

The Rise of Self-Employment in Rural China: Development or Distress?

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Summary. — This paper evaluates the role of self-employment in China's rural economy, while paying attention to whether the rise of self-employment promotes entrepreneurship and is a sign of development, or whether it is a stopover for disadvantaged workers and a sign of distress. Using data on 20-year labor market histories of a nationally representative sample of individuals, we provide descriptive evidence that self-employment in rural China, unlike in some other places, is a sign of development. Econometric evidence from a random-effects probit model and a continuous-time Markov model shows also that self-employment in rural China shares many features of a productive small-business sector.

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1. INTRODUCTION

One of the most significant employment trends in rural China is the rise of off-farm self-employment; in recent years, there has been a veritable explosion of traders, merchants, and small- and medium-scale, individual- and household-run businesses (Entwisle, Henderson, Short, Bouma, & Zhai, 1995). During 1988–95, up to 30 million self-employed workers emerged in rural China (Rozelle, Guo, & Minggao, 1999). According to the survey, during 1988–95 the self-employment sector was the fastest growing off-farm sector in rural China (Rozelle *et al.*, 1999). During this period, almost 40% of all new off-farm jobs belonged to the newly self-employed. Self-employment grew fastest in the rich coastal provinces but rural residents began working for themselves in other provinces as well. While either the reasons for or broader implications of the rise of self-employment are still not well understood, it is clear that the increase in earnings from self-employed work was a major contributor toward increasing China's rural incomes in the late 1980s and 1990s (Parish, Zhe, & Li, 1995).

Many development and transition economists believe that the emergence of a strong self-employment sector in an economy plays an important role in the overall development

process, apart from being a source of income and employment for rural residents (Blau, 1985; Yu, 1999).¹ Schumpeter described the sector as the “prime mover of economic growth” (Schumpeter, 1943, p. 132). de Soto (1989) described the emergence of self-employed workers as “the foundation of development” (p. 243). Transition economists believe the rise of self-employment to be a sign of the growing importance of markets relative to the state (Gerber, 2001). Essentially, self-employment opens up new opportunities for workers that can significantly improve incomes, increase capital assets and the overall standard of living in the rural community as new enterprises grow into medium and large size businesses (Henley, 2002).

However, not all scholars agree that the rise of self-employment is a sign of a healthy labor market and some downplay its importance in the process of economic development. At the heart of this alternate view of the sector is the observation that the emergence of self-employment often parallels the rise of informal forms of employment in developing economies (Mazumdar, 1983; Portes, Castells, & Benton,

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1989). Some scholars believe that self-employment may be part of a less productive informal sector that serves as a coping mechanism for disadvantaged workers who are less educated and unskilled, or those who are seeking employment and cannot obtain a formal job (e.g., Gong & Soest, 2002; Tokman, 1992). In short, it is a sign of distress, not development. In fact, some analyses of developing economies consider the rise of self-employment as an indicator of reform failure. In other words, in these cases self-employment is not viewed as a step-up on the development ladder, but instead as a last resort for laborers who cannot find a job in the formal sector.²

The overall goal of this paper is to understand the role that self-employment is playing in China, one of the fastest growing countries in the world. In light of differing opinions over the contribution of self-employment to the future development of an economy, it is important to consider whether or not the rise of a self-employed class in rural China truly signals the arrival of entrepreneurs, innovators and imitators in the rural economy who will help accelerate the process of economic development. In contrast, one may wonder if self-employment in rural China is merely a stopover for workers experiencing difficulties in the formal wage-employment sector. Is it possible that the self-employed are anxious, looking forward to exiting the sector as opportunities in other sectors open up? What are the factors that affect an individual's mobility in and out of self-employment? In China, policymakers need to understand the nature of the self-employment sector in order to devise measures to help foster it if it is contributing to development, or to look for reasons why labor markets are festering if it is an indicator of distress.

To meet our broad goal and answer some of these questions, we have three specific objectives. First, we examine the rise of the importance of self-employment in the off-farm sector during the first two decades of China's reform, 1981–2000. Our aim here is to show how off-farm employment opportunities have grown in rural China during the course of the country's transition toward a market economy, and how workers are increasingly turning to self-employment.

Our second objective is to examine the nature of the evolution, and the quality of self-employment activity in rural China. To do so, we decompose the self-employment sector into two sub-sectors on the basis of the nature of

self-employment activity and the level of capital invested in the self-employed business (Arum, 1997; McManus, 2000). In this sense we seek to divide a broad class of employment into those that appear to be more dynamic, capital forming and have a greater likelihood of leading to higher productivity (*high productivity self-employment*, henceforth) from those that involve more trivial, less capital-intensive pursuits and are less likely to lead to future productivity growth of China's economy (*low productivity self-employment*, henceforth). In this context, we evaluate also if self-employment activities are attracting young, dynamic and more educated people to participate in the sector. One interpretation of more educated workers participating in the sector, particularly in high productivity self-employment, is that the sector is becoming more sophisticated over time, and requiring entrepreneurs to be increasingly technically qualified. Alternatively, one could interpret this phenomenon as indicative of problems and imperfection in the labor market.

Our third objective is to examine the determinants of self-employment, identifying some of the factors that allow workers to participate in high productivity self-employment activities. To do so, we use a static framework and examine how individual characteristics (such as educational attainment, age, and skill training), household characteristics (such as the size of household labor force), and parental characteristics (such as father's primary occupation) affect participation. We supplement our analysis with a dynamic framework and analyze the nature of labor movement in and out of self-employment over time to evaluate whether self-employment in rural China seems to be a stopover for workers moving into more desirable sectors over time, or whether it represents upward mobility and is a resource that is capable of generating economic growth.

To meet these objectives, the rest of the paper is organized as follows. In Section 2, we introduce the data that are used for the analysis. We use a set of rural household data that were collected with information on labor market histories and other characteristics of more than 2000 individuals across China. In Section 3, we use descriptive analysis and non-parametric regressions to demonstrate the growth of off-farm labor markets in China's rural economy over the past two decades, the growth of self-employment in particular and its evolution over time. In Section 4, we examine the determinants

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