policy intervention? – and to develop an understanding of the possible quantitative effects of policies, both for the targeted outcome and in other dimensions. For unemployment and self-employment, policies that have been considered include income support to the unemployed, the (de)regulation of business entry, and efforts to improve the matching of job searchers and firms.

Key findings

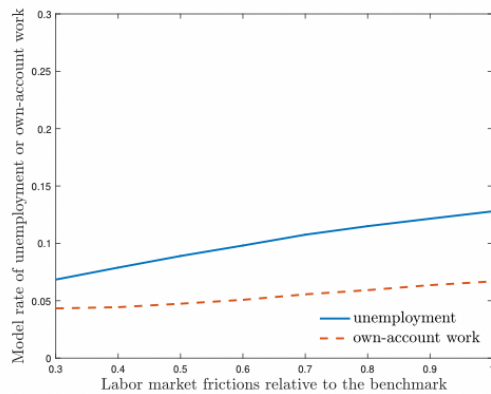
Key research questions	Summary of key findings
<p>What is the importance of different labour market frictions for unemployment? How does this vary by skill group?</p>	<p>Job finding rates are very low and low-skill separation rates very high by international standards. Low job finding rates and high separation contribute to similar degrees to high unemployment. High separations also play a role in reducing hiring by firms. A transition from current continental European job finding rates combined with Anglo-Saxon job destruction rates to the inverse (i.e. higher finding rates and lower destruction rates) could reduce unemployment and self-employment rates by up to two thirds for the low-skilled and a third or more for the high-skilled.</p> <p>(See the solid lines in Figure 1.)</p>

<p>What are the determinants of high levels of low-skill own-account work?</p>	<p>Labour market frictions are a central driver of high rates of low-skill own-account work. (See the broken lines in Figure 1.) At current levels of frictions, they respond more to changes in labour market frictions than to reductions in entry costs.</p>
<p>What are the aggregate, distributional and welfare effects of income support to the low-skilled unemployed?</p>	<p>Lower job finding rates and higher unemployment once financing is taken into account. Benefits also make search more attractive relative to own-account work, amplifying the increase in unemployment. Income support can still increase aggregate welfare, since gains for the low-skilled outweigh the cost borne by the high-skilled. It should be noted that aggregate welfare implications from model simulations are sensitive to detailed model assumptions.</p>

Figure 1: The effect of reducing labour market frictions on unemployment and own-account work, by skill.



(a) No diploma or degree



(b) Diploma or degree

Note: Status quo level of frictions corresponds to 1 on the horizontal axis.

Policy recommendations

- **Improve the matching process:** Findings clearly suggest that improving the matching process of workers and firms could reduce both unemployment and low-skill own-account work. There would thus be

large benefits from improving the matching process. To assess the best way of doing this, future work should study why exactly matching is inefficient. There are different potential explanations, most prominently that search is costly for searchers and that firms and job searchers have difficulty identifying good matches simply from applications on paper or interviews. These different explanations have different policy implications.

- **Reduce search costs:** Easier access to job information and easier submission of applications would reduce search costs for workers. Currently, search often requires travel to places where information on jobs is aggregated. Distributing it more widely would cut commuting costs for job search.
 - **Information provision:** Experimental evidence from other studies suggests that lack of information could drive both low finding rates and high separation rates. Skill certification programs have shown promise in experiments.
 - **Data collection:** A more detailed analysis of the precise nature of frictions leading to low job finding and high separation rates would require longitudinal data on job searchers and firms, ideally at a high frequency. This would allow documenting churn precisely and assessing better why it occurs. A smaller first step would be to include questions about job tenure and about characteristics of previous work (type, duration, remuneration) in the NLS or the UEUS.
- **Income support to the unemployed** would redistribute resources and provide insurance, and potentially increase aggregate welfare. Benefits to the unemployed would attract low-skill own-account workers into job search. Due to the high level of unemployment, it is a costly policy and in practice, collecting the taxes required to finance the program may be a challenge. Screening beneficiaries may also be a challenge. Subsidised transport for concrete job search activities, or other ways of promoting job search and promoting outcomes, may be superior policy alternatives.