Self-Employment in the Developing World

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Summary. — This paper analyzes heterogeneity among the self-employed in 74 developing countries, representing two-thirds of the population of the developing world. After profiling how worker characteristics vary by employment status, it classifies self-employed workers outside agriculture as “successful” or “unsuccessful” entrepreneurs, based on two measures of success: whether the worker is an employer, and whether the worker resides in a non-poor household. Four main findings emerge. First, jobs exhibit a clear pecking order, with household income and worker education highest for employers, followed by wage and salaried employees, non-agricultural own-account workers, non-agricultural unpaid family workers, and finally agricultural workers. Second, a substantial minority of own-account workers reside in non-poor households, suggesting that their profits are often a secondary source of household income. Third, as per capita income increases across countries, the structure of employment shifts rapidly, first out of agriculture into unsuccessful non-agricultural self-employment, and then mainly into non-agricultural wage employment. Finally, roughly one-third of the unsuccessful entrepreneurs share similar characteristics with their successful counterparts, suggesting they have the potential to be successful but face constraints to growth. The authors conclude that although interventions such as access to credit can benefit a substantial portion of the self-employed, effectively targeting the minority of self-employed with higher growth potential is important, particularly in low-income contexts. The results also highlight the potential benefits of policies that facilitate shifts in the nature of work, first from agricultural labor into non-agricultural self-employment, and then into wage and salaried jobs.

Key words — self-employment, informality, entrepreneurship, development

1. INTRODUCTION

Although most workers in developing counties are self-employed, relatively little is known at a broader level about their characteristics and prospects, and how types of employment differ between countries at different levels of economic development. This paper uses a comprehensive set of household surveys to document the heterogeneity of the self-employed, by which we mean both employers and own-account workers. In developing countries, self-employed workers are often classified according to their perceived prospects for growth. A small minority of self-employed are innovative, successful entrepreneurs with further growth potential and ambition (Bennett & Estrin, 2007; de Soto, 1989). On the other hand, the majority of the self-employed work for themselves and earn little, either because they are rationed out of wage jobs (de Mel, McKenzie, & Woodruff, 2010; Fields, 1975; Tokman, 2007) or because they prefer the autonomy and flexibility of self-employment (Maloney, 2004).

The less successful self-employed workers, whether self-employed by choice or not, are also heterogeneous. For example, Grimm, Knorringa, and Lay (2012) distinguish between two types of unsuccessful entrepreneurs in several West African cities. The first type has the profile, in terms of age, education, and sector of work, of more successful entrepreneurs, but has yet to acquire significant capital. Although it is impossible to know exactly why these entrepreneurs’ enterprises have failed to grow, the authors assume that their lack of success is partly attributable to personal and environmental constraints, such as inadequate skills and experience, access to capital, or physical infrastructure. The second group of unsuccessful self-employed, on the other hand, does not share the same observed characteristics as successful entrepreneurs, and are therefore assumed to more likely be constrained by their age, education, and sector of work than unobserved features of their skill set or external environment.

In this paper, using data from nationally representative micro-level household surveys from almost 100 countries, we examine the characteristics of the self-employed throughout much of the developing world. Building on our profile of the self-employed, we use two admittedly coarse but nonetheless meaningful measures to classify the self-employed as successful: whether a self-employed worker is an employer as opposed to an own-account worker, and whether the self-employed worker lives in a non-poor household. Given data limitations, the analysis is unable to isolate which characteristics or factors

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cause some self-employed to be successful along these mea-
sures. Nonetheless, we can characterize the extent to which
the currently unsuccessful self-employed possess basic traits
that are correlated with success, which may lead them to have
greater potential to become successful.

We first examine the characteristics associated with agricultu-
ral workers, and of non-agricultural employers, own ac-
count workers, non-paid employees, and wage and salary
employees. Employers and own-account workers are classified
as successful or unsuccessful based on two coarse measures of
entrepreneurial success that are present in the data: (i) whether
the self-employed are employers (vs. own account workers) and
(ii) whether the worker lives in a household with per capita
consumption above the $2/day poverty line. While these
measures, particularly household per capita consumption,
are rough and imperfect measures of the entrepreneur’s suc-
cess, they convey meaningful information about the economic
position of the self-employed. We then measure the percent of
the self-employed that are successful, according to these crite-
ria, in each country, and describe the characteristics associated
with successful self-employment. Finally, we estimate the per-
centage of unsuccessful self-employed that share the basic
characteristics of their successful counterparts, and therefore
can be considered to have greater likelihood to become suc-
cessful.

Throughout the analysis, we are particularly concerned with
how the characteristics of the self-employed change at different
levels of economic development. We examine this issue by
comparing the profile of the self-employed in countries at dif-
f erent levels of per capita GDP. For example, as per capita in-
come increases across countries, how does the proportion of
successful, lower-potential, and higher-potential self-employed
change? As per capita GDP increases across countries, do
more lower-potential self-employed become high-potential or
successful entrepreneurs, or are they absorbed into wage
employment?

Our results have implications for labor market strategies at
different stages of countries’ development. For example, if a
high proportion of workers are unsuccessful self-employed
with little potential to become innovative and successful, pol-
cies to promote self-employment, such as microlending or
extension services, may be more effective if they are targeted
to the narrow set of entrepreneurs with greater potential. Fur-
thermore, if the unsuccessful self-employed are absorbed into
wage employment as countries develop, this suggests that the
growth of the private wage and salary sector is a key priority for
development. On the other hand, if countries develop by
creating a larger share of higher-potential or successful entre-
preneurs, then broadly targeted investments in human capital
and access to finance may be more important. Although there
has been research investigating the heterogeneity of the self-
employed in several countries (i.e., de Mel et al., 2010; Djan-
kov, Miguel, Qian, Roland, & Zhuravskaya, 2005; Djankov,
Qian, Roland, & Zhuravskaya, 2006; Grimm et al., 2012), this
is to our knowledge the first analysis that takes a more global
perspective on the nature of self-employment across a wide set
of middle and low income countries.

2. PREVIOUS LITERATURE

Our analysis is inspired by three strands of the literature.
The first strand compares the characteristic of entrepreneurs
in developing countries to those of wage and salary employees
and other workers. The second strand attempts to measure the
extent to which the self-employed are self-employed by
necessity (and would rather be wage and salary employees)
or are potentially successful entrepreneurs, while the third
attempts to identify and measure the characteristics of those
self-employed who have the potential to be successful but
are constrained by lack of access to capital or other reasons.

A recent and growing literature studies the characteristics of
entrepreneurs in developing countries. Djankov et al. (2005)
collected data on the personal, family and business character-
istics of approximately 1500 entrepreneurs and non-entrepre-
neurs in 2004 in China. Djankov et al. (2006) use similar
data (from 2003 to 2004) to examine the characteristics of
entrepreneurs in Russia. They find that compared to non-
entrepreneurs, entrepreneurs in China and Russia are more
mobile, more willing to accept risk, have parents who are more
educated, are more likely to have parents and other family
members who were entrepreneurs, and are more willing to
trade away leisure for more money. Djankov et al. (2005,
2006) further distinguish between entrepreneurs and “failed
entrepreneurs” (who at one point were entrepreneurs but are
not now). Failed entrepreneurs score worse on aptitude tests
compared to entrepreneurs, but have the best self-reported
performance in school.

De Mel, McKenzie and Woodruff (2008) perform a similar
analysis using data from surveys carried out in Sri Lanka dur-
ing 2005–07 of employers in small and medium sized firms,
own account workers, and wage and salary employees. Al-
though they do not find that entrepreneurs are more willing
to accept risk, they do confirm other patterns from China and
Russia. Compared to own account workers and wage and sal-
ary employees, employers are older, more educated, have par-
ents who are more educated, and lived in wealthier households
as children. Employers and own account workers are more
likely than wage and salary workers to have parents who were
self-employed. Years of schooling is highest for employers, fol-
lowed by wage and salary workers, and lowest for own ac-
count workers. Finally, own-account workers score lower on
measures of cognitive “ability” than both employers and wage
and salary employees.

In part, this literature examining the characteristics of entre-
preneurs in developing countries stems from a recent debate
about the extent to which self-employment reflects voluntary
exit vs. involuntary exclusion from the wage sector. For sev-
eral years, the dominant view was that the large numbers of
self-employed workers in developing countries reflected the
rationing of employment opportunities in the wage sector,
due to regulations or efficiency wages that pushed wages above
their market clearing level. This consensus was challenged by a
series of studies of job mobility from Mexico and Brazil, which
found high rates of mobility into self-employed jobs as well as
several self-employed who report moving by choice (Bosch &
Maloney, 2010; Maloney, 2004).

The current consensus is that both types of self-employed are
present in developing countries, and subsequent research has
tried to assess their relative prevalence. De Mel, McKenzie,
and Woodruff (2008), for example, use discriminant
analysis to discover whether the characteristics of own
account workers are more similar to the characteristics of
employers or wage and salary employees. They find that
roughly two-thirds of own account worker have characteristics
that make them more similar to wage and salary employees
than to the employers of small and medium firms. This is con-
sistent with relatively low rates of mobility from wage work
into own-account work, as over half of own-account workers
reported being self-employed throughout their entire working
lives. On the other hand, the remaining more dynamic entre-
preneurs were in many cases able to grow, as nearly 10% of
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