

Wage Cutting in Kenya Will Expand Poverty, Not Decent Jobs

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Some economists blame excessive labour costs for the lack of growth of productive employment in low-income countries. For example, a 2005 paper by the World Bank, "Jobs in Kenya: Concept Note," gives primary emphasis to this explanation. But does this make sense? We think not, as we explain in our recent report, '[An Employment Targeted Economic Program for Kenya](#)'.

Labour costs are considered excessive when the total compensation of workers exceeds their productive contribution. The two standard explanations are excessively high wages and rigid labour-market regulations, such as those due to unions or minimum wages. Let's start with the issue of high wages.

High Wages

We assume a goal of boosting private formal-sector jobs by 25 per cent (i.e., from 777,000 jobs to 960,000, an increase of 190,000 jobs). Using the 2005-6 Kenya Integrated Household Budget Survey (KIHBS), we simulate how much the wages of the average private formal-sector worker would have to be cut in order to achieve our goal.

If we assume a 'wage elasticity of employment' of -0.6 (based on elasticities estimated for similar countries), average private formal-sector wages would have to fall by 42 per cent to generate 190,000 new private formal-sector jobs. The resulting average wage would be Ksh 4,100 (Ksh 5,220 in urban areas and Ksh 2,784 in rural). This national average would be 15 per cent below the poverty level.

The average wage of urban workers would fall from 50 per cent above the poverty line to 10 per cent below and that of rural workers from 34 per cent above to 23 per cent below. About 1.7 million Kenyans would correspondingly suffer (the 770,000 workers plus their 900,000 dependants).

But 400,000 Kenyans would benefit, i.e., the 190,000 workers obtaining new formal-sector jobs and their 210,000 dependants. If we assume that these workers with new jobs graduate from informal-sector activities, their earnings would rise by an average of 60 per cent.

But these 400,000 Kenyans would still be living below the poverty line (10 per cent below in urban areas and 23 per cent below in rural). In addition, the total size of the private formal sector would remain very small, i.e., about seven per cent of the Kenyan labour force. So wage cutting is not a viable solution in a low-income country such as Kenya. While the depth of poverty might be

reduced for some workers, the net effect would be to markedly broaden the incidence of poverty.

Labour Unions

What about problems with labour unions? The World Bank's "Jobs in Kenya: Concept Note" regards them as a major source of labour-market rigidities. But unions represent a small and diminishing share of Kenya's labour force. This is also the case in many other low-income countries that have undergone structural adjustment.

Between 1985 and 2000, for instance, union membership in Kenya fell from about 700,000 to about 436,000—a sharp decline of 38 per cent. Unions now represent only about four per cent of the total labour force. Moreover, a 2003 Kenya survey reported that about 94 per cent of firms reported zero days of work lost to strikes or labour unrest.

Union workers are often accused of enjoying wage premiums. But elite workers, who enjoy high premiums based on education or skill, usually do not join labour unions in Kenya. Unions are concentrated in the public sector, representing workers below the senior level. In the private sector, they tend to represent production-level workers who are not highly skilled. So, for these various reasons, unions are not a likely source of labour-market rigidities.

Minimum Wages

Do minimum wages hamper employment creation, especially among poorer workers, by making their unskilled labour too expensive? It is true that the confusing array of 45 separate minimum wage standards in Kenya needs simplification.

But drawing on data from the 2005-6 KIHBS, we find that almost three quarters of all workers paid on an hourly basis receive wages below the average level for the statutory minimum. For workers in the private sector paid on a daily or monthly basis (who are the overwhelming majority of all paid employees), wages are 43-50 per cent below the *lower range* of the statutory minimum wage. Being so low, minimum wages exert little influence on wage-setting.

Instead of accepting advice that reducing or eliminating minimum wages, weakening unions or cutting wages could create more jobs, the Government should concentrate on directly expanding decent employment through a comprehensive employment-targeted economic programme, including measures to raise worker productivity, broaden the availability of credit and enhance access to economic and social infrastructure.