

ERSA Research Brief

May 2019

Who benefits from being self-employed in urban Ghana?

By Adeola Oyenubi

The income gap between the self-employed and wage earners is of interest particular in developing countries. This is because this gap can explain to some extent the observed inequality in income. Literature suggests that in developing countries formal sector workers tend to be wage earners while the self-employed mostly work in the informal sector. Formal sector jobs are limited in supply and are associated with good remuneration and better working conditions in general. On the contrary, the informal sector where most of the population typically find employment is less rewarding in terms of income and associated with difficult working conditions. Furthermore, there is a demographic aspect to the divide between self-employed individual and wage earners. With formal sector jobs favoring the male gender while females and the young dominate the informal sector.

One policy recommendation that has been put forward to mitigate income inequality is making self-employment jobs (in particular) and informal sector enterprises (in general) rewarding and sustainable. To do this successfully there is need to understand who benefits from being self-employed? There is, however, an econometric issue, namely how the unobserved time-invariant heterogeneity enters the model (in the panel data context). This term refers to unobserved covariates that don't change over time like innate ability. The default assumption is that this unmeasured variable is additive in the income equation in which case this component can be eliminated in the estimation without changing the income gap at any portion of the income distribution. The other alternative is to allow this component to have different influence the parameters at different portions the outcome distribution.

Our result suggests that this assumption matter for the result. Specifically, result based on additive fixed effect assumption suggests that self-employed individual at the lower end of the income distribution have incomes that are similar to wage earners. However when this assumption is relaxed self-employed individuals at the lower end of the income distribution pay a significant penalty.

The implication of this result is that as one will expect results are sensitive to assumption. However, this has not been appreciated when quantile effects are being investigated in the labour market context. This difference in result that can be attributed to the difference in the assumption will have implication for labour market policies that are designed to address income inequality.

Lastly, we found that formal sector premium, gender earnings gap and informal sector premium (where it exists) all favour male and older cohorts of workers at the expense of young and female workers.