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# Taxes, economic conditions and recent trends in male self-employment: a Canada–US comparison

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## Abstract

North American workers have increasingly turned to self-employment since the 1970s. Using microdata for the period 1983–1994 from Canada and the United States, I assess the importance of macroeconomic conditions and the tax environment in explaining the trends in male self-employment in these two countries. My findings suggest that higher income tax and unemployment rates are associated with an increase in the rates of self-employment among North American men. Changes in the tax environment account for a considerable amount of the secular trends in male self-employment over this period, while changing economic conditions played a smaller role in determining these trends. © 2000 Elsevier Science B.V. All rights reserved.

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## 1. Introduction

The resurgence of self-employment in the United States has recently attracted the attention of a number of researchers (e.g., Blau, 1987; Evans and Leighton, 1989; Devine, 1993). Attempts to explain this phenomenon have however met

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with only limited success, for a number of reasons. First, standard shift-share analyses tend to show that the factors most commonly invoked to explain this trend — industrial restructuring, and shifts in the demographic composition of the workforce — typically can account for only a small fraction of the observed changes. Second, another commonly invoked explanation — changes in technology — remains very difficult to test, and in practice is often simply treated as a label attached to otherwise unattributable changes.

Finally, although this is not typically noted in the literature, there is a third reason to be skeptical of structural and technological explanations of rising self-employment: recent trends in self-employment rates are far from uniform across developed countries (OECD, 1992). Indeed, with declines almost as common as increases across OECD countries, international statistics strongly suggest that country- or region-specific factors, rather than widely shared trends like cheaper computing power, feminization of the labor force, or the move to a service economy, may play central roles in the evolution of self-employment rates.

The goal of this paper is to examine the role of two less commonly analyzed factors which do vary across regions and countries—macroeconomic conditions and the income tax environment — in explaining recent self-employment trends. Macroeconomic conditions have often been cited as a potential contributor to self-employment, especially to the extent that self-employment is used by some individuals as a “job” of last resort in poor labor markets (Quinn, 1980; Becker, 1984; Bishop, 1987). Tax policy, and especially the rate of personal income tax, have also been cited (e.g., Long, 1982; Blau, 1987; Devine and Mlakar, 1993) as possible determinants of self-employment rates, largely because self-employment offers individuals greater opportunity to shelter, or hide, income from tax authorities, an option which is especially valuable in high-tax jurisdictions. Clearly, if macroeconomic conditions and tax policy, rather than fundamental technological change, are driving recent increases in self-employment in some countries, policy prescriptions may differ.

Because of their focus on data from a single country and, in some cases their lack of regional disaggregation, previous authors have been limited in their ability to isolate the importance of tax and macroeconomic factors: essentially they are restricted to using a single time series of tax and macroeconomic variables. In the current paper, I address this problem in two ways. First, I use 10 years of microdata covering the 12-year period 1983–1994<sup>1</sup> from two countries, Canada and the US, which are perhaps more similar in overall institutional structure than any other two countries, but which differ substantially in their income tax policy, macroeconomic conditions, and self-employment trends. Second, I disaggregate

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<sup>1</sup>Data pertaining to the years 1984 and 1985 were not available. There was no 1984 Canadian Survey of Consumer Finances and information on incorporated self-employed was not available for 1985 in Canada.

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