

Self-Employment in the Developing World

BACKGROUND RESEARCH PAPER

Gary S. Fields

Submitted to the
High Level Panel on the Post-2015
Development Agenda

This paper reflects the views of the author and does not represent the views of the Panel.

It is provided as background research for the HLP Report, one of many inputs to the process.

May 2013

Self-Employment in the Developing World:
A Report to the High-Level Panel of Eminent Persons *

Gary S. Fields

Cornell University and IZA

May, 2013

Background

This paper was commissioned to help the High-Level Panel set the post-2015 Development Agenda with respect to the theme “Employment and Economic Growth”. Within this theme, the focal area for this paper is “Self-Employment in the Developing World”. The paper is charged with the tasks of 1) helping the High-Level Panel understand the current state of knowledge, broad trends, and areas of consensus regarding self-employment in developing countries, and 2) indicating what would be the key policy planks which could define a post-2015 development agenda around improvements in labor market and growth outcomes for the self-employed, including priority interventions to increase the returns for workers who remain self-employed and priority interventions to promote the graduation of the self-employed from one segment to another, higher-earning form of employment.

* A High-Level Panel of Eminent Persons has been convened to construct such a post-2015 development agenda. The panel is co-chaired by President Susilo Bambang Yudhoyono of Indonesia, President Ellen Johnson Sirleaf of Liberia and Prime Minister David Cameron of the United Kingdom.

Poverty and the Labor Market

The justly famous Millennium Development Goal #1 is to eradicate extreme poverty and hunger.

The United Nations reports that extreme poverty is falling in every region of the world, the poverty reduction target (reducing poverty in half by 2015) has already been met, the target of halving the proportion of people without access to improved sources of water has been met, and parity in primary education between girls and boys has been achieved in the world (United Nations, 2012). And yet, despite the progress that has been made, an enormous problem remains.

The poor are those who live below a minimum amount. At present, 1.3 billion of the world's people live on less than \$1.25 per person per day in Purchasing Power Parity-adjusted dollars and another 1.7 billion live on between PPP\$1.25 and PPP\$2.50 per person per day.¹

It is often said, rightly, that the main asset of the poor is their labor. Thinking of the labor market as comprising both those who sell their labor services to others in an employment relationship and those who sell their labor services to themselves in self-employment, the main factor differentiating people who are poor from those who are not is how much they and other household members earn from the work they do. It is often thought that the main reason for poverty is unemployment, but this is incorrect. In the world, 200 million people are unemployed and earning nothing in a given week. This is a large figure, but it pales beside the 900 million people who are employed but earning so little that they and their families cannot achieve a standard of living of even \$2 per person per day (ILO, 2013).

¹ The number living on less than US\$1.25 PPP per day is reported in Chen and Ravallion (2012). I thank Shaohua Chen for providing a specialized POVCAL run estimating the number in the US\$1.25-2.50 range.

The poor are to be found mostly in self-employment, to which we now turn.

Self-Employment: Definition and Profile

Self-employment is defined here as persons operating individual enterprises, perhaps employing others or perhaps not (the latter sometimes being called “own-account workers”), plus persons operating or working in household enterprises. The self-employed may be in urban or rural areas. They may be in agriculture or outside of agriculture.

In the developing countries, self-employment is the norm: 53% of workers in low-income countries and 36% in lower-middle-income countries are self-employed, predominantly in agriculture in both cases (Ginding and Newhouse, forthcoming). In South Asia, 85% of Indian workers are in self-employment or casual employment, and self-employment accounts for 73% of non-agricultural employment in Bangladesh (Chen and Duane, 2008, P. 5). In sub-Saharan Africa, self-employment accounts for 66% of total employment in Kenya, 83% in Mali, and 85% in Madagascar and Ghana. South Africa is an outlier; there, only 19% of the employed are in self-employment (Heintz and Valodia, 2008, PP. 9-10). Moreover, in sub-Saharan Africa, most new non-farm jobs have been generated by households starting household enterprises (Fox and Sohnesen, 2012). An eighteen-country study reports that fully half of the extremely poor in urban areas (those living on less than one dollar a day) operate a non-agricultural business (Banerjee and Duflo, 2011, p. 210).

Self-employment is sometimes equated with working informally, but equating the two is not helpful for two reasons. One is that “working informally” and the associated terms “informal economy” and “informal sector” are not defined consistently, with the consequence that

“informality” means different things to different people. Second, even when the conceptualization is clear, as when “informal employment” is thought to comprise those who are outside the protection and regulation of the state, it is difficult to take this concept to data and get a handle on how many of the self-employed are informal by this concept and how many not. For clear statements of the various definitions and estimation methods used, see Chen (2012) and Charmes (2012).²

Self-employment is also equated on occasion with entrepreneurship, but this too may be misleading. To many, “entrepreneurship” conjures up the image of a person taking the risk of setting up a business with the intent of making it grow and prosper; see, for example, Parker (2004) or Baumol and Schelling (2008). However, in the context of developing countries, the goal of much self-employment is a much more limited one: to earn money for a time – hopefully, a short time – until the individual can get out of that activity and into a more remunerative one.

² The following definitions have been officially recommended:

The ILO (1993) defined the “informal sector” as the group of household enterprises or unincorporated enterprises owned by households that includes:

- Informal own-account enterprises, which may employ contributing family workers and employees on an occasional basis; and
- Enterprises of informal employers, which employ one or more employees on a continuous basis.

An even broader notion is that of “informal employment.” The WIEGO-ICLS-ILO definition of employment in the informal economy (WIEGO: Women in Informal Employment: Globalizing and Organizing; ICLS: International Conference of Labor Statisticians; ILO: International Labor Organization) comprises informal employment of two kinds:

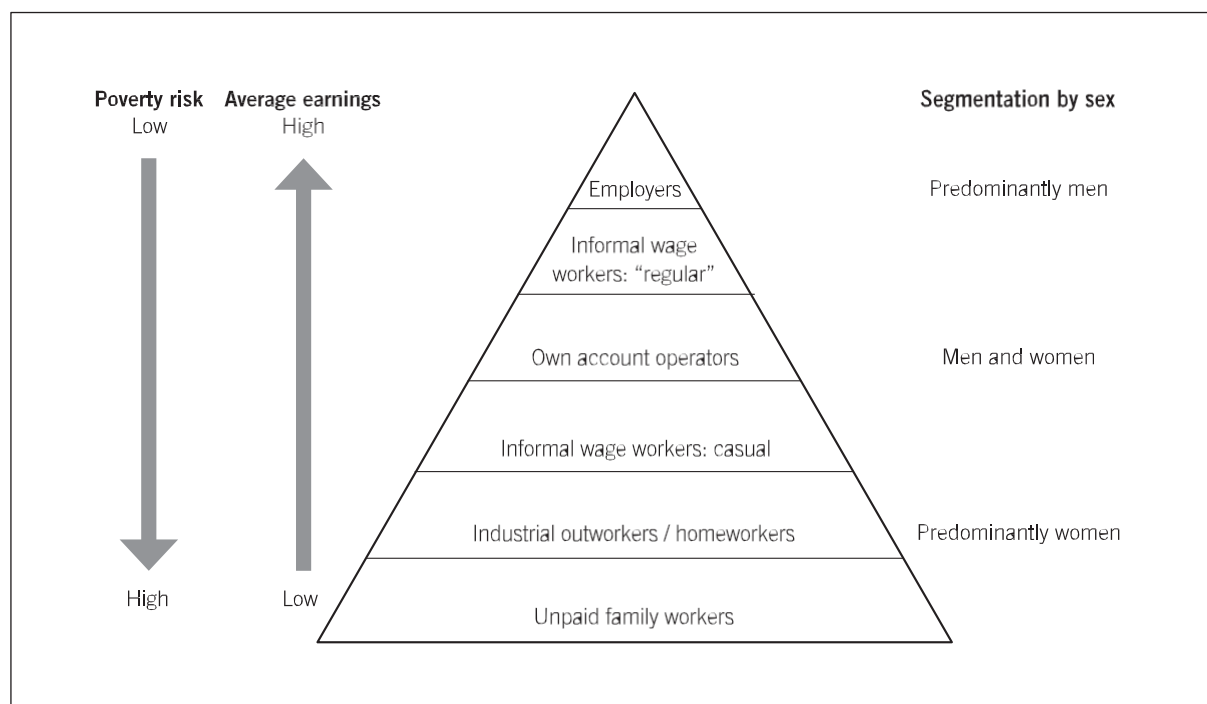
- (1) Self-employment in informal enterprises (small unregistered or unincorporated enterprises) including: employers, own account operators and unpaid family workers in informal enterprises; and
- (2) Paid employment in informal jobs (for informal enterprises, formal enterprises, households, or no fixed employer) including: casual or day laborers, industrial outworkers, unregistered or undeclared workers, contract workers and unprotected temporary and part-time workers.

These are fine definitions. Unfortunately, though, these recommended definitions are not used consistently in empirical studies.

An example is saving up money to buy a package of twenty cigarettes, then selling them one at a time at a higher unit price and surviving off the profits. In the everyday sense of the term, the workers (mostly young men) engaged in such survival self-employment can hardly be called “entrepreneurs”; they engage in such activities reluctantly until they can get out of doing them. Studies of Sri Lanka (De Mel, McKenzie, and Woodruff, 2010) and West Africa (Grimm, Knorriniga, and Lay, 2012) conclude that the majority of the self-employed lack the potential to grow.

In the current literature, consensus has been reached that people are self-employed for two quite different kinds of reasons. Clearly, a large number of people are self-employed because they do not have the possibility of being wage-employees, which they would prefer if they could obtain a wage-employment job. In this sense, they are self-employed because they had no choice – it was either be self-employed and earn something or be unemployed and earn nothing, and they are too poor to remain unemployed and earn nothing. But in addition, other people are self-employed because they were wage-employees, could have continued in wage-employment, but willingly left wage-employment to create their own self-employment enterprises. In the literature, there is controversy over the relative importance of choice versus no-choice, and research is needed to investigate this issue in various countries. But regardless of whether the percentage of people who are working in self-employment because they have no choice is 80% or “just” 60%, it is a large group.

The self-employed are also a poor group. The international network known by its acronym WIEGO (Women in Informal Employment: Globalizing and Organizing) offers up the following profile:



Source: Chen (2012, p. 9).

As can be seen, the self-employed are concentrated in the high-poverty-risk, low-average-earnings categories. See, also, Gindling and Newhouse (forthcoming).

In the words of one study of the poor, “Perhaps the many businesses of the poor are less a testimony to their entrepreneurial spirit than a symptom of the dramatic failure of the economies in which they live to provide them with something better.” (Banerjee and Duflo, 2011, p. 226).

See also Rosenzweig (2012, p. 124) and McKenzie (2013).

Let us now address policy.

Some Possible Policy Interventions

The policy interventions aimed at raising the labor market earnings of the self-employed can be put into two broad groups: 1) help raise the returns for the self-employed in the activities and sectors where they now are, and 2) help get the self-employed out of where they now are. For details, see Fields (2012).

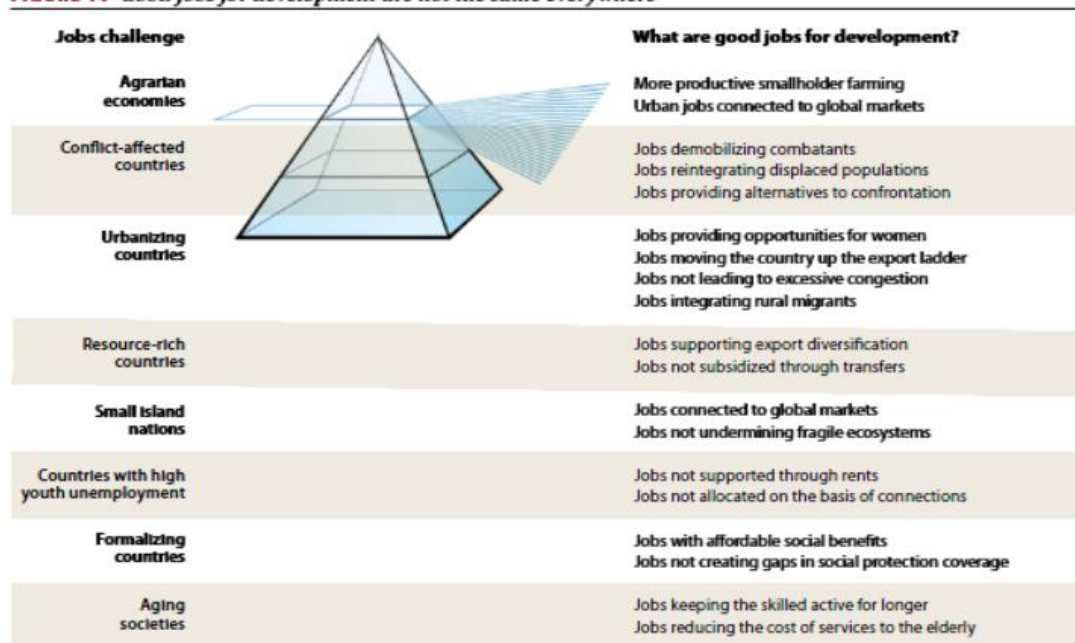
The options for helping raise the returns for the self-employed in the activities and sectors where they now are include: designing products to help raise the productivity of the self-employed; adopting a positive policy stance toward the self-employed and avoiding hassling them; providing the poor in agriculture with more to work with; facilitating supplemental off-farm wage-employment and self-employment; making capital available to the poor at affordable rates; building skills and business know-how; and stimulating microfranchising.

The options for helping increase wage-employment so that the self-employed can get out of where they now are include a number of general measures having a bearing on the labor market: stimulating economic growth; carefully seeking a more open international trade environment; increasing foreign aid; and harnessing the energies of private companies. They also include a number of measures within the labor market aimed specifically at generating more wage-employment: avoiding prematurely high labor costs; removing undue barriers to employment; increasing workers' skills and productive abilities to the extent that skill deficiencies are causing job vacancies to go unfilled; and establishing workfare and other programs aimed at creating jobs for the poor.

What the highest priority interventions are varies from country to country and from place to place and group to group within a country. This is because different countries have different

objectives, tradeoffs exist both on the policy side and on the budgetary side, many constraints exist, the various constraints bind differentially, the most important constraint to overcome differs from one circumstance to another, and the most cost-effective way of intervening to relax the constraints also varies. In its latest World Development Report entitled Jobs, the World Bank (2013) has offered the following recommended typology of priority policy interventions for different kinds of countries:

FIGURE 14 *Good jobs for development are not the same everywhere*



Source: World Development Report 2013 team.

There is no one single silver bullet. There are, however, some particularly promising interventions that have been tried in different places. The following section highlights some of these.

Some Provisional Conclusions Regarding Policy Priorities

The terms of reference for this paper request recommendations regarding priority policy interventions on behalf of the self-employed. Here, I highlight a number of interventions which, in my judgment, appear to have been particularly effective and which might help guide efforts in the future; further details are available in Fields (2012).

1. Focusing economic growth on improving the earning opportunities of the poor: the East Asian experience

Throughout East Asia, the growth paths pursued by Japan, then the Asian tigers, then the Asian cubs, and then China and Vietnam have entailed improving conditions for workers by embodying their labor in products manufactured not only for the domestic market but also for export to the rest of the world. The self-employed benefited from this economic growth in a variety of ways: among them, by being hired into wage jobs, by remaining self-employed and participating in the supply chain, and by being the recipients of government programs which previously had been unaffordable. But the growth in labor earnings was not limited to the East Asian countries' manufacturing sectors - real labor earnings rose also for wage-employees and the self-employed in agriculture and services. The benefits of a tight labor market brought about by economic growth have been widespread.

2. Creating off-farm employment opportunities: India's NREGA

India's National Rural Employment Guarantee Act (NREGA) is the most ambitious workfare program ever attempted. In all 625 districts of India, rural households are offered 100 days of employment per year. This is more than just an opportunity to apply for work – it is a *guarantee*, to which *all* rural households in India are entitled. Despite the “operational deficiencies” (that is,

corruption) on the ground, India's NREGA is credited with substantially raising rural workers' labor earnings. Among the beneficiaries are the self-employed, workers in household enterprises, and day laborers. The lessons from the NREGA, both positive and negative, are receiving careful study.

3. Training people for wage-employment: Mexico's SICAT Program

One way of helping the self-employed is to provide them with the skills needed to be able to fill existing job vacancies. The government of Mexico has created a program known by its Spanish acronym SICAT which provides for employers to offer training in skills they need. The government does not prescribe what these skills are – employers do – and so training is offered in such areas as air conditioning repairing and lathe operating. Among the beneficiaries are previously self-employed persons who are able to exit low-paying self-employment activities and move into better-paying wage-employment ones.

4. Making micro-credit affordable: Andhra Pradesh's Self-Help Group – Bank Linkage Model

Throughout the developing world, the self-employed have many potentially-profitable activities in which they might invest if only they could secure affordable credit. In most countries, the interest rates charged to the self-employed are astronomical: 10% per *month* in much of the developing world, 40% per *month* in the Philippines, and 4.69% per *day* in Chennai, India. To remedy this state of affairs, the government of the Indian state of Andhra Pradesh, with a population of 80 million people, has created a program whereby banks lend to groups of women at the rate of 12% per *year*. And moreover, borrowers are offered a prompt repayment incentive whereby those who repay their loans on time receive a subsidy of nine percentage points from

the state government, lowering their effective interest rate to 3% *per year*. The Andhra Pradesh model bears careful study in terms of its applicability elsewhere.

These policy priorities – focusing economic growth on improving the earning opportunities of the poor, creating off-farm employment opportunities, training people for wage-employment, and making micro-credit affordable – are not the only possible policy interventions. They do, however, hold particular promise and are worth thorough consideration.

References

Banerjee, Abhijit V. and Esther Duflo, *Poor Economics*, New York, Public Affairs Press, 2011.

Baumol, William J. and Melissa A. Schilling, "Entrepreneurship," in Steven N. Durlauf and Lawrence E. Blume, eds., *The New Palgrave Dictionary of Economics, Second Edition*, 2008.

Charmes, Jacques, "The Informal Economy Worldwide: Trends and Characteristics," *Margin: The Journal of Applied Economic Research*, 6(103), 103-132, 2012.

Chen, Martha, *The Informal Economy: Definitions, Theories and Policies*, WIEGO, Cambridge, MA, 2012.

Chen, Martha and Donna Doane, *Informality in South Asia: A Review*, WIEGO, Cambridge, MA, 2008.

Chen, Shaohua and Martin Ravallion, *An Update to the World Bank's Estimates of Consumption Poverty in the Developing World*, World Bank, Washington, 2012.

de Mel, Suresh, David McKenzie, and Christopher Woodruff, "Who are the Microenterprise Owners? Evidence from Sri Lanka," in Lerner and Schoar, eds. *International Differences in Entrepreneurship*. University of Chicago Press, Chicago, 63-87, 2010.

Fields, Gary S., *Working Hard, Working Poor*, Oxford University Press, New York, 2012.

Fox, Louise and Thomas Pave Sohnesen, *Household Enterprise in Sub-Saharan Africa: Why they matter for growth, jobs and poverty reduction*, World Bank, Washington, 2012.

Gindling, T.H. and David Newhouse, "Self-Employment in the Developing World," *World Development*, forthcoming.

Grimm, M., P. Knorringa, and J. Lay, “Informal Enterprises in Western Africa: Constrained Gazelles in the Lower Tier,” *World Development* 40(7), 1352-1368, 2012.

Heintz, James and Imraan Valodia, *Informality in Africa: A Review*, WIEGO, Cambridge, MA, 2008.

International Labour Organization, *Global Employment Trends 2013*, ILO, Geneva, 2013.

McKenzie, David, “Business Regulations and Low Scale Entrepreneurship in Developing Countries,” *IZA World of Labor*, 2013.

Rosenzweig, Mark R., “Thinking Small: A Review of *Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty*” by Abhijit Banerjee and Esther Duflo,” *Journal of Economic Literature*, 50(1), 115-127, 2012.

United Nations, *The Millennium Development Goals Report 2012*, United Nations, New York, 2012.

World Bank, *World Development Report 2013: Jobs*. World Bank, Washington, 2013.