



# The labour market consequences of self-employment spells: European evidence <sup>☆</sup>

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## Abstract

We examine how those re-entering paid-employment after a brief self-employment spell fare upon return using data from the European Community Household Panel. Unconditionally, those re-entering paid-employment appear to have considerably lower wages than those staying in the wage sector. This difference appears to be larger in Europe than in the US. Conditional analysis suggests, however, that the difference is more apparent than real: It seems that Europeans select negatively into (and possibly out-of) self-employment, *i.e.*, the likelihood of entering (and exiting) entrepreneurship correlates negatively with unobserved ability and/or in-paid-employment productivity. Our analysis of non-wage outcomes indicates that the selection is mostly involuntary, and that for highly educated men, the brief self-employment spells are unemployment in disguise.

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## 1. Introduction

Each year, hundreds of thousands of Europeans enter self-employment and start their own businesses, although many of them exit shortly thereafter.<sup>1</sup> According to *Business demography in Europe* (EC, 2004a), three-year survival rates of European enterprises born in 1998 ranged from 53.5% (Denmark) to 66.9% (Norway), the lowest survival rates being in general in the services sector, such as in the hotel and restaurant business.<sup>2</sup> Smallest businesses and self-employment ventures are terminated even sooner than that: the death rates of very small (0–4 employees) European enterprises was in 2000 about 4–5 times higher than those of slightly larger (5–9 employees) enterprises.<sup>3</sup> Despite the recurrence and prevalence of entrepreneurial exits, not much is known about what happens to those Europeans who leave self- for paid-employment after a short spell. What are the economic consequences faced by the exiting entrepreneurs? In particular, what is the effect of self-employment experience on (subsequent) wage and non-wage outcomes, such as job security?

There is some evidence for the US on how those who revert back to paid-employment fare upon return (Bruce and Schuetze, 2004; Evans and Leighton, 1989; Williams, 2000). This evidence suggests that a year of self-employment lowers earnings compared to a year of work experience, even though not all findings for the US are entirely consistent with each other or across different demographic groups. No comparable analyses exist for Europe, except for Williams (2003) providing related evidence for one country, Germany.<sup>4</sup> The aim of this paper is to augment this earlier literature by providing the first comprehensive European evidence on these effects: Our data come from the *European Community Household Panel* (ECHP), which allows us to track flows from paid-employment either to self- or to unemployment, and back to paid-employment for most of the EU-15 countries.

Lack of comprehensive evidence for Europe is surprising, especially since many European policy-makers appear to have a strong prior belief that exiting entrepreneurs are somehow ‘scarred’ and that those leaving self- for paid-employment after an entrepreneurial spell are not treated fairly upon returning to paid-employment. It has been argued, in

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<sup>1</sup> *Business demography in Europe* (EC, 2004a), a publication by The Enterprise Directorate-General of the European Commission and Eurostat, tracks the number of genuine enterprise births and deaths by using harmonised data on business demography within the European Union. In the seven participating countries (Denmark, Spain, Italy, Luxemburg, the Netherlands, Finland and Sweden), the total number of enterprise births was on average about 664,000 between 1999–2001. There were about 89 newly born enterprises in the whole of the business economy for every 10,000 inhabitants aged between 20 and 59 years old in these EU countries, providing us with a rough indicator of the average density of birth rate.

<sup>2</sup> These numbers refer to the participating countries listed in Footnote 1; see *Business demography in Europe* (EC, 2004a), Tables 4.3 and 4.11.

<sup>3</sup> See *Business demography in Europe* (EC, 2004a), Table 5.6. In Britain, as many as 50% of the self-employment ventures started in the early 1990s did not survive their first two years in business (Taylor, 1999). In Finland, the median survival time has been 4–5 years (Tervo and Haapanen, 2005).

<sup>4</sup> While the focus of Williams’ paper is on returns to schooling, it also documents that self-employment experience is rewarded a slightly lower return on the German job market than paid-employment experience.

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