Abstract

Dissertation at Uppsala University to be publicly examined in Hörsal 2, Ekonomikum, Monday Mars 3, 2008 at 13:15 a.m. for the degree of Doctor of Philosophy. The examination will be conducted in English.


This thesis consists of three self-contained essays.

Essay 1: Hurst and Lusardi (2004) use higher-order polynomials in wealth in estimating the relationship with entrepreneurship. They find evidence conflicting with the existence of extensive liquidity constraints in the United States. In this paper, their approach is replicated on Swedish data. A positive relationship between wealth and entrepreneurship is found, which supports the liquidity constraints hypothesis. Alternative methods attempting to handle the endogeneity problem and distinguish between absolute decreasing risk aversion and liquidity constraints give further support to the hypothesis. The paper suggests that there exist liquidity constraints in Sweden, which are possibly more extensive than in the United States.

Essay 2: Displacement is expected to decrease the reservation wage of self-employment by decreasing earnings in paid employment and increasing the probability of unemployment. This paper examines whether displacement increases the probability of self-employment using propensity score matching on Swedish register-based data. The data include all individuals displaced due to plant closures in 1987 and 1988, and a random sample of 200,000 employed individuals. The results suggest that displacement almost doubles the probability of entering self-employment the year after displacement. A sub-sample analysis indicates that individuals with a potentially worse position on the labor market react more strongly to displacement in terms of entering self-employment.

Essay 3: A large literature has studied the effect of displacement on labor market outcomes in general, but no one has evaluated how the displaced succeed as self-employed. This paper studies how the survival of the business is affected by displacement in connection to entry, using a discrete-time proportional hazard model on a matched sample of displaced and non-displaced individuals. The main result of the paper is that, as a consequence of previous displacement, the probability of switching from self-employment to paid employment decreases and the probability of switching to unemployment is unaffected.
Acknowledgement

Applying to the Ph.D. program was not exactly something I had planned since my childhood, but rather a spontaneous whim. Although those around me were somewhat surprised, it is a decision I have certainly not regretted. The reason for not regretting it is just as much the satisfaction the graduate studies have given me by allowing me to spend a lot of time on questions I really find it interesting to answer, as the people I have gotten to know in the process.

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Jenny Nykvist
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Introduction

Many claims about self-employment are commonly stated in the public debate, but too often they lack independent empirical evidence. Most of the debate in Sweden focuses on the economic incentives of business ownership that are argued to be low, and complicated regulations. Lack of adequate capital is also commonly raised as an important obstacle to new and expanding business owners. To be able to design self-employment policies creating economic and social prosperity, more empirical facts about these questions and self-employment in general are required. Here, economic research has an important role to play.

Economic research on self-employment and entrepreneurship has its origins in Frank Knight and Josef Schumpeter more than half a century ago. They had different views of entrepreneurs. While Knight viewed entrepreneurs as individuals bearing the uncertainty associated with new ventures by providing capital, Schumpeter emphasized the innovative role of entrepreneurs. Nowadays, more attention is drawn to empirically determining what factors help explain who becomes an entrepreneur, the economic importance and value of entrepreneurship and the role of the government.\(^1\) My thesis contributes to the literature on self-employment and entrepreneurship by three self-contained essays.

In **Essay 1**, I try to bring more clarity to one of the commonly discussed obstacles to business start-ups, namely, liquidity constraints. In the presence of liquidity constraints, less wealthy individuals will be constrained from starting a business. This will not only hinder social mobility but might also create economic inefficiencies as the most talented entrepreneurs are potentially constrained from entering self-employment. On the other hand, people with capital but without any talent may enter self-employment and fail. This is a problem for them but less of a problem for society. In the essay I replicate the method of Hurst and Lusardi (2004) on Swedish data. I use a higher order of polynomials in wealth to find out whether there is a relationship between wealth and business start-up, which would indicate liquidity constraints. The results indicate a positive relationship between wealth and business entry for the main part of the wealth distribution. This result is contrary to those of Hurst and Lusardi (2004), which indicated no extensive liquidity constraints in the United States. Alternative

\(^1\)For a comprehensive overview of the literature on self-employment and entrepreneurship, see Parker (2004).
methods attempting to handle the endogeneity problem between wealth and business ownership and to distinguish between absolute decreasing risk aversion and liquidity constraints give further support to the hypothesis.

**Essay 2** discusses the mechanisms behind self-employment and tries to add evidence on who becomes self-employed. In particular, the essay examines whether displacement affects the probability of entering self-employment, using propensity score matching. Previous literature on displacement has typically found that displaced workers face less fortunate conditions on the labor market, with more frequent and longer spells of unemployment and smaller earnings. The tougher conditions on the labor market imply that the reservation wage for self-employment is decreased, which is expected to result in an increased probability of self-employment entry. Swedish register-based data are used. The data set includes detailed information on all individuals displaced due to plant closures in 1987 and 1988, and a random sample of 200,000 individuals employed in 1986. The findings of the paper suggest that the probability of entering self-employment as a consequence of displacement has almost doubled. Hence, the result supports the recession-push hypothesis, which predicts a higher self-employment rate in times of high unemployment, in the sense that individuals seem to respond to job-losses by entering self-employment. A sub-sample analysis suggests that individuals with a worse position in society and on the labor market are more likely to become self-employed in response to displacement.

Individuals who lose their jobs hence seem to be more likely to enter self-employment than non-job-losers. The natural following question is how those who enter due to displacement will manage as self-employed. Are individuals who are pushed over the threshold as successful as others? Will worse outside options result in the displaced remaining self-employed to a larger extent? **Essay 3** studies these questions by estimating the effect of displacement on self-employment survival using the same data as in the second essay. Based on the previous evidence of worse conditions on the labor market, the displaced are expected to remain longer in self-employment. Based on lower entrepreneurial ability being sufficient for self-employment to yield the highest expected utility after displacement, however, less able individuals may select into self-employment. This should increase the failure rate. A two-step approach is
employed to identify the effect of displacement on survival. In the first step, propensity score matching is used in order to create a matched sample of displaced and non-displaced individuals. Then, a duration analysis is carried out on those individuals from the matched sample who select into self-employment. A discrete-time proportional hazard model indicates that displacement decreases the probability of leaving self-employment for employment while the risk of leaving for unemployment is unaffected. The interpretation of the results is that displaced individuals remain longer in self-employment due to worse outside options but there is no evidence of different selection processes into self-employment implying a larger failure rate for the displaced as compared to the non-displaced.

How can the results from the essays of this thesis contribute to the self-employment policy debate? In the third essay, the result suggests that the displaced do not fail to a larger extent and hence, it does not seem as if the self-employment entry decision crucially depends on pay-off. Although the result should be interpreted with caution it does, together with similar previous evidence (see, for instance, Parker (2003)), suggest that self-employed do not necessarily respond to economic incentives. The result would certainly surprise or, at least, conflict with the arguments that improving the economic incentives would increase the number of entrepreneurs. Whether Sweden, or any other country, needs more self-employed is a further question. It is difficult to empirically decide whether a country were to gain if more self-employed were to enter the market and whether all entries entail a positive contribution. Within the Global Entrepreneurship Monitor project, for instance, a major finding is that only those self-employed who enter because they have the perception of having an unexploited business opportunity, as compared to those who enter due to the lack of better options, will have a positive effect on the welfare of society (see, for instance, Harding and Bosma (2006)). Although more research on the subject is needed, the result highlights the fact that more self-employed might not always be better. Instead of focusing on increased economic incentives and ‘the more self-employed the better’, a more fruitful debate would focus on policies creating the most successful pool of business owners possible. In the first essay of the thesis, liquidity constraints are shown to be an obstacle to self-employment entry. Policies eliminating those liquidity constraints and other potential obstacles as complicated and elusive
regulations, which create inefficiencies in the sense that not necessarily the individuals with the best business concepts become self-employed, would have the highest probability of being gainful to the whole society and not only the self-employed. Such policies would in addition make social mobility prosper.

References


