

# Is it a good policy to promote self-employment for job creation? Evidence from Spain

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## Abstract

An often applied labour market policy to combat unemployment is to stimulate unemployed individuals to start their own businesses. Such policy may at least, temporarily lead to increases in self-employment, in particular, in the number of own-account workers. These policies may be called successful when the formerly unemployed individuals remain in employment for a longer period of time either as self-employed or as paid-employed worker and also when they become employers they contribute to reduce unemployment not only by creating their own jobs but also by hiring new employees. In this paper we investigate empirically the long-run relationship between the two components of self-employment over the business cycle and discuss its implications for entrepreneurship policy.

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## 1. Introduction

The search of solutions to the unemployment problem at present time is the major issue for governments around the world, particularly in Europe. In that sense, much of the discussion on finding solutions to the unemployment problem has centered on the pivotal role to foster

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entrepreneurship as a way to reduce unemployment – i.e. as an instrument of active labour market policy (Pfeiffer & Reize, 2000a; Pfeiffer & Reize, 2000b; Reize, 2004).

As it is well-known, there are two channels through which self-employment can contribute to reduce unemployment. First, there is a direct effect of removing a newly self-employed individual from the stock of unemployed. Second, there is an indirect effect of eventual job creation by entrepreneurs who succeed in running enterprises which require outside labour. Therefore, new self-employed people are not only viewed as an engine for innovation and economic growth as several empirical and theoretical works suggest<sup>1</sup> but also as creators of additional employment opportunities (Carroll, Holtz-Eakin, Rider, & Rosen, 2000; Cowling, Taylor, & Mitchell, 2004).

The logic of this conception of the promotion of self-employment as a way to directly reduce unemployment is quite simple: promoting the transition from unemployment to self-employment by using start-up incentives or tax reductions among others such that the relative valuation between self-employment and salaried work is altered in favor to the former. The changes which these incentives introduce into the occupational choice problem's parameters result in some unemployed people reviewing their initial decision and switching to self-employment as a better alternative to face the scarce job opportunities in the labour market. The problem is that policies devised to increase the self-employment rate may attract the worst entrepreneurs<sup>2</sup> – i.e. among unemployed people who face-up to lower job-offer arrival rate and even propitiate some 'unexpected' transitions from paid employment to self-employment for evading the most onerous elements that Employment protection legislation imposes to firms leading a loss of rights for these workers (Román, Congregado, & Millán, 2009).<sup>3</sup> Therefore, and given the current slow-down in the job-offer arrival rate, one could argue that the existence of high levels of unemployment in conjunction with these incentives schemes in a highly regulated labour market should lead to rise in self-employment rates and changes in the relative participation of own-account workers and employers in self-employment.

However, more is not necessarily better<sup>4</sup> as the majority of people becoming self-employed are not entrepreneurs in the sense of people creating firms that generate both innovation and wealth (Baumol, 2008; Shane, 2009) but actually some of them are dependent self-employed workers and others are 'necessity' entrepreneurs (Henrekson, 2007). Since people who switch from unemployment to self-employment show a lower probability of survival, the promotion of self-employment as a way of combating unemployment will have temporary effects (Millán, Congregado, & Román, 2010); and finally, in most advanced countries only a minority of self-employed people hire other workers<sup>5</sup> – i.e. only a minority becomes job creators.

<sup>1</sup> See for instance, Audretsch (2003), Audretsch and Keilbach (2004), Audretsch and Keilbach (2007), Baumol (1990), Baumol (2008), Iyigun and Owen (1999), Lazear (2005) and van Stel et al. (2005).

<sup>2</sup> The works of Rissman (2003), Reize (2004), Baumgartner and Caliendo (2008), Mandelman and Montes-Rojas (2009), Caliendo and Künn (2010), or Millán et al. (2010) among others, address the problem of turning unemployment into self-employment.

<sup>3</sup> These new self-employed workers are old paid-employees who are doing the same activities that they did previously when they worked as employees. From this last perspective the net job creation would be zero.

<sup>4</sup> On the one hand, self-employment could be encouraged because of the lack of employment opportunities but on the other hand the number of jobs may increase when people moves from unemployment or paid-employment to self-employment (see Parker (1996), Faria et al. (in press) or Folster (2000) for opposite empirical findings about this controversy). Regarding other macroeconomic variables, the higher self-employment rates don't seem to be correlated with higher GDP levels. Using the expression popularized by Blanchflower (Blanchflower, 2004): 'More may not be better'.

<sup>5</sup> In the EU-15 only 33,5% of self-employed are job creators (Eurostat, 2009). In Spain, in 2008, only the 34,7% of self-employed are employers (INE, 2009).

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