



Heterogeneity in subjective wellbeing: An application to occupational allocation in Africa[☆]



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ABSTRACT

By exploiting recent advances in mixed (stochastic parameter) ordered probit estimators and a unique longitudinal dataset from Ghana, this paper examines the distribution of subjective wellbeing across sectors of employment. We find little evidence for the overall inferiority of the small firm informal sector relative to the formal salaried sector at the conditional mean. Moreover, the estimated underlying random parameter distributions unveil substantial latent heterogeneity in subjective wellbeing around the central tendency that fixed parameter models cannot detect. All job categories contain substantial shares of both relatively happy and disgruntled workers.

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1. Introduction

Subjective measures of job and life satisfaction have proven good proxies for both job quality and wellbeing (see e.g. Oswald, 1997; Frey and Stutzer, 2002), important determinants of economic behavior, and powerful predictors of job tenure

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(e.g. Freeman, 1977; Akerlof et al., 1988), productivity (e.g. Oswald et al., 2013) and future earnings (e.g. Wright and Staw, 1999). They are particularly useful tools in assessing the relative desirability of different employment sectors since the weights needed to combine various observable job characteristics into a unidimensional metric are typically not known and may vary across individuals with different preferences (Clark and Senik, 2010),¹ and because some of the most important job attributes may be unobservable. For example, settling the debate over whether self-employment is a desirable option relative to salaried employment has been complicated by the difficulty of measuring and weighting such factors as the appropriate risk premium, aversion to hierarchy, or the value of flexibility. Subjective indicators mitigate these problems by virtue of being comprehensive and relying on individuals' own weighting of various attributes, and consistently suggest the existence of a self-employment satisfaction premium, both in developed and developing countries (Blanchflower and Oswald, 1998; Blanchflower, 2000; Idson, 1990; Benz and Frey, 2008a,b).

However, the central tendency of the satisfaction premium alone may be insufficient to capture the richness of the processes that determine sectoral allocation and subjective wellbeing. For instance, Evans and Leighton (1989) also argue for the presence in self-employment in the U.S. of “misfits cast off from wage work” who are likely to have experienced a fall in satisfaction in the transition from wage to self-employment.² It is thus possible that despite a positive *average* premium in self-employment, for a large share of individuals in the sector the premium is negative. More generally, the notion of latent heterogeneity underpins many matching models of the labor market, and is often appealed to in explaining why agents with identical observable characteristics exhibit differential responses to common shocks, such as policy changes. A crucial feature of these types of models is that individuals differ in the amount of utility they derive from being in a particular job. Such differences may arise from differences in the preferences of the worker, or the characteristics of the job. Hence, exploring latent heterogeneity of satisfaction within sectors is important for our understanding of labor markets.

This paper undertakes such an exploration by using recent advances in stochastic random parameter (mixed) discrete choice models to provide a more complete description of the distribution of subjective welfare across employment sectors. We do so in the developing country context where the role and implications of the extensive self-employed and small firm sector have been intensely debated for decades. We focus on informal employment, defined here as working in private firms with fewer than 5 employees, either as a proprietor or a wage employee. Our definition of informality is out of necessity based on firm size, and not on contract type or social protection, as we lack detailed data on these. In doing so, we build on an established literature³ and international statistical conventions ratified by the International Labor Organization (ILO) and the United Nations (UN), which have long included a firm-size definition of informality as one of their principal metrics.⁴

While the advanced country literature stresses the desirability of independence and being one's own boss that self-employment and the small firm sector offer, the developing country literature has tended to conclude from the attendant lack of social protection, and the association with poverty more generally, that such jobs are the inferior part of a highly segmented labor market.⁵ However, demonstrating segmentation requires showing that, at the margin, utility is not equated across sectors; the existence of marginal utility differentials would imply that workers would be better off working in a different segment of the labor market than the one in which they are employed. Wages have often been used to proxy marginal utility and assess segmentation, but this is problematic since conditional wage premia may reflect compensating differentials for other job characteristics that may be difficult to quantify (e.g. risk, independence, taxes avoided, the perceived value of benefits, or training). Subjective measures of satisfaction offer a useful alternative metric for characterizing the informal sector.

¹ Relatedly, in explaining why objective and subjective poverty measures diverge significantly in Russia Ravallion and Lokshin (2002) suggest that the weights assigned to different elements used to construct objective poverty lines might be inappropriate and that the low dimensionality of the objective measure of poverty misses key dimensions of perceived poverty

² According to Evans and Leighton (1989, p. 532); “The disadvantage theory which views entrepreneurs as misfits cast off from wage work is consistent with many of our findings. People who switch from wage work to self-employment tend to be people who were receiving relatively low wages, who have changed jobs frequently, and who experienced relatively frequent or long spells of unemployment as wage workers.”

³ To give a few examples, in a study on Central America Funkhouser (1996) defines informal enterprises as those having fewer than 5 employees; similarly, in a study of informality in Kenya Livingstone (1991) uses a cutoff of 10 employees; Falco et al. (2011) use a cutoff of 5 employees to define informality in Ghana. Pradhan and van Soest (1995, 1997) and Maloney (1999) consider enterprises with fewer than 6 employees in Bolivia and Mexico, respectively, informal. Marcouiller et al. (1995) adopt a similar definition to define informality in Mexico, El Salvador and Peru.

⁴ The firm size criterium was formally adopted by the International Labor Organization by means of the Resolution Concerning Statistics of Employment in the Informal sector at the Fifteenth International Conference of Labor Statisticians in 1993. The Resolution left the exact size cut-off to be determined according to national circumstances, but in 1999 the UN Expert Group on Informal Sector Statistics (Delhi Group) recommended that for international reporting the size-criterion should be defined as less than five employees.

⁵ Most evidence for segmentation relies on the observation that there is a sizeable formal sector wage premium; larger firms pay workers with otherwise similar observable characteristics more (see Söderbom et al., 2006); and sorting is a key determinant of differences in labor income (Fafchamps et al., 2009). Yet evidence based on longitudinal data on labor market transitions from Latin America (see e.g. Maloney, 1999; Gong and Van Soest, 2002; Gong et al., 2004; Bosch and Maloney, 2006, 2010) suggests that characterizing self-employment as inferior to wage employment may be inappropriate since for many workers self-employment is a desirable alternative to formal sector employment, offering more flexibility and better pay. Although studies of this type are less prevalent in Africa, there are signs that African labor markets may not be highly segmented. To start with, average wages have been surprisingly responsive to unemployment rates (Kingdon et al., 2005). Secondly, while earnings vary systematically across sectors and are higher in formal wage employment, there is tremendous heterogeneity in returns within wage- and self-employment (Falco et al., 2011); many of the self-employed earn more than comparable individuals in wage jobs. Moreover, Günther and Launov (2006) test the dualistic labor market hypothesis by means of a mixture model that allows for endogenous segment selection using data from Cote d'Ivoire and reject it in favor of the Cunningham and Maloney (2001) and Fields (2005) views that argue that the informal sector has its own internal dualism.

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