Self-employment and the role of health insurance in the U.S.

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Abstract

We investigate the role of health insurance coverage in explaining transitions in and out of entrepreneurship in the U.S. We first consider the effect of individual coverage, along with that from a spouse, on the likelihood of entry and exit. Next, we examine the tax deductions granted to the self-employed through amendments made to the 1986 Tax Reform Act. Using the Current Population Surveys for 1996–2007, we find that while the increasingly generous tax deductions left entry decisions largely unaffected, they had limited effects on exits. Thus, the health care system in the U.S. may have implications for entrepreneurial activity.

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1. Executive summary

At the individual level, the decision to enter entrepreneurship involves assuming various forms of uncertainties associated with running a new business venture. Leaving wage/salary employment for entrepreneurship often means risking the security of a steady source of income. The unique health care system in the U.S. poses an additional challenge for those who consider engaging in entrepreneurial activity because departing a wage/salary job often means losing access to good health care coverage as well. The U.S. is the only major industrialized country without universal health care. The cost and availability of health insurance in the U.S. has long been identified as a major concern for smaller businesses. The self-employed and those who work for very small businesses (fewer than 10 employees) make up more than a third of uninsured working non-elderly in the U.S. (Fronstin, 2013).

With a few notable exceptions, the established literature has overlooked the possibility that the health care system in the U.S. may have implications for entrepreneurial activity. Instead, the existing studies have primarily focused on whether health insurance factors significantly reduce the labor market mobility of wage/salary workers, i.e. “job-lock.” In this paper, we address the gap in the

Representatives, Nancy Pelosi, stated that, international disparity. The recent health care reform, under the Affordable Care Act (ACA) of 2010, attempts to address some of and SE in the economy. They cite the employer-based health care system in the U.S. as one of the a possible explanations for this analyze data from 22 rich OECD countries and rank the U.S. near the bottom in terms of its proportional size of small businesses identification, namely a series of amendments made to the 1986 Tax Reform Act between 1996 and 2003 that allowed entrepreneurs to deduct a gradually increasing portion (from 25% to 100%) of their health insurance premiums from their taxable income. We show that the increasingly generous tax deductions offered to the self-employed had a limited effect on entrepreneurial survival without much of an impact on the entry decisions. Therefore, offering tax deductions alone, without adopting other policies in the U.S. health care system, may not provide sufficient incentives to increase the attractiveness of entrepreneurship.

2. Introduction

While other industrialized countries have universal health care systems, health care coverage in the U.S. has largely been tied to full-time wage/salary (WS) employment. It is estimated that in 2011, the majority (56%) of non-elderly Americans received health insurance through their employer or their spouse’s employer (Kaiser Commission on Medicaid and the Uninsured, 2012). This link arose and persisted for decades for various reasons including the nature of the U.S. tax system and the economies of scale achieved when insurance is sold to large firms. As a result, those who are left out of the current arrangement, including the self-employed (SE) and small business owners, are more likely to be uninsured. Our own calculations, based on the Current Population Survey (CPS), reveal that about 28% of SE persons were without health insurance during the period 1995–2005, while only 10% of full-time WS workers lacked coverage.

Over the last few decades, per capita health care spending in the U.S. has grown more rapidly than the overall economy and has similarly outpaced the growth in other industrialized nations as well (KFF, 2010; U.S. CBO, 2008). Unpaid medical bills are estimated to be the top reason for bankruptcy filings, surpassing credit-card bills or unpaid mortgages (Mangan, 2013). According to the U.S. Small Business Administration (2009), the cost and availability of health insurance had been the top concern for small businesses up until the most recent economic downturn. There are various difficulties and expenses associated with finding, qualifying, and obtaining private coverage in the non-group health insurance market. A 2010 Kaiser Family Foundation survey (KFF, 2010) reveals that the most common reason why individuals purchase their coverage in this market is because they are SE or a small business owner (45% of all responses). The 2006 U.S. Census Bureau’s Statistics of U.S. Businesses figures confirm that the SE make up more than 80% of all small businesses with less than 10 employees and that they constitute about 78% of all small businesses with less than 500 employees.

The role of entrepreneurial activity in a capitalist economy is vital, as it is often credited with encouraging competition, introducing new ideas and technology, creating jobs, and promoting economic growth (e.g., Acs and Armington, 2006; Audretsch et al., 2006; Moore, 2003; Thurik et al., 2008; van Praag and Versloot, 2007). At the individual level, however, workers face substantial uncertainties when they consider leaving relatively more stable WS jobs behind to start up their own businesses. In the U.S., they face an additional challenge of losing “the guarantee of subsidized health insurance coverage sponsored by the employer for the uncertainty of the non-group health insurance marketplace” (Blumberg et al., 2013). Schmitt and Lane (2009) analyze data from 22 rich OECD countries and rank the U.S. near the bottom in terms of its proportional size of small businesses and SE in the economy. They cite the employer-based health care system in the U.S. as one of the a possible explanations for this international disparity. The recent health care reform, under the Affordable Care Act (ACA) of 2010, attempts to address some of these problems and create opportunities for coverage outside of typical employer arrangements. The speaker of the U.S. House of Representatives, Nancy Pelosi, stated that, “this legislation will unleash tremendous entrepreneurial power into our economy” (Tozzi, 2010). However, it is not clear as to what extent such efforts will foster entrepreneurship.

For the most part, the established literature has overlooked the possibility that the U.S. health care system may have implications for entrepreneurial activity. Existing studies have primarily focused on the link between WS employment and health insurance to determine whether there is any job-lock, and if so, how much. Job-lock, or entrepreneurship lock, occurs when a WS worker’s job mobility is reduced for fear of losing his/her employer-sponsored insurance (ESI). This may lead to reduced job search and hence, labor market inefficiencies may occur. This paper investigates the role of health insurance in explaining labor market transitions with a special emphasis on the SE, thus extending the notion of job-lock to entrepreneurial endeavors. Specifically, we examine the decisions of (i) entering SE from WS employment, and also (ii) exiting SE and instead becoming WS.

We begin by following much of the mainstream job-lock literature (e.g., Buchmueller and Valketta, 1996; Madrian, 1994) and consider variations in individual and spousal insurance coverage. Next, our preferred set of models exploit an exogenous source of identification, namely a series of amendments made to the 1986 Tax Reform Act (TRA86). The TRA86 granted SE persons the ability to deduct 25% of their health insurance premiums (purchases for their own as well as their spouse and dependents) from their taxable income. Between 1996 and 2003, a series of amendments were made to the TRA86, which gradually increased the deduction from 25% to 100%. We analyze the entire set of amendments and study whether they improved the chances of
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