

Labour Market Power, Self-employment, and Development

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Self-employment opportunities shape the market power of employers in low-income countries, with implications for manufacturing sector growth and industrial policy.

Introduction

The creation of salaried jobs is one of the hallmarks of economic growth. In poor countries, good (stable and formal) jobs are scarce as many local labour markets feature only a handful of medium to large firms. At the same time, self-employment is common – even within manufacturing – and workers switch often between wage work and self-employment. In this research, we ask if this matters for wage employment sector growth and industrial policy.

Using data on firms and workers in Peru, we investigate the extent to which employment at the local level is concentrated in a few firms, and whether this correlates with wages as well as self-employment rates and earnings. We then develop a theoretical model that builds upon the salient data features, estimate it using Peruvian data, and use it to evaluate the impact of different industrial policy instruments.

Data and Methodology

Our study focuses on Peru where, similarly to several other low and middle-income countries, limited wage employment opportunities coexist with high rates of informal self-employment. Our empirical analysis combines balance sheet data on medium and large manufacturing firms with worker-level survey data on employment and earnings from 2004 to 2011.

Firm-level data come from the Peruvian Annual Economic Survey (Encuesta Económica Anual, EEA), a national firm-level survey administered yearly by the national statistical agency (Instituto Nacional de Estadística e Informática, INEI). The data includes standard balance-sheet information, such as revenues and labour and material expenditures, as well as information on the location of each plant. The survey questionnaire is filed electronically and required for all firms with net sales above a given known threshold. As a result, the EEA provides information on the universe of medium and large firms in the wage employment sector.

Worker-level data belong to the Peruvian National Household Survey (Encuesta Nacional de Hogares, ENAHO), which is carried out by the INEI every year to measure households' living conditions and the impact of social programs. The survey covers urban and rural areas and is representative at the national and regional levels.

Respondents aged 14 or older fill out a specific module that includes questions on employment status, pay, and occupation.

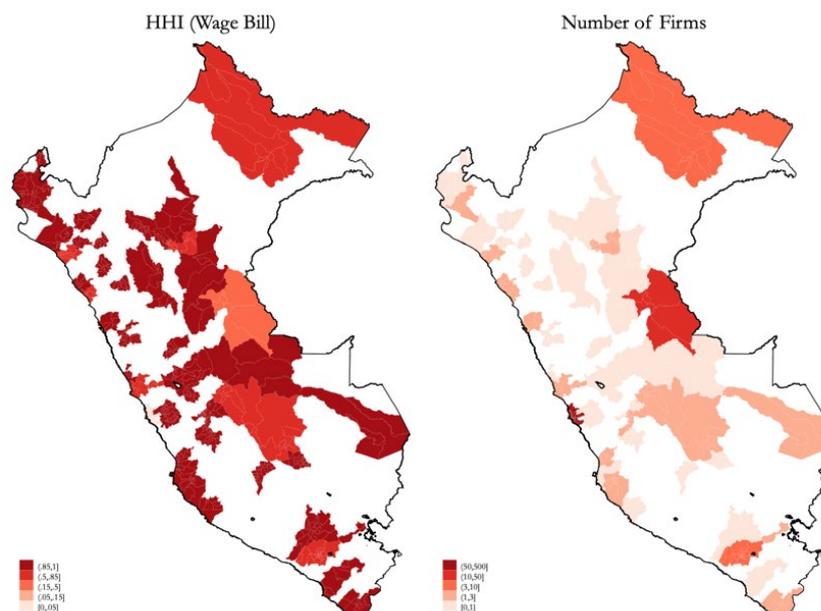
For the purpose of the analysis, we define a local labour market as an industry within a geographical area. We measure concentration among medium and large formal employers in each local labour market using an Herfindahl index of wage bill or employment, or simply the number of operating firms.

Upon developing the theoretical model, we estimate it using the Peruvian data, and conduct two sets of counterfactual exercises. First, we study the transmission of productivity and profitability shocks from firms to workers through wages. Second, we study the aggregate and distributional consequences of industrial policies in our economy with labour market power. We consider three sets of policy instruments that decrease firm entry cost, increase firm productivity, or improve workers' skills.

Main Findings

First, Peruvian local labour markets are highly concentrated. The average local labour market counts about six medium to large firms. Within a local labour market, the probability that two randomly chosen employees work for the same firm is as high as 63%. Around 8% of formal manufacturing employment is in local labour markets with only one medium or large firm. Figure 1 shows the geographical distribution of wage-bill HHI (left panel), and the number of firms (right panel) within the country averaged over the period 2004-2011. For each province, it reports the average concentration across local industries.

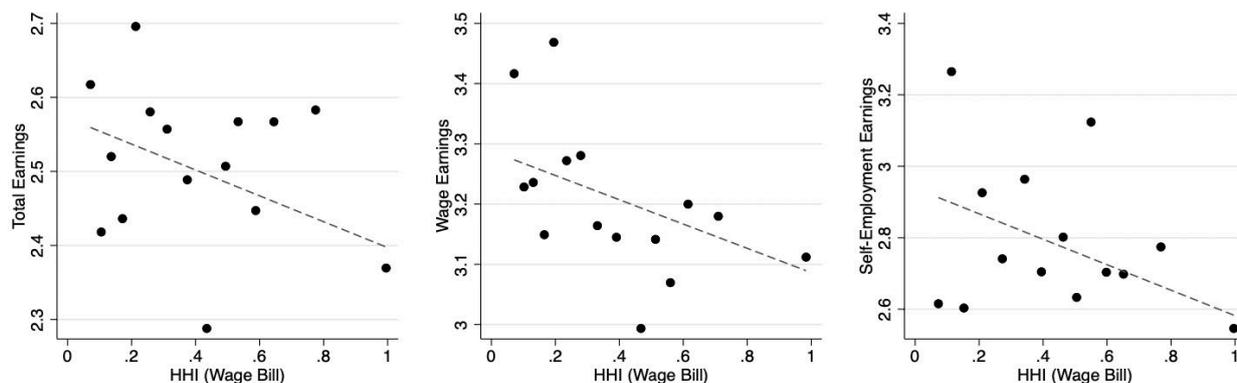
Figure 1: Employer Concentration Map



Second, self-employment is common. In manufacturing, wage workers account for 55% of the workforce while the self-employed account for 40%. Self-employment is almost entirely informal, and more prevalent in labour-intensive industries. For instance, the share of self-employed workers is higher than 50% in clothing and furniture manufacturing as well as other unclassified manufacturing which includes jewellery and trinkets, musical instruments, etc. Self-employment is also a very dynamic sector, with high rates of transitions from and to wage employment.

Third, concentration relates systematically to features of both wage work and self-employment. Where employer concentration is higher, wages are lower, and self-employment is more prevalent but less remunerative, as shown in Figure 2.

Figure 2: Employer Concentration and Earnings



Motivated by these facts, we develop a model where employer concentration as well as wage employment and self-employment rates and earnings are jointly determined in general equilibrium. On the firm side, multiple forces affect their entry decision: the levels of productivity and fixed entry costs, and workers' ability or skill level in the market. On the worker side, workers decide whether to work for a wage or being self-employment according to their skills and earnings in the two sectors.

According to the estimated model and counterfactuals, changes in the level of concentration among employers magnify the transmission of productivity and profitability shocks to wages, but worker sorting across wage and self-employment mitigates these effects. We also find that policies that increase firm productivity are more effective in expanding wage employment and increasing workers' earnings than other interventions that improve workers' skills or decrease firm entry cost.

Policy Impact

Policymakers in low-income countries prioritise the creation of “good” (stable and formal) jobs to sustain inclusive economic growth. These objectives have motivated active industrial and labour market policies promoting wage employment sector growth, with generally modest results. This research shows that taking the market power of employers and the availability of self-employment opportunities into consideration is key to understand the factors determining the success of these policies.

Moving Forward

More research is needed to understand the role of other labour (search costs, migration, etc.) and capital (access to credit, Foreign Direct Investment, etc.) market features for labour market power and industrial policy. We also plan to incorporate in our analysis the process of workers’ transition out of agriculture along the structural transformation path.

This note is based on research conducted as a part of PEDL [ERG 6500](#).