

Does Self-Employment Increase the Economic Well-Being of Low-Skilled Workers?

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Self-employment is growing and becoming an increasingly more important form of employment in the U.S. There is also a common perception that self-employment and microenterprises are engines of job growth. The importance of entrepreneurship is reflected in state and federal policies, as well as numerous non-profit organizations, efforts to promote business start-ups and to assist business owners. Recently, this is reflected in the American Recovery and Reinvestment Act of 2009 (ARRA) which includes stimulus funds to the U.S. Small Business Administration (SBA) with the intent to spark business start-ups. Among the groups directly affected by ARRA are low-skilled entrepreneurs. One of its provisions is an expanded micro-loan program which targets low-income individuals.

The number of self-employed in the U.S. has steadily increased over the last decades, from 9.9 million in 1980 to 17.3 million in 2007. Women and immigrants play key roles in the self-employment growth but they do so in different skill segments. Among college graduates, U.S. born women accounted for the greatest increase in the number of business owners while immigrant men contributed the greatest boost to the number of low-skilled entrepreneurs. Although the self-employment rate of low-skilled native born increased over this period, the data reveal that vast majority of the increase in the number of low-skilled business owners is due to immigrants. We also show that today there are more low-skilled business owners in the U.S. (6.9 million) than there are entrepreneurs with a college degree (5.6 million).

Low-skilled workers do not fare well in today's skill intensive economy and their opportunities continue to diminish. Given that individuals in this challenging skill segment of the workforce are more likely to have poor experiences in the labor market, and hence incur greater public expenses, it is particularly important to seek and evaluate their labor market options. Utilizing data from the decennial census, the American Community Survey and longitudinal data from the Survey of Income and Program Participation, the research provides a comprehensive analysis of the economic returns to business ownership among low-skilled workers - defined to be individuals with no more than a high school degree- and addresses the essential question of whether self-employment is a good option for low-skilled individuals that policymakers might consider encouraging.

Our empirical analysis of low-skilled workers reveal that although top earning entrepreneurs earn more than top earning employees, most low-skilled business owners have lower annual earnings than low-skilled workers in wage/salary employment. This is true in spite of entrepreneurs possessing more of the characteristics typically associated with higher earnings, such as being on older and working more hours per week than employees.

Our analysis of earnings growth reveals that the long-run financial gains to low-skilled self-employment are relatively high for men, who are found to have higher earnings growth than wage/salary earners and are predicted to have as high or higher earnings than employees after approximately 13-14 years in business for U.S. born business owners and somewhat sooner among immigrant entrepreneurs. Self-employed women are not expected to reach the earnings of women in wage/salary employment in the long-run. Using poverty alleviation as an alternative way to evaluate the gains to low-skilled self-employment we find that the earnings of low-skilled self-employed men is above the poverty levels relevant to most entrepreneurs after about 3 and 10 years in business respectively for U.S. and foreign born men. Most female entrepreneurs will not be able to reach the earnings above the poverty level for a family of three.

While the returns to low-skilled self-employment among men is relatively high we find that wage/salary employment is a substantially more financially rewarding option for most women. Although our analysis reveal that the lower returns among women is partly due to less favorable previous labor market experiences, many enter from non-employment, the low economic rewards to business ownership raises the question of why low-skilled women choose self-employment over wage/salary employment. Focusing on child care availability and limited opportunities in the wage/salary sector as motivations for self-employment entry, we examine whether presence of young children and previous labor market experience play a role.

Among native born workers, we find evidence that women with young children are more likely to enter self-employment than men with young children. The empirical analysis also shows that unemployment increases the probability of a business start-up more among U.S. born women than men. The results suggest that lack of affordable child care options and limited labor market opportunities in the wage/salary sector motivate women to enter self-employment. Empirical evidence supporting this is weaker for low-skilled immigrant women.