

The Development of Self-Employment in Russia

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February 2001
PONARS Policy Memo 186
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Despite the important economic, social, and political roles the self-employed can potentially play in Russia's market transition process, little is known about the extent of self-employment, the composition of the self-employed (i.e., their demographic and social characteristics), their material standing, and attitudes. We can gain insight into these issues from two nationally-representative social surveys: the Survey of Employment, Income, and Attitudes in Russia, given to 4824 respondents in January-March 1998, and the Survey on Education, Inequality, and Social Change in Post-Soviet Russia, given to 4809 respondents in September-November 2000. Although self-employment has grown relatively slowly, the self-employed have established a firm presence in the Russian workforce. Since 1994 they have represented 4.5% to 6.7% of those working outside agriculture (the standard point of reference, since the agricultural sector has distinct labor market conditions and employment patterns). Most self-employed are engaged in "individual work activity" without hired employees. But both the individually self-employed and small employers report higher levels of income, subjective material satisfaction, and more support for market reforms than most or all other occupational groups. In Russia, as elsewhere, an individual's human capital, current employment status, and industry of employment all influence the odds that they will become self-employed. But unlike in other developed countries, younger Russians enter self-employment more frequently than older or middle-aged Russians. In the United States and Western Europe female self-employment rates gained on men's during the 1990s, but in Russia the "gender gap" in self-employment has shown no signs of shrinking.

Given the material standing, orientations, and composition of the self-employed, the further promotion of self-employment overall (and particularly among the unemployed, the young, and women) would produce a number of economic, social, and political benefits. There are a number of measures that are likely to promote a salutary growth in self-employment, including: following through on the government's efforts to reform and simplify the taxation and regulatory codes, bolstering programs providing financing to individual and small businesses, improving the performance of domestic commercial banks, and targeting self-employment assistance to the unemployed, women, and the young.

Why is Self-Employment Important?

Self-employment plays several vital roles in market economies. The economic, social, and political benefits of self-employment are especially important in societies undergoing market transition. For market transition to ultimately succeed, economic growth must be restored, market institutions must be relied on to alleviate poverty and economic disadvantage, effective and legitimate political institutions must develop, and pro-market attitudes must take hold. Small firms run by entrepreneurs are associated with flexibility, innovation, dynamism, and job creation--all of which contribute to long-term economic growth. Self-employment provides individual opportunities for material advancement, especially to immigrants, those with few educational or financial resources, and, increasingly, the unemployed. The success of small entrepreneurs helps legitimate the market system in the eyes of the larger society. The self-employed also represent a potential counterweight to the undue economic and political influence (state capture) of large corporate interests. Their economic interests make them a constituency for more effective and transparent government institutions and higher-quality governance, both of which would contribute more broadly to Russia's economic and political health.

How Widespread is Self-Employment in Russia?

Russia's reform policies have emphasized macro-economic stabilization and privatization of the state sector rather than the growth of a new private sector. Moreover, Russian commercial banking has been slow to develop, and even slower to provide financing to indigenous small enterprises. High taxes, changing tax rates, and inconsistent applications of tax law have placed undue burdens on small firms. Excessive and changing regulatory regimes have posed strong barriers to entry and expanded the opportunities for corrupt officials to demand bribes from new entrepreneurs. Weak legal institutions increase transaction costs and permit organized criminal groups to demand protection payoffs from new firms and self-employed individuals.

As a result of these conditions, in the 1990s self-employment has grown more slowly in Russia than in Hungary, Poland, and the Czech Republic, not to mention most Western capitalist societies. Nonetheless, by January 1, 2000, there were 890,600 privately owned small businesses operating in Russia, according to official figures. Actual self-employment is certainly more widespread, as these figures do not capture those Russians who are individually self-employed, i.e., those who engage in "individual work activity" as their main source of income.

The survey data offer an alternative to official data for gauging annual self-employment rates among Russians ages 18-59 working outside of agriculture:

PERCENTAGE OF THE ACTIVE WORK FORCE ENGAGED IN SELF-EMPLOYMENT (SURVEY ESTIMATES)

	1991	1992	1993	1994	1995	1996	1997	1998	2000
Individually Self-employed	0.7	1.3	1.9	3.1	3.2	4.6	5.1	4.4	4.3
Employers	0.6	0.8	1.1	1.4	1.6	1.8	1.6	1.6	1.1
TOTAL:	1.3	2.1	2.9	4.5	4.8	6.4	6.7	6.0	5.4

These data show that self-employment grew in Russia in the years following market transition, and has since stabilized in the range of 4.5-6.7% of the non-agricultural workforce. This range puts Russia behind Western and Eastern European countries, where the equivalent rates have approached or exceeded 10% during the later 1990s. Nonetheless, the self-employed have clearly established a solid foothold. The predominance of the individually self-employed also distinguishes Russia from other developed countries. The most common business activities of the Russian self-employed are trading, selling, and street vending, transportation (taxis, trucks), construction, and various services (e.g., medical services, accounting, security, cleaning, personal care, sewing, even astrological consulting).

Material Standing and Political Views of the Self-Employed in Russia

To assess the larger significance of the growth in self-employment, consider the material standing and views on market reform of the self-employed. In early 1998 and late 2000 (the dates of the surveys), both the individually self-employed and employers reported higher average earnings than any other occupational class aside from managers (whose mean earnings were statistically equal to those of the individually self-employed). Also, both contingents of the self-employed reported greater satisfaction with the material situation of their family than any other occupational class, without exception. Finally, the two groups of self-employed voiced higher levels of support for market reforms than any other group: in both the 1998 and 2000 surveys, clear majorities of both groups of self-employed endorsed continuing market reforms. This was also true only for managers and upper professionals in 1998, and for no other occupational class in 2000. In short, self-employment in contemporary Russia is associated with higher earnings, subjective material satisfaction, and support for market reforms.

The high material standing and pro-market views of the individually self-employed in Russia are especially noteworthy. Some studies of other countries portray the individually self-employed as economically marginalized individuals. But although Russian employers generally rank higher on material standing and pro-market views than the

individually self-employed, the latter nonetheless rank above most or all other groups. Whatever the case in other countries, in Russia the individually self-employed should be counted, along with small employers, among the "winners" in the market transition process. Additional growth in the ranks of both the individually self-employed and employers will produce positive social and political, as well as economic, results for the longer-term success of Russia's market transition.

Who Becomes Self-Employed in Russia?

Because self-employment represents a path to material success, it is worth considering which groups of Russians most often avail themselves of this path. Multivariate statistical analyses reveal that the highly educated, males, and those who work in services, trade, and construction are more likely to enter self-employment (controlling for other variables). These effects are also observed in many other countries. However, in some countries the effect of education is curvilinear because the college-educated enjoy great opportunities for lucrative salaries as professional employees of large organizations. The Russian labor market has not evolved to the point where it pays an equivalently high premium for college education, so self-employment--even individual self-employment--remains an attractive alternative for the college educated. As with other countries, in Russia the unemployed and those not in the labor force are more likely than hired employees to take up self-employment, probably because they face lower opportunity costs of becoming self-employed.

Other aspects of "recruitment" to self-employment in Russia are distinct. Younger Russians are the most likely to enter self-employment; the probability of doing so diminishes steadily with age. Elsewhere, self-employment rates are highest among the middle-aged, since they are more likely to have accumulated the necessary experience and resources. The negative age effect in Russia may be a generational phenomenon, as Russians in their 20s today had little adult experience with Soviet-era institutions. In most countries, the "gender gap" in self-employment has diminished in recent decades: not so in Russia, where it has held steady throughout the 1990s. Increasing female self-employment may help reverse the growing feminization of Russian poverty revealed in a recent World Bank report.

How to Encourage Self-Employment in General and Among Targeted Groups

Overall growth in self-employment can be promoted by implementing policies that diminish well-known obstacles to entering and succeeding at self-employment. The Russian government has recently undertaken major overhauls of the Tax Code and the system of business regulations. If these measures are effectively followed through, they promise to reduce the burdens of taxation and regulation that impede small business. Also, by streamlining processes of reporting and complying, they should limit the opportunities for corrupt officials to extract bribes. Thus, successful tax and regulatory reforms should stimulate self-employment.

Lack of financing is a universal impediment to self-employment and to small business growth. In Russia the problem is acute because a healthy commercial banking sector has been slow to develop. International institutions have established programs to provide financing and technical assistance to small entrepreneurs in Russia. One program that appears to be especially successful is the EBRD's Russian Small Business Fund (RSBF), which has been financed with matching contributions from the G-7 nations. From its inception in 1994 through July 1999, the program made over 26,000 loans totaling \$370 million to entrepreneurs across Russia. The EBRD estimates that these loans led directly to 500,000 new jobs. Loans are distributed on a strictly commercial basis by Russian partner banks, who first receive extensive training in retail lending practices. Despite some setbacks associated with the August 1998 financial crisis, the payback rates for loans disbursed through the program have been consistently near 99%. Expanding this program and then initiating similar programs would provide direct financial assistance to worthy micro and small businesses, and simultaneously develop the commercial banking sector.

Financing and technical assistance might be fruitfully directed toward the unemployed, the young, and women. Most European countries, including Hungary and Poland, now encourage the unemployed to enter self-employment by providing some combination of startup funding (bridging allowances or loans), training, and advice. There is some controversy over how effectively these programs promote long-term self-employment. But proper screening procedures to prevent opportunistic behavior, long-term oversight, and technical support increase the odds that they will have a positive impact. Such programs would also signal the government's commitment to encourage self-employment and to improve the lot of the unemployed by helping them help themselves. Because the unemployed and the young already enter self-employment more frequently than others, targeting assistance programs to these groups is likely to be effective. But self-employment assistance programs should also target women, because their economic situation appears especially dire and the labor market offers them fewer opportunities. Assistance to women should include child care and health care benefits, as these may explain why the gender gap in self-employment has persisted so stubbornly in Russia.