

Analisi d'opera*

HOLTZ-EAKIN D. - ROSEN H.S. (eds.), *Public Policy and the Economics of Entrepreneurship*, Cambridge (Mass.), MIT Press, 2004.

This book edited by Douglas Holtz-Eakin and Harvey S. Rosen collects seven independently authored chapters covering topics related to entrepreneurship and public policies. The analysis is fundamentally empirical. It presents interesting facts and figures that are extremely valuable to readers unfamiliar with this literature.

The analysis is presented in a straightforward and simple fashion. This has advantages and disadvantages. On the one hand, the simplicity of the analysis makes the book easily accessible to a large audience of readers, not only academics or specialists. On the other, it makes it difficult to cope adequately with questions that are inherently complex. Consequently, the book does not address questions such as which kinds of policies promote entrepreneurship.

There is no doubt that this book presents a valuable introduction to topics central to public policy and entrepreneurship. The reader, however, should not expect definitive answers to some of the core questions in entrepreneurial studies. Nor are there recommendations of specific policies. Rather, I would consider the topics presented in the book starting points for potential research proposals and further investigation. I will turn next to the discussion of each individual chapter.

1. - When Bureaucrats Meet Entrepreneurs: The Design of Effective “Public Venture Capital” Programs

This Chapter by Josh Lerner presents and describes the main issues related to the desirability and structuring of a public venture

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capital program. An important question is why we need public venture capital. Two common arguments are presented: (i) the private sector provides insufficient capital to new firms; and (ii) the government either can identify investments which can ultimately yield high social and/or private returns or can encourage financial intermediaries to do so.

The first point urges us to answer the question of why the private sector would provide insufficient funds. The chapter provides two possible answers. The first is that some public institutions have greater ability to identify good investment projects than the private sector. From that the valuable contribution of public institutions in certifying good business initiatives. The second possibility is the presence of positive externalities created by investment projects. Unfortunately, the market is unable to compensate businesses for the social benefits they create. As a result, these businesses are not sufficiently developed from a social point of view.

There is no doubt that the externality argument is important. After all, the literature on innovation and growth has repeatedly emphasized the limited ability that innovators have in capturing all the benefits created by their innovations. I am skeptical, however, about the idea that government agencies have greater ability to identify good investment projects with higher "private" return. This requires greater ability to value market opportunities and I do not see an obvious reason why this is so. It can be claimed that public agencies have a greater ability to collect market data. But even if we accept this, there is no need for these agencies to design financing programs for specific projects. By making the analysis public, the market will be able to use this information to direct the funding to the most promising projects.

In general, if there is a role for public intervention, this is only justified in the presence of positive externalities. In this case, we can make the case for the important contribution of public venture capital funds. Simple public transfers do not work. Not so much for the political distortions that may arise in the political process as discussed in the chapter (these distortions will also arise in the choice of investment projects to finance), but because monitoring is an indispensable mechanism for the success of this process. Diversion of

straight subsidies is too tempting in projects that have high social returns but small private returns.

One question that this chapter does not address is whether public venture funding could crowd out private funding. Obviously, if the focus is on the financing of projects with high social returns but low private returns, it is unlikely that there is a large crowding out effect. However, if the goal of the public venture program is to fund high “private” return projects, the crowding out hypothesis is likely. The Chapter also suggests that the public venture funds should concentrate their efforts to the funding of projects that do not receive private venture capital funding. For example, it suggests a greater focus on “technologies which are not currently popular among venture investors”. The problem with this recipe is that it lacks an analysis of the reasons why private venture investors neglect these technologies. It is possible that these technologies are neglected because they have the requisites for being funded through standard financing channels (for example, through bank loans). It may also be the case that these technologies are not very promising in terms of private returns. Again, the desirability of these programs are highly questionable if you doubt that public agencies have better evaluation and monitoring capabilities than private, profit-oriented institutions.

To conclude, I think that this chapter contains interesting and useful material for an introduction to public venture capital. Perhaps the Chapter provides a too optimistic view about the potential contributions of public venture funds. This may create the perception that public institutions could outperform market institutions in evaluating business projects, even when these projects do not create uncompensated social benefits, that is, they do not create positive externalities.

2. - The Self-Employed Are Less Likely to Have Health Insurance Than Wage Earners. So What?

There are some concerns about the fact that self-employed individuals have a lower health coverage than wage workers. This has

motivated the proposal and introduction of policies that create incentives for self-employed workers to acquire medical coverage. Should we be concerned about the fact that a substantial percentage of self-employed workers are without coverage? Are these policy proposals justified? The most obvious reason for concern is that the health of these workers may deteriorate. From a macroeconomic perspective, this reduces the overall quality of the labor force, which in turn reduces aggregate production.

In this Chapter, Craig William Perry and Harvey S. Rosen show that the lower coverage for self-employed workers does not imply a worse state of health of these workers. At first, this result may not appear surprising. If we think that self-employed workers are less risk-averse, they will prefer lower insurance in general and face higher out-of-pocket medical expenses. However, the authors claim that out-of-pocket expenses are not higher for self-employed workers. Therefore, the lower coverage for these workers implies a lower use of health services.

If we also accept the result that the health of entrepreneurs does not explain the occupational choice (which is important because it dismisses the possibility that entrepreneurs are healthier), the Chapter seems to point out that the use of health services does not improve the general health of the population. This casts doubts about the desirability of policy incentives to increase health insurance coverage because it does not seem to improve the overall health of the self-employed.

From the title of the Chapter I would have expected a somewhat broader and comprehensive analysis. The main question is whether there is a problem with the fact that self-employed workers have lower insurance coverage. In this respect, I would have expected the considerations of several arguments in favor or against more extended coverage, in addition to the general health of entrepreneurs compared to wage workers. Here are a few examples. Recent research with time-inconsistent preferences emphasizes that the insurance choices of private agents may not be optimal (from a planner point of view) in absence of specific incentives. Another example builds on the inefficiencies introduced by different taxation treatments. Because wage earners may have different incentives in the

current tax system, the same incentives should be given to self-employed workers. Notice that this does not necessarily mean that more incentives should be given to the self-employed. It may require lower incentives for wage-workers.

Even neglecting the potential problems of the testing procedures, the Chapter's results and general discussion do not provide a clear policy prescription. Given that the insurance coverage does not affect the health status of entrepreneurs, what are the policy implications?

3. - Business Formation and Deregulation of the Banking Industry

This Chapter by Sandra E. Black and Phillip E. Strahan studies the effects of banking deregulation on the volume of credit and business formation as proxied by business incorporations. It conducts an analysis across US states and finds that, after deregulation, the volume of per-capita credit has increased. Furthermore, the increase in the per-capita volume of credit seems to have increased the number of business incorporations.

Especially important for the topic of this book is the second result, that is, the fact that an increase in the amount of credit facilitates the formation of new corporations. Of course, the fact that the number of business incorporations tends to relate to the volume of banking credit does not necessarily mean that more credit causes higher business formation. It could also be that better investment opportunities increase the demand, and therefore, the volume of credit. The authors are well aware of this endogeneity problem and use instrumental variables estimations. The IV results seems to support the prior notion that more banking credit, generated by banking liberalization, stimulates the formation of business creation.

There are two issues that the Chapter does not address but should. Generally speaking, the timing of liberalization seems to be aligned with the timing of a stock market rally. As the market assigns more value to a corporation, there could be more incentives to create new corporations. Because corporations are worth more,

the banking sector is also willing to expand their credit. How can we be sure that this is not the real story as opposed to the story presented in the Chapter? I would be more confident about the interpretation of the Chapter if the variable used in the analysis was the whole business formation, not only incorporations. It is true that Table 4 shows that there is a strong cross-state correlation between business start ups and incorporations. However, for the question addressed in the Chapter what matters is not the cross-state correlation but the correlation over time in the same state.

A natural exercise to conduct, given the question addressed in the Chapter, is to regress directly the business incorporation variable on the deregulation dummies. This variable is only used as an instrument in the IV estimation. It would have been useful to know why this exercise has not been pursued.

Finally, I would like to point out that the review of the literature about the importance of personal wealth to become an entrepreneur does not provide the whole picture. A recent paper by Hurst and Lusardi (2004)¹ casts some doubts about the robustness of these findings.

4. - Public Policy and Innovation in the US Pharmaceutical Industry

In this Chapter, Frank R. Lichtenberg describes the possible impact of real US government policies on research and development investment in the pharmaceutical industry. In particular, he describes the 1962 Kefauver-Harris Amendment, the 1992 Prescription Drug User Fee Act, the 1965 Social Security Amendments, the 1984 Hatch-Waxman Amendments, and the 1993 health care reform proposal under the Clinton administration.

This is one of the few Chapters in the book that discuss public policies explicitly. The material presented is very interesting and intuitively compelling given the major theories about R&D invest-

¹ See HURST E. - LUSARDI A., «Liquidity Constraints, Household Wealth, and Entrepreneurship», *Journal of Political Economy*, vol. 112, no. 2, 2004, pp. 319-47.

ment. Most of the analysis is descriptive, often supplemented by key Graphs. Although these Graphs seem to support the main claims, it is always difficult to establish causation relations simply by looking at one or two time series. Correlations could be spurious.

In the second part of the Chapter the analysis becomes more quantitative. The goal is to investigate whether the classical q-theory of investment captures the behavior of R&D investment in the pharmaceutical industry. The results show that the q-theory does explain R&D investment.

The author does not provide a discussion about the endogeneity problem between R&D and the value of the firm. Generally speaking, the q-theory predicts that the market value of the firm (relative to the replacement value of its assets) affects investment. However, investment also affects the market value of the firm. Some discussion about the avoidance of this endogeneity problem should have been provided.

5. - Dimensions of Nonprofit Entrepreneurship: An Exploratory Essay

Joseph J. Cordes, Eugene Steuerle and Eric Twombly characterize some key differences between standard entrepreneurial firms and non-profit organizations. The general message is that, beyond the formal or legal definition, the distinction between a profit and a non-profit organization is not clear. Many have emphasized the different objective posed by the founder: profit maximization versus utility maximization. But also this distinction is to some extent artificial. The entrepreneur of a for-profit organization also maximizes utility. What may differ is the structure of this utility.

This Chapter provides an interesting and informative introduction to the structure and dynamics of nonprofit organizations. The Chapter also discusses how public policies could have a large impact on the birth and success of these organizations. Perhaps, some more discussion about the likely impact of tax incentives for the creation and dynamics of these organizations would have been useful.

6. - Does Business Ownership Provide a Source of Upward Mobility for Blacks and Hispanics?

In this Chapter Robert W. Fairies asks whether individuals engaged in entrepreneurship experience faster earning growth than wage workers. A second question is whether the differences in earnings profiles between entrepreneurs and wage workers vary across blacks, hispanics and whites. The analysis is conducted separately for men and women. The results suggest that the earning profiles of entrepreneurs are steeper than for wage workers.

Perhaps, a more interesting question is whether the level of entrepreneurial earnings is higher than that of wage workers and whether it differs across racial groups. These figures are presented in the first part of the Chapter. It is shown that entrepreneurs earn more than wage workers in all racial groups. Moreover, entrepreneurs in minority groups earn less than white entrepreneurs. This is also the case for the group of wage workers. There are some exceptions for women.

These numbers are very interesting. The next step then is to investigate the factors that explain the earning differences between entrepreneurs and wage earners. Is race a significant explanatory variable after accounting for observable differences such as age, education, or wealth? Unfortunately, the chapter does not provide any answer to this question, which I think is more interesting than finding the differences in the slope of the earning profiles.

I do not see a very tight connection between the slope of the earning profiles and the question of mobility raised in the chapter. In thinking about upward mobility, we often have in mind a situation in which individuals improve their lifetime well-being. However, if after 20 years a person has a higher income than a wage worker simply because that person earned less in the first 10 years, it does not mean that his lifetime well-being is higher.

In the empirical analysis, I would have also considered hourly earnings because the number of hours worked are probably quite volatile across different groups. The exclusion of individuals with working hours below 1,400 may not be enough. This is especially important considering that entrepreneurs work more hours than

wage workers (see Table 3 in Chapter 2). This could be especially important for women who are likely to experience larger differences in working hours. Perhaps, this could explain some of the apparently unexpected statistics for women reported in the chapter.

7. - Entrepreneurial Activity and Wealth Inequality: A Historical Perspective

Carolyn M. Moehling and Richard H. Steckel present interesting facts about the increasing wealth inequality between 1820 and 1910 in the state of Massachusetts. The goal of the chapter is to investigate whether entrepreneurship could have played an important role in generating the increasing concentration of wealth.

Of course, there are data quality limitations. But with some creativity the authors are able to divide the sample between entrepreneurs and wage workers. After doing that, they decompose the impact of the change in wealth inequality in three factors: 1) the change in the share of entrepreneurs (loosely speaking, inequality increases with the fraction of entrepreneurs, who are wealthier); 2) change in the mean wealth of entrepreneurs (inequality should increase if the wealth of entrepreneurs increases relative to wage workers); 3) changes in the distribution of wealth within entrepreneurs and/or wage workers (if inequality in one group increases, this is likely to increase inequality for the whole population).

The interesting finding is that most of the increase in wealth inequality between 1850 and 1900 was due to the third factor, that is, the increasing inequality within the group of wage workers and within the group of entrepreneurs.

The Chapter also provides some discussion of whether models with entrepreneurs developed in the literature are consistent with this finding. This discussion is too general and to some extent imprecise. For example, it is said that the findings of an increasing inequality among non-entrepreneurs is not captured (or anticipated) by the “standard models” of entrepreneurship with imperfect credit markets. But in fact, this is fully consistent with these models if we allow for mobility in and out of entrepreneurship.

One of the models I am most familiar with is the one studied in Quadrini (2000)². In this model there are agents that at a particular point in time are wage workers but they may have been entrepreneurs in the recent past. These agents could be quite wealthy because they accumulated substantial amounts of wealth during the entrepreneurial tenure and it takes time to consume their wealth once they cease their entrepreneurial activities. Therefore, entrepreneurship generates wealthy individuals also among current wage earners. This is more relevant when there is a significant movement in and out of entrepreneurship. If we think that during the period investigated by the Chapter there has been an increasing movement in and out of entrepreneurship (because, as pointed out by the authors of this Chapter, the scale and scope of industrial production increased dramatically during this period), then at a particular point in time we could find greater inequality both within entrepreneurs and within wage workers.

Concluding Remarks

In conclusion, these Chapters as a set provide an interesting and well presented introduction to various issues related to entrepreneurship and public policy. The analysis, fundamentally empirical, is accessible and straightforward. This makes the book suitable for a wide ranging, non-specialized group of readers. It is also valuable reading for students interested in conducting research on the topic of entrepreneurship. They will find interesting figures and arguments that could stimulate research ideas at the empirical as well as theoretical level.

² See QUADRINI V., «Entrepreneurship, Saving and Social Mobility», *Review of Economic Dynamics*, vol. 3, no. 1, 2000, pp. 1-40.