

## Self-employment and the distribution of income

The number of self-employed people in the UK nearly doubled during the 1980s. Detailed analysis of the income levels of the self-employed, and of older people who have been self-employed during their working lives, shows that the expansion of self-employment has increased overall inequality of incomes in the UK. The study by Nigel Meager, Gill Court and Janet Moralee of the Institute of Manpower Studies found that:

- f** Different types of people have been entering self-employment since the early 1980s, with more women, more young people and more unemployed people setting up in self-employment.
- f** Many of the businesses of 'new' self-employed are found in crowded, low value-added markets, especially in parts of the service sector, where earnings levels and business survival prospects have been relatively poor.
- f** Incomes are more unequal among the self-employed than among employees, with a higher proportion of very wealthy self-employed at one end, and of relatively poor self-employed at the other.
- f** A self-employed person has over three times the odds of being in the poorest tenth of labour incomes than does an employee.
- f** Women are over-represented among the poorer self-employed.
- f** These differences between employees and the self-employed persist in later life. The incomes of older people who have been self-employed are more dispersed than those of employees. Older people who have been self-employed are much more likely to have low savings and pension entitlements and the odds of them being in the poorest 10% of older people are double those of people who have never been self-employed.

### Why did self-employment grow?

Self-employment in the UK grew extremely rapidly during the 1980s; rapidly in comparison with previous UK experience, and rapidly in comparison with what was happening in other countries. Self-employment almost doubled over the period 1979-89, and by 1989 one-in-eight of those in work were self-employed. This development can be attributed to a range of factors, including:

- The growth in unemployment (providing, for some groups, a 'push' into self-employment).
- The expansion of the service sector, where self-employment is more prevalent, and the decline in manufacturing, where it is less common.
- A shift towards 'contracting out' of service activities by larger employers.
- A regulatory environment and financial market in which (in comparison with some other countries) business start-up was both relatively easy and actively supported by public policy.

Self-employment in the UK has not only grown rapidly, but has become highly 'dynamic', with much higher rates of inflow and outflow than in other European countries. This implies that for any given stock of self-employment in the UK, a larger proportion of the working population experiences spells of self-employment during their working lives than is the case in other countries. Self-employment experience may, therefore, be even more widespread within the working population than the total self-employment figures themselves suggest.

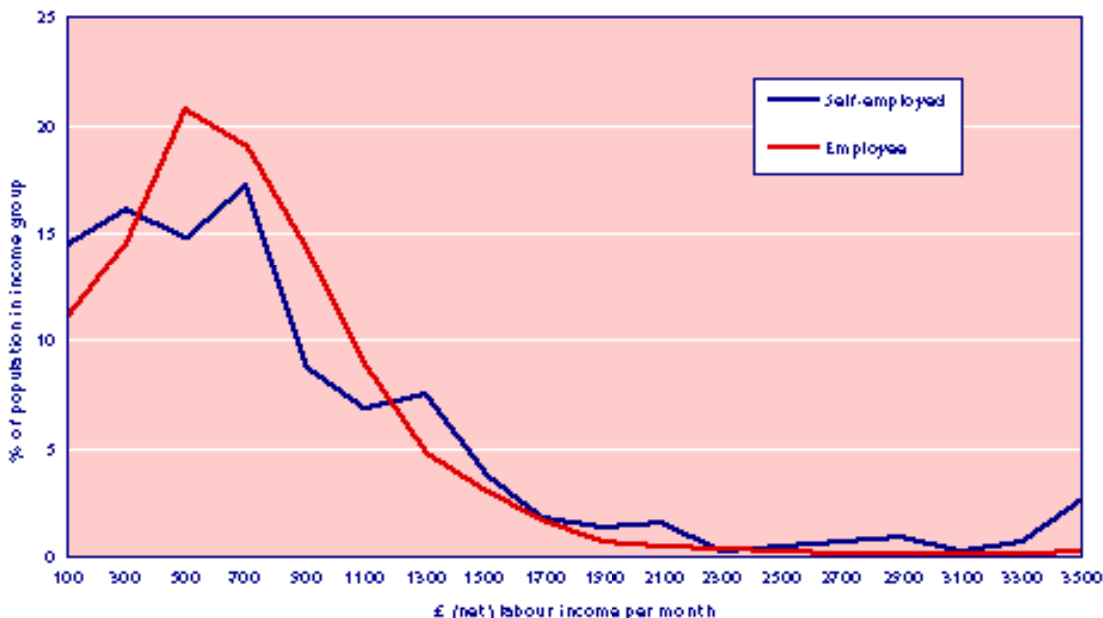
### What kinds of people are becoming self-employed?

To examine the impact of self-employment growth on income levels and distribution, however, we need to look not only at how many self-employed there are and how this has been changing, but also at how the types of people becoming self-employed, and the types of activity they enter have changed. This study found:

- An increasing share of women among the 'new' self-employed, compared with the existing self-employed. Women now account for just over a quarter of the self-employed, up from less than a fifth in 1979.
- Relatively more young people among the new entrants to self-employment.
- A high rate of entry to self-employment from unemployment (compared with other EU countries). This grew strongly during the 1980s.
- A tendency for a disproportionately high share of the 'new' self-employed to enter certain service-sector activities.

Many of these characteristics of the 'new' self-employed are embodied, for example, in the participants of government-funded programmes such as the Enterprise Allowance Scheme (now renamed Business Start Up). A key question raised by these developments concerns the extent to which the 'new' self-employed have both a reasonable earnings potential, and the ability to provide for financial security in later life.

Figure 1: Income inequality greater among self-employed



### What does it mean for incomes?

The study confirms and extends existing knowledge on the incomes of the self-employed, showing in particular that:

- There is a greater dispersion of incomes among the self-employed than among employees, which persists even once differences in hours of work are taken into account (Figure 1);
- There are larger proportions of both very high and very low earners among the self-employed than among employees. The self-employed are thus over-represented in both the richest and poorest ten per cent of earners.

These findings suggest that the growing share of self-employment has increased overall income dispersion in the working population.

Income dispersion among the self-employed themselves also increased strongly during the 1980s with the increase in inequality being particularly due to changes at the lower end of the distribution. A growing share of low-income self-employed is broadly consistent with some of the compositional changes in self-employment identified above. Critical in understanding the reasons for inequality among the self-employed is defining the characteristics of the poorer self-employed.

### Who are the 'rich' and the 'poor' self-employed?

The study shows, in particular, that:

- There are important gender differences, with men over-represented among high earning self-employed, and women among low-earning self-employed (and the latter is only partly due to the greater tendency for part-time work among women).
- Whilst the part-time self-employed are over-represented in the upper ends of the distribution of individual labour incomes (in comparison with part-time employees), the full-time self-employed are heavily over-represented in the lower end of the distribution (in comparison with full-time employees).
- The 'poor' self-employed are disproportionately found in certain sectors of activity, notably 'other services' (eg hairdressing and cleaning), agriculture, and 'other manufacturing' (eg the clothing industry). The 'better-off' self-employed, by contrast are over-represented in sectors such as banking, finance and business services, as well as construction.
- After controlling for other factors (such as age, sector, occupation *etc*), the data suggest that a self-employed person has over three times the odds of falling into

the poorest tenth of the overall income distribution than does an employee (these increased odds persist even if we make a reasonable allowance for under-reporting of income by the self-employed).

- By contrast, the influence of self-employment on a person's chances of falling into the richest ten per cent is not statistically significant, once other factors are controlled for (suggesting that the over-representation of the self-employed in this 'rich' category is not due to their self-employment *per se*, but to other personal or economic characteristics).
- The self-employed have higher levels of non-labour income than their employee counterparts, but even after including this, the greater dispersion of self-employed compared with employee incomes persists.
- An examination of the characteristics of the 'poor' self-employed (those in the lowest tenth of the self-employed income distribution), shows that they are disproportionately likely to be;
  - female;
  - young;
  - in 'other services' occupations (including a range of personal and domestic services);
  - drawn from those who have recently been unemployed or economically inactive; and
  - in a 'dependent' form of self-employment (sub-contractors *etc*)

These are all groups in which self-employment grew particularly rapidly during the 1980s.

### What happens to the self-employed in later life?

Clearly, most of the 'new' self-employed of the 1980s are still in the workforce, and it is not possible directly to examine their income prospects for later life, and the extent to which self-employment affects their pension entitlements and savings base. The study's analysis of data from retirement surveys — where under-reporting of incomes is less of a problem — does, however, throw light on the effects that earlier self-employment has had on the incomes of those currently in old age. The study examines the relationship between periods of self-employment during the working life and subsequent income levels in later life, and the implications of self-employment for the retirement decision. Key findings include:

- Older individuals with self-employment experience had been self-employed for an average of 15 years during their working lives.
- Work histories which include self-employment are associated with greater dispersion of incomes in later life, than work histories which are based only on wage employment.

- After controlling for other personal characteristics, having been self-employed significantly increases an individual's likelihood of falling into a very low income group in later life (it more than doubles the odds of falling into the poorest tenth, for example).
- The ex-self-employed who have worked in certain sectors (distribution, hotels and catering, and some 'other services'), and certain occupations (personal services, sales, transport) are over-represented among the low-income groups in later life, as are those who have spent longer than average periods in self-employment.
- Although the ex-self-employed have higher levels of savings and financial capital in old age than their ex-employee counterparts, there is a significant group with low levels of savings.
- Non-state pensions are the main source of relative prosperity in retirement; the ex-self-employed are generally worse off than ex-employees in this respect. Their relative lack of occupational pensions is only partly offset by a greater access to personal (private) pensions. There is, however, no clear evidence that the ex-self-employed have lower entitlement to state pensions and benefits than their ex-employee counterparts — it seems, rather, that they are more likely than average to be dependent on these.
- Looking at the poorest older people, the ex-self-employed in this low-income group are much more likely than ex-employees to have low or negligible savings levels and no (non-state) pension entitlement.
- Those with self-employment experience tend to retire later than their employee counterparts. There is some evidence that this is associated not only with a desire to continue working but, in many cases, with a (financial) need to do so.

#### About the study

The study was based on an extensive review of existing research and data sources about the incomes of the self-employed, as well as in-depth analysis of three data sets. The first was the UK Labour Force Survey (a survey, previously annual and now quarterly of some 60,000 UK households), which was used to provide a picture of the changing volume and composition of self-

employment. The second was the first wave of the British Household Panel Survey, a new data source, which since 1991, interviews 10,000 individuals annually, drawn from a nationally representative sample of households in Great Britain. The third was a survey of Retirement and Retirement Plans, conducted in the late 1980s on behalf of the Department of Social Security, and which surveyed just over 3,500 people aged between 55 and 69.

#### Further information

The full report of the study, *Self-Employment and the distribution of Income*, is published by the Institute of Manpower Studies, Mantell Building, University of Sussex, Falmer, Brighton BN1 9RF (Tel: 0273 686751) as IMS Report no. 270. The report is available from BEBC Distribution, PO Box 1496, Parkstone, Poole, Dorset BH12 3YD (Tel: 0202 715555) and costs £25.00.

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