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Article

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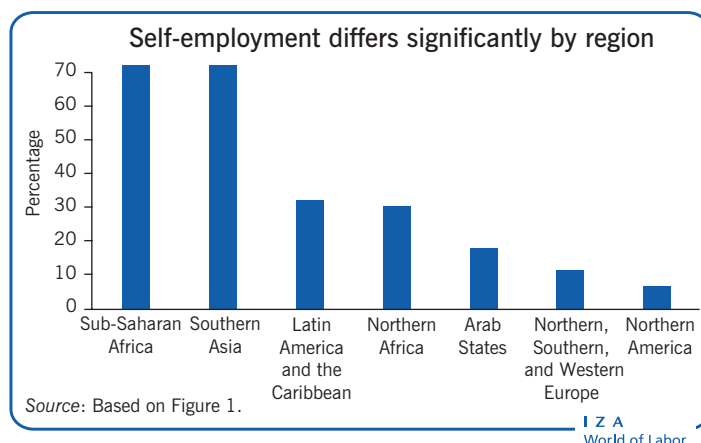
Self-employment and poverty in developing countries

The right policies can help the self-employed to boost their earnings above the poverty level and earn more for the work they do

Keywords: self-employment, poverty, labor earnings

ELEVATOR PITCH

A key way for the world's poor to escape poverty is to earn more for their labor. Most of the world's poor people are self-employed, but because there are few opportunities in most developing countries for them to earn enough to escape poverty, they are working hard but working poor. Two key policy planks in the fight against poverty should be: raising the returns to self-employment and creating more opportunities to move from self-employment into higher paying wage employment.



KEY FINDINGS

Pros

- + Most workers in low- and middle-income countries are self-employed, but earnings are typically higher and social protection programs are more widespread in wage employment.
- + Most workers are self-employed because they have no choice.
- + One goal for public policy would be to raise the returns to labor of the self-employed.
- + Another goal would be to move the self-employed into wage employment.
- + Improving the earning opportunities, creating off-farm employment, training people for wage employment, and making microcredit affordable are among the most promising policy interventions.

Cons

- Absolute poverty is not primarily a problem of unemployment, but a problem of low labor market earnings among the employed.
- Not enough is known about how many of the self-employed previously worked in wage employment, or why they left.
- Self-employment is not the same as entrepreneurship, nor is self-employment necessarily informal.
- Although some regulation is necessary and appropriate, the self-employed are often hindered excessively, which unfairly limits their earning power and may deprive them of their means of earning a livelihood.

AUTHOR'S MAIN MESSAGE

Governments should support self-employment as a means of creating livelihood opportunities for the poor and expand opportunities for better-paying wage employment. Too often, public policies hinder the self-employed. With the right policies in place, the self-employed can boost their earnings above the poverty level. Four interventions have proved effective in a range of settings: (i) focusing economic growth on improving earning opportunities for the poor, (ii) creating off-farm jobs, (iii) training for wage employment, and (vi) making microcredit affordable.

MOTIVATION

Ten per cent of the world's people live in extreme poverty and another 15% in poverty but not extreme poverty [1]. They are overwhelmingly concentrated in developing countries. Although they work, they are poor because there are not adequate opportunities for them to earn enough to escape poverty. They are working hard but working poor [2].

Who are the poor?

In 2015, one-quarter of the world's people lived on less than US\$3.10 in purchasing power parity dollars. Together, these poor people are identified as the “global” poor: people with the same purchasing power over commodities, no matter where they live, based on minimum nutritional requirements for good health and normal activities.

In addition, poverty is measured in two other ways in individual countries. Some use *country-specific poverty lines* (e.g. the country-specific poverty line for the US is much higher than the one for India, reflecting the US' higher national income). In contrast, other countries, particularly in Europe, typically measure relative poverty, with the *relative poverty* line being set as a percentage of average income.

Poor people typically respond to the lack of adequate employment opportunities by creating their own self-employment opportunities. Most do this out of desperation: the only alternative to working and earning very little is to be unemployed and earning nothing.

In low- and middle-income countries (developing countries), the number of people wanting employment and capable of working in wage employment far exceeds the number of jobs. Some poor people prefer self-employment to wage employment, but for most, self-employment is worse than wage employment. Yet in the absence of unemployment insurance and other social protection programs, it is better than nothing.

DISCUSSION OF PROS AND CONS

Poverty and labor markets are linked

The first UN Sustainable Development Goal (SDG), like the first Millennium Development Goal (MDG) before it, for good reason, is to eradicate extreme poverty and hunger. Despite the progress that has been made, worldwide poverty remains enormous.

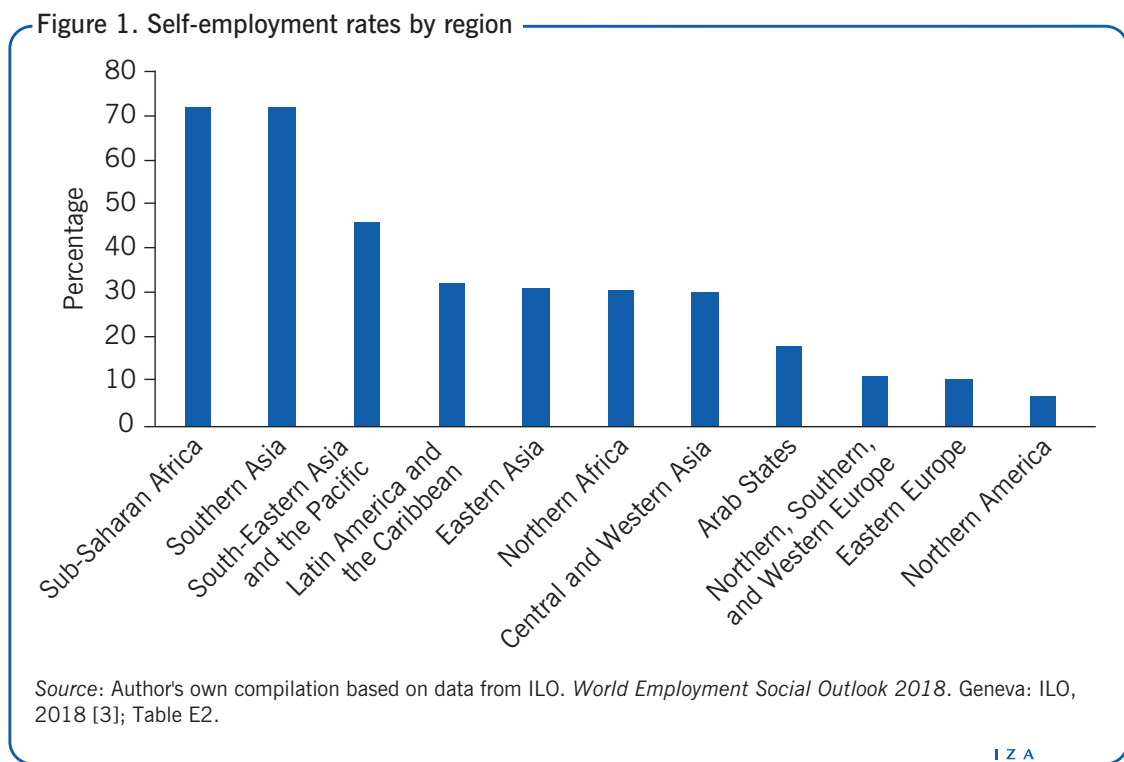
Because labor is the main asset of the poor, unemployment is often thought to be the main reason for poverty. This is wrong. In a given week, some 190 million people are unemployed and earn nothing. This is a large number, but it pales beside the 730 million people who are employed but earn so little, in cash or in kind, that they and their families cannot achieve a standard of living of even US\$3.10 per person per day [3]. (The US\$3.10 figure is the current international definition of poverty in purchasing power parity (PPP) dollars. A lower figure, US\$1.90 (PPP) is used internationally to define extreme poverty. More than 300 million workers around the world are in extreme poverty.)

In view of these figures, what the world has is an employment problem more than an unemployment problem [4]. What differentiates people who are poor

from those who are not, then, is not whether they are employed, but how much they and other household members earn from the work they do. Fully half of the extremely poor in urban areas operate a non-agricultural business, according to an 18-country study [5].

Most workers in developing countries are self-employed

In developing economies, as noted, many poor people—often a majority—are self-employed in both urban and rural areas and inside and outside agriculture. The self-employed include own-account workers and contributing family workers. Own-account workers are self-employed individuals who do not employ others. Contributing family workers are those workers who hold self-employment jobs as own-account workers in a market-oriented establishment operated by a related person living in the same household. The ILO defines vulnerable employment in exactly the same way that self-employment is defined here (i.e. own-account workers plus contributing family workers), but that terminology is not widely used. ILO figures show that the self-employment rate for the world as a whole is equal to 42.5%. The extent of self-employment within countries varies inversely with the level of economic development, using the ILO’s country classification scheme: 76.5% of all employment in developing countries, 46.2% in emerging countries, and 10.0% in developed countries. These three groups of countries are respectively called low-income, middle-income, and high-income in other parlance. Broken down by regions of the world, sub-Saharan Africa is tied with Southern Asia for the highest rate of vulnerable employment—both have a rate of 72.1%. Figure 1 displays these rates for each of the ILO’s country groupings.



Self-employment is not the same as entrepreneurship or informal employment

Self-employment is sometimes equated with entrepreneurship, but this can be misleading. To many people, “entrepreneurship” conjures the image of a risk-taker setting up a business with the intent of making it grow and prosper. In developing countries, however, the goal of much self-employment is far more modest: to earn money for a time—preferably, a short time—before transitioning to a more remunerative activity.

An example is saving money to buy a package of 20 cigarettes and then selling them individually at a higher unit price and surviving on the profits. Workers (mostly young men) engaged in such survival self-employment can hardly be called “entrepreneurs” in the everyday sense of the term. They engage in such activities reluctantly and only until they can find something better. The majority of self-employment enterprises lack the potential to grow, as studies in Sri Lanka, West Africa, and elsewhere demonstrate.

Self-employment is also sometimes equated with working informally. But equating the two is unhelpful. “Working informally” and the associated terms “informal economy” and “informal sector” are not defined consistently in empirical studies, so “informality” means different things to different people. And even when the conceptualization is clear, as when informal employment refers to work outside the protection and regulation of the state, it is difficult to quantify this concept in the data.

While many people who engage in unprotected and unregulated work are paid workers, not self-employed, there are only vague estimates of how many there are. Even less is known about how many self-employed people are engaged in informal activity according to the unprotected/unregulated definition and how many are not. The evidence points to most own-account enterprises and other very small firms being unregistered despite government efforts to get them to register [6].

Does self-employment reflect choice—or lack of choice?

The literature distinguishes two quite different reasons for self-employment. Some are self-employed because they have ideas for profitable businesses and seek to become successful entrepreneurs. An example is a backyard auto mechanic who learned his trade as a paid employee in an established garage, then left voluntarily to set up his own business. Others are self-employed because they do not have the possibility of being wage employees, a condition most of them appear to prefer. In this sense, they are self-employed because they have no choice. They are too poor to remain unemployed and earn nothing.

Duality within self-employment is found throughout the developing world. Controversy remains over the relative importance of the choice and no-choice routes to self-employment, and more research is needed to investigate this issue in specific countries. One careful study concludes that two-thirds of self-employment in the developing world as a whole results from individuals having no better alternatives [7]. Another finds an approximately equal split in non-OECD countries [8]. It is crucial to have data on how many of the self-employed in developing countries had previously been wage employees and could have continued in wage employment but left their jobs willingly in order to create their own enterprise. Although little is known about this, it seems to be relatively rare.

Self-employment and poverty are closely linked, albeit not perfectly. The international network Women in Informal Employment: Globalizing and Organizing (WIEGO) finds that the self-employed are concentrated in high-poverty-risk, low-average-earnings categories [9]. In the words of one study of the working 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” [5].

Women in Informal Employment: Globalizing and Organizing (WIEGO)

WIEGO is a global action research policy network that aims to enhance the status of poor people (especially women) working in informal employment. Its key mission is to empower these workers economically, so that they have equal opportunities and rights. The network comprises: membership-based organizations of informal workers; researchers looking at the informal economy; and professionals from development agencies who work on issues related to the informal economy. WIEGO seeks to improve conditions for the working poor in the informal economy by increasing their voice, visibility, and validity—addressing low earnings, high risks, and adverse working environments. They do this by: researching the experiences of those informally employed; educating policy decision-makers and the public about ways to improve circumstances; and helping membership-based organizations of the working poor. As of 2018, WIEGO had 193 individual and institutional members in 45 countries.

Source: <http://wiego.org/>

How policies harm the working poor: Hindrances, restrictions, and regulations

Street vendors are ubiquitous throughout the developing world. They sell handicrafts, ice cream, lottery tickets, and just about everything else. But South Africa is different [10]. In cities like Johannesburg, Cape Town, and Durban, street vending is entirely absent or confined to a very restricted area. The reason for this is local government policies: for example, Durban had issued just 872 trading permits as of 2005, far fewer than the number of people who want to be street traders. The government arrests, fines, or jails unlicensed traders and confiscates their inventory. This all-too-real threat deprives countless people of a livelihood.

Some regulations are needed to protect against abuses. Products that are illegal or dangerous need to be regulated. And some sales practices are threatening to customers, who need to be protected. But some regulations and restrictions needlessly hinder the self-employed poor and prevent them from earning even a meager living.

Two groups of beneficial policy measures to support the self-employed

Policy interventions to boost the labor market earnings of the self-employed can be put into two broad groups: those that raise the returns to the self-employed in their current activities and sectors, and those that help the self-employed transition into new, better-paying wage activities.

Labor markets

Labor markets are the mechanisms that enable labor services to be bought and sold. They include wage employment, where employees sell labor services to an employer, as well as self-employment, where workers sell labor services to themselves. Labor markets include both agricultural and non-agricultural activities.

Policies that can raise the returns to the self-employed in their current activities and sectors include:

- adopting a positive policy stance toward the self-employed that avoids hampering them;
- designing productive inputs (such as irrigation equipment) that can raise the productivity of the self-employed;
- providing poor farmers with more to work with, such as more land, equipment, extension and outreach services, and fertilizer and other inputs;
- facilitating off-farm wage employment and self-employment in rural non-farm enterprises;
- making capital available to the poor at affordable rates;
- building skills and business know-how;
- stimulating microfinance and microfranchising.

Other policies can expand opportunities for wage employment so that the self-employed poor can move into more remunerative employment. These include general measures affecting labor markets:

- Stimulating job-enhancing economic growth.
- Working toward a more open, but not predatory, international trade environment.
- Encouraging more foreign aid.
- Harnessing the energies of private companies.

Policies can also include labor market measures aimed specifically at generating more wage employment:

- Avoiding prematurely high labor costs.
- Removing excessive barriers to employment.
- Increasing workers' skills and productive abilities in areas where job vacancies go unfilled because people lack the skills needed to fill them.
- Establishing workfare and other programs aimed at creating jobs for the poor.

The highest priority interventions vary from country to country, and from place to place and group to group within a country. Countries have different objectives and different

trade-offs and constraints on both the policy and the budget sides. The constraints bind differently, the most obstructive constraints differ by circumstances, and the most cost-effective way of intervening to relax the constraints also varies. The World Bank's 2013 *World Development Report* entitled *Jobs* offers an eight-way typology for prioritizing policy interventions for different categories of countries [11].

In all countries, however, policies are needed that provide opportunities for poor, self-employed workers to earn more at their current activity or move into more remunerative activities. To be avoided are policies, evident in many countries, that make life more difficult for the self-employed and deprive them of the opportunity to earn a living.

As always, no single policy or group of policies will work everywhere. But there are some particularly promising interventions that have succeeded in multiple contexts, and some of them are highlighted in what follows.

Some especially promising policy interventions to assist the self-employed poor

Four interventions appear to be particularly effective and could guide future efforts to improve employment opportunities for the poor [2]:

- focusing economic growth on improving the earning opportunities of the poor;
- creating off-farm employment opportunities;
- training people for wage employment; and
- making microcredit affordable.

These policy priorities are not the only potentially powerful policy interventions. Entrepreneurship policies might also be worth pursuing. But these four policy priorities hold particular promise and have demonstrated their effectiveness in a range of settings.

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

Across East Asia, the growth paths pursued by Japan, then the Asian tigers (Hong Kong, Taiwan, Singapore, and South Korea), then the Asian cubs (Indonesia, Malaysia, Philippines, and Thailand), and then China and Vietnam have improved conditions for workers by focusing production not only on the domestic market but also on exports to the rest of the world. The self-employed benefited from this economic growth by remaining self-employed and participating in the expanding supply chain, by being hired into wage jobs, and by taking advantage of government programs previously unavailable or unaffordable to them. The growth in labor earnings spread beyond the target manufacturing sectors in these countries to wage employees and the self-employed in agriculture and services. The benefits of the tighter labor market brought about by economic growth have been widespread.

Creating off-farm employment opportunities in rural areas: India's National Rural Employment Guarantee Act

India's National Rural Employment Guarantee Act (MGNREGA) is the most ambitious workfare program ever attempted. In all 625 districts in India, rural households are

guaranteed 100 days of employment a year. More than just an opportunity to apply for work, this program entitles all rural households to take advantage of the employment guarantee. Program participants include the self-employed, workers in household enterprises, and day laborers. Despite some “operational deficiencies” on the ground (a polite way of saying “corruption”), the program is credited with substantially raising the labor earnings of rural workers.

Training people for wage employment: Mexico’s Bécate program

One way to help the self-employed is to equip them with the skills to fill existing job vacancies. The government of Mexico created the job-training program Bécate (formerly Sicat and before that Probecat) to enable employers to offer training in the skills they need. The government does not prescribe what these skills should be—employers do—so training is offered in specific areas, such as air conditioning repair and lathe operation. Among the beneficiaries are previously self-employed people who are able to move from low-paying self-employment into better-paying wage employment.

Making microcredit affordable: Andhra Pradesh’s Self-Help Group model

Across developing countries, the self-employed would willingly invest in many potentially profitable activities if they could secure affordable credit. But in most countries, the self-employed face extortionate interest rates: 10% a *month* in much of the developing world, 40% a *month* in the Philippines, and 4.7% a *day* in Chennai, India. In the Indian state of Andhra Pradesh, with a population of 80 million people, the government has moved to remedy this situation by establishing a program for banks to lend to groups of women, rather than to individual women, and charge 12% interest a *year*. Borrowers are offered a prompt-repayment incentive by the state government, which gives borrowers a nine percentage point subsidy if they repay their loans on time, lowering their effective interest rate to 3% a year.

LIMITATIONS AND GAPS

The largest gap in understanding self-employment in developing countries is knowing why so many people are self-employed. How many self-employed people came to self-employment after wage employment? Could their wage employment have continued, or were they in casual employment that ended? Are people choosing self-employment because of such non-wage benefits as being one’s own boss and enjoying greater flexibility between work and family responsibilities? What are the roles of family, personal preference, and health status? How do workers’ net earnings in self-employment compare with what they might have earned in wage employment? How do the answers to these questions differ by gender?

Another major gap is the lack of social (rather than personal) cost–benefit analysis of possible policy interventions. How do the direct social benefits of any given intervention compare with the direct social costs? Because there are always policy trade-offs (given scarce resources, money used for one purpose comes at the expense of another), it is important to know which policy intervention produces the highest social benefits relative to its costs. In which circumstances have various policy interventions proved socially beneficial and in which have they not?

Finally, more research is needed to establish how many people are self-employed by choice and how many because they have no choice. The numbers in the second category are clearly large, but greater precision is needed, especially on a country by country basis, to end the controversy over exact numbers.

SUMMARY AND POLICY ADVICE

Self-employment is the predominant mode of economic activity among the world's poor, but because there are few opportunities in most developing countries for the self-employed to earn enough to escape poverty, they are working hard but working poor. Self-employment should be recognized as an important means of providing the poor with a decent livelihood and deserving of support so that the self-employed can escape from poverty.

Two key policy planks in the fight against global poverty should be raising the returns to self-employment and creating more opportunities for poor people to transition from self-employment into higher paying wage employment. Four interventions appear to be particularly effective and could guide efforts to improve employment opportunities for the poor:

- focusing economic growth on improving the earning opportunities of the poor;
- creating off-farm employment opportunities;
- training people for wage employment; and
- making microcredit affordable.

These four measures have demonstrated their effectiveness in a range of settings. Entrepreneurship policies might also be worth pursuing. And, above all, governments should avoid over-regulation that hinders rather than supports the self-employed.

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Competing interests

The IZA World of Labor project is committed to the IZA Code of Conduct. The author declares to have observed the principles outlined in the code.

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