Editor’s note

Both labour economists and the general public tend to entertain several very disparate stereotypes of the “self-employed”. One such stereotype is the prosperous and stable professional: the doctor, lawyer, dentist, or accountant. Another is the immigrant working long hours for a low income, perhaps “pushed” into self-employment by racial or ethnic discrimination. There is the new home business, made possible by advances in computer and Internet technology, supplying business services, creative services, or selling a niche product on line. Not to be forgotten is the displaced middle-manager, labeling himself as a “consultant”, but who might be more accurately described as unemployed. Finally, the clever tax-minimizer has set up a business alongside her regular paid work to take advantage of strategic deductions. She may even have given up paid work but — with her former employer’s cooperation — continues to perform the same services as before outside the purview of a variety of regulations and taxes.

Which of the above stereotypes, or which weighted combination of these stereotypes, best characterizes self-employed people today? Given that, what factors contribute most to the growth and survival of self-employed businesses, and what (if anything) should be done to encourage them? What are the effects of a spell of self-employment on workers, and what are the effects of a high self-employment rate on national economic performance?

The above questions were the focus of an international conference on self-employment, held on September 24–26, 1998, in Burlington, Ontario, Canada. This conference was jointly sponsored by the Local Economic and Employment Development (LEED) Programme of the Organization for Economic Cooperation and Development (OECD), the Canadian Employment Research Forum (CERF), and the Canadian International Labour Network (CILN). A central premise of the OECD/CERF/CILN conference was the potential value of an international perspective in shedding new light on the nature, determinants and effects of self-employment. Almost all previous analyses of self-employment had considered only a single country at a time, in the vast majority of cases the US. While valuable in their own right, these studies cannot take advantage of the tremendous international variation in institutions, demographics, and economic conditions that
might help shed light on self-employment. For this reason, conference submissions were invited from a wide variety of countries, and special encouragement was given to cross-national analyses.

This issue of *Labour Economics* contains seven papers selected from the proceedings of the OECD/CERF/CILN conference. All of them were subject to this journal’s standard refereeing process. Three of the articles are cross-national in scope (Blanchflower’s on 23 OECD countries; Earle and Sakova’s on six transition economies; and Schuetze’s pooled analysis of 50 US states and 10 Canadian provinces). Of the remaining papers, two (Bruce and Williams) address novel questions about self-employment using US data, one is on Germany (Pfeiffer and Reize) and the other on the United Kingdom (Clark and Drinkwater). Together, I believe they shed some important new light on a number of questions concerning self-employment.

David Blanchflower’s paper begins, usefully, with an up-to-date survey of the economic literature on self-employment, which places this entire volume into perspective. Clearly, this once-neglected area is emerging as a new focal point for research in labour economics. A substantial amount is now known about the empirical correlates of self-employment on the individual level, including the role of demographic characteristics and of liquidity constraints. At the same time, surprisingly little work is available on the institutional determinants of self-employment, among them the tax system (this might be, in part, a result of the typical one-country focus of most existing research). Finally, a recurring question in much of the existing research concerns the cyclical aspects of self-employment — do recessions push unemployed people into self-employment, or does self-employment tend to rise when a booming economy offers more abundant opportunities? As Blanchflower points out, the literature has not reached anything approaching a consensus on this issue.

Blanchflower’s own research shows the following. First, there remains a widespread downward trend in total self-employment rates in most countries, associated with a continuing decline in the relative importance of agricultural employment. Abstracting from this effect, however, there is no clear trend in non-agricultural self-employment rates across countries: in 1996, non-agricultural self-employment rates in a sample of 23 OECD countries ranged from 5.4% in Luxembourg and Norway to 25% in Greece. Between 1966 and 1996, non-agricultural self-employment rates fell in 11 of those countries, rose in 11 of them, and was unchanged in one.¹ This tremendous heterogeneity suggests the importance of factors — such as institutional ones — which vary across countries rather than oft-cited factors like de-industrialization, feminization of the labour force, technological change, or an aging population, which are shared by most OECD countries.

¹ 1966 Data are unavailable for Greece, New Zealand and Turkey; in these countries, more recent starting points are used. See Table 2 in Blanchflower (this volume).
In his microeconometric analysis of pooled individual data from 19 countries, Blanchflower finds some common patterns across all countries: self-employment rates rise with age, are higher for men than women, exhibit a U-shaped relation with education, and increase (at least for men) with household size. As suggested by the lack of consensus in existing work, Blanchflower’s analysis of cyclical effects on self-employment rates yields mixed results, which vary across countries and depend on the precise specification of the dependent variable.

What are the effects of self-employment? On the individual level, Blanchflower reports that a remarkable 63% of Americans, 48% of Britons and 49% of Germans would prefer to be self-employed to being employed for pay. The relatively few who actually achieve self-employment are happier than the non-self-employed. A high self-employment rate, however, does not increase an economy’s flexibility, at least in some dimensions. In a sample of 13 OECD countries, self-employed people indicate significantly less willingness than others to relocate geographically to improve their work or living conditions.

The theme of institutional effects on self-employment, suggested by Blanchflower’s data, is taken up by Herb Schuetze in a novel kind of cross-national analysis. Arguing that broader international comparisons might be contaminated by too many hard-to-control differences, Schuetze focuses on two very similar countries: Canada and the US. The countries are distinguished, however, by different tax regimes, macroeconomic conditions and self-employment rates, all of which also vary substantially on a subnational level in both countries. Schuetze thus assembles a panel of US states and Canadian provinces over 12 years to assess the importance of taxes and economic conditions on self-employment rates.

Certainly, the broad Canada–US differences and trends are consistent with a tax hypothesis: Canada — not widely reputed to be a more “entrepreneurial” or risk-loving country than the US — has much higher income tax rates and a higher non-agricultural self-employment rate throughout the period under study. Further, between 1983 and 1994, both the overall level of income taxation and the self-employment rate increased in Canada, while the opposite occurred in the US. This crude evidence is supported by microeconometric analyses using provincial or state “tax climate” variables, with a variety of fixed effect and time trend variables to correct for unobserved heterogeneity. Schuetze also finds that high local unemployment tends to “push” both Americans and Canadians into self-employment, though these effects are smaller in magnitude than the tax effects.

By what mechanism does the tax environment affect the self-employment decision? Useful details on this issue emerge from Donald Bruce’s analysis of US men’s transitions into self-employment. Using waves of the Panel Survey of Income Dynamics from 1979 to 1991 — a period which contained important changes to the relative tax treatment of self-employment versus wage income — and adjusting in a variety of ways for the potential endogeneity of an individual’s tax rates, Bruce finds, as expected, that a higher relative average tax rate in self-employment reduces the entry rate into self-employment. Perhaps unexpect-
edly, however, an increase in the relative *marginal* tax rate in self-employment has the opposite effect, actually raising transitions into self-employment. One interpretation of this result, as both Bruce and Schuetze argue, is that the primary mechanism via which taxes affect self-employment decisions is via under-reporting of income (and potentially over-reporting of expenses) among the self-employed: holding the average tax rate constant, the advantages of underreporting *increase* with the marginal tax rate.

A very different context in which to examine self-employment is the transition economies of Eastern Europe. This area is examined by John Earle and Suzana Sakova, who consider the determinants of self-employment in Bulgaria, Czech Republic, Hungary, Poland, Russia and Slovakia. Certainly, the role of self-employment in the transition to a market economy, marked by a massive wave of industrial reorganization and high unemployment, is of key interest in its own right. In addition, however, Earle and Sakova argue that the abrupt nature of the transition from communism to free markets in these countries provides a unique “quasi-natural” experiment with which to address a number of more general and long-standing questions about self-employment. The socialist economy, they argue, may have reduced the correlation between family background and wealth that plagues other attempts to assess the importance of liquidity constraints in the self-employment decision. Another key contribution of Earle and Sakova’s study is their ability to distinguish the “own-account” self-employed (i.e. those without employees) from those with employees, an important distinction which is not made in most other analyses of self-employment.

Earle and Sakova find, first of all, that there has been a large increase in self-employment in all six countries since the transition. Post-transition self-employment probabilities, both own-account and as an employer, are strongly related to both pre-transition income and the receipt of property through restitution, suggesting — as argued above — a role for liquidity constraints. Interestingly (despite popular perceptions to the contrary), political connections to the former communist party do not appear to increase self-employment after transition. Finally, the authors find that individuals with a high predicted earnings advantage in (non-own-account) self-employment are more likely to occupy that state, while the opposite is true for the own-account self-employed: paradoxically, own-account self-employment becomes more likely the lower one’s relative earnings are in own-account employment. Earle and Sakova argue that this suggests rationing: the own-account self-employed are simply unable to find better-paying paid employment. As a result, the post-transition increase in own-account self-employment may represent, in part, a “push” out of better-paying jobs related to the wave of mass layoffs and displacements during the transition.

The subject of self-employment among ethnic minorities and immigrants has been considered by a number of authors in the US, among them are Borjas and Bronars (1989) and Fairlie and Meyer (1996). Much less is known in other countries, a gap which is addressed in part by Kenneth Clark and Stephen
Drinkwater’s useful analysis of the high self-employment rates of ethnic minorities in England and Wales. Perhaps unsurprisingly, Clark and Drinkwater find that, among minorities, those individuals with low English fluency and who immigrated recently are less likely to be self-employed. More surprisingly, in contrast to the hypothesis that ethnically-homogeneous enclaves provide a self-employment “haven” from discrimination, Clark and Drinkwater find lower minority self-employment rates in such areas. Finally, as Earle and Sakova found for the non-own-account self-employed, Clark and Drinkwater find that individuals with a large predicted earnings advantage in self-employment are more likely to be self-employed. Interestingly, they label this responsiveness to the earnings differential as a “push” factor (referring to the possible effect of discrimination on the level of the paid wage), unlike Earle and Sakova who identify it with the “pull” of greater earnings opportunities.

Clearly, the “push-versus-pull” question will continue to figure prominently in future analyses of self-employment. But as the articles in this volume (and elsewhere) demonstrate, it is unlikely to be answered by structural probit coefficients on the relative wage in paid - versus self-employment: a high relative wage in self-employment can be caused either by a high wage in self-employment (“pull”) or a low wage in paid work (“push”). Time-series analyses of the effects of aggregate economic conditions on self-employment rates offer a more conceptually-appropriate test of the “push-versus-pull” hypotheses, but as already noted, they yield estimates that differ widely across countries, data sets and time periods.

Taking it as given that at least some individuals are “pushed” into self-employment by low-quality or scarce job opportunities, some countries have decided to augment this “push” with explicit policies. Policies designed to help unemployed workers start a business play a significant role in the unemployment insurance systems of Canada and Germany, and a smaller, largely experimental role in some US states. How well do these policies work? In a careful analysis of German data, Friedhelm Pfeiffer and Frank Reize report that these policies led to a sharp rise in the number of business startups by unemployed persons after 1994. Of course, the ultimate success of these policies should be judged not just by the number of new businesses created but by their survival rates — a question at the heart of Pfeiffer and Reize’s analysis. Comparing businesses started under the unemployment assistance program to other new businesses, Pfeiffer and Reize find that foundation from unemployment reduces 1-year survival rates by about 6%. At the same time, however, the level of the 1-year business survival rate in Germany is an astonishing (by US standards) 90%, and subsidized German startups have similar employment growth rates to nonsubsidized startups. Although Pfeiffer and Reize appear skeptical, this might indicate that self-employment assistance for unemployed workers should be further explored as a complement to the standard unemployment insurance system, both in Germany and elsewhere.

Suppose a person has had a spell of self-employment which, for any number of possible reasons — both voluntary and involuntary — has now ended. How does
this affect their current success in the paid labour market? To my knowledge, this question had not been posed until 1998, when Donald R. Williams wrote his article for this volume. Williams’ question has an important bearing on the econometric analysis of self-employment decisions because — unless future earnings are completely unaffected by a spell of self-employment — the costs and benefits of self-employment may go well beyond the current wage and/or earnings that enter into most econometric models of sector choice. The entire future stream of earnings or wages can be altered, even if the self-employed person eventually returns to paid employment.

Aside from its implications for the self-employment literature, Williams’ question also makes an important contribution to a very different literature: the literature on the gender–wage differential. Ever since Mincer and Polachek (1974), labour economists have been interested in the role played by career interruptions in explaining the relative earnings of women and men. Typically, these analyses have focused on spells of unemployment, or (more importantly for women) of nonparticipation. Using data from the US National Longitudinal Survey, Williams poses the same question for spells of self-employment. Interestingly, currently-employed women pay a substantial earnings penalty for a previous spell of self-employment, while men do not: men’s self-employment experience is rewarded at the same rate as their experience in paid employment, even if they are not currently self-employed. Williams’ result thus adds a useful new piece to the large and important puzzle of why women earn less than men in all industrialized countries.

Among the many new results in this volume, is there any single lesson that emerges as most important? If forced to make a choice, I would pick the following: institutions, especially taxes, probably matter a lot. Fundamentally, self-employment and paid employment can be thought of as alternative forms of contracting for the delivery of a service. Although some very large-scale activities (perhaps automobile assembly?) may be very difficult to organize through a series of contracts with self-employed providers, many labour services can be relatively effectively provided under either form of contract. Given a reasonable degree of substitutability between contractual forms in enough kinds of activity, it seems likely that any fiscal or legal considerations that make one form more attractive than the other can have substantial effects on measured self-employment rates. While definitive proof of the central role of legal and tax factors in international self-employment differentials remains elusive, the econometric results of Schaezle and Bruce, as well as the wide divergence in both the levels and trends of non-agricultural self-employment across industrialized countries documented by Blanchflower, strongly suggests the importance of country-specific factors such as

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2 Ferber and Waldfogel (1998) simultaneously considered some closely related issues, but did not conduct separate analyses for the currently employed versus the currently self-employed.
these, rather than industrial and demographic trends which are shared by most OECD countries.

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References


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