

A Life-Cycle Model of Entrepreneurial Choice: Understanding Entry into and Exit from Self-Employment*

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Abstract

Data from the 1979 cohort of the National Longitudinal Survey of Youth (NLSY79) show that the average percentage that (nonfarm or nonprofessional) self-employment occupies of all yearly labor supplies by young (ages 20-39 in years 1979-2000) white males is as high as 7 percent, while nearly 30 percent of individuals in the data have at least one year of experience as a self-employer in the covered years. The goal of this paper is to give a coherent framework that accounts for these two contrasting figures which together suggest the importance of understanding not only entry into but exit from self-employment as well. Specifically, I present and estimate a life-cycle model of entrepreneurial choice and wealth accumulation, using a subsample of white males aged 20 to 39 from the NLSY79. It also includes two basic components of human capital (educational attainment and labor experience) with intent to better capture observed patterns of labor supply as well as those of income profiles and wealth accumulation over the life cycle. The estimation results show that nonpecuniary benefits from continuing self-employment are relatively large to yield the observed persistence of being self-employed. Policy experiments with the use of the estimated model, however, indicate that pecuniary factors also have large impacts on the formation and continuation of self-employed businesses. Specifically, I find that while both direct subsidies for self-employment and enhancement of human capital specific to self-employment only encourage entries with short duration, relaxation of borrowing constraints encourages entries into self-employment and makes the average duration longer, especially for the non-college educated.

Keywords: Self-Employment; Entry and Exit; Human Capital; Borrowing Constraints

JEL classification numbers: J21 (Labor Force and Employment, Size, and Structure); J24 (Human Capital; Skills; Occupational Choice; Labor Productivity); L26 (Entrepreneurship)

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