



**The Absence of the African-American Owned Business: An Analysis of the Dynamics of Self-Employment**

Robert W. Fairlie

*Journal of Labor Economics*, Volume 17, Issue 1 (Jan., 1999), 80-108.

Stable URL:

<http://links.jstor.org/sici?sici=0734-306X%28199901%2917%3A1%3C80%3ATAOTAO%3E2.0.CO%3B2-U>

---

Your use of the JSTOR archive indicates your acceptance of JSTOR's Terms and Conditions of Use, available at <http://www.jstor.org/about/terms.html>. JSTOR's Terms and Conditions of Use provides, in part, that unless you have obtained prior permission, you may not download an entire issue of a journal or multiple copies of articles, and you may use content in the JSTOR archive only for your personal, non-commercial use.

Each copy of any part of a JSTOR transmission must contain the same copyright notice that appears on the screen or printed page of such transmission.

*Journal of Labor Economics* is published by The University of Chicago Press. Please contact the publisher for further permissions regarding the use of this work. Publisher contact information may be obtained at <http://www.jstor.org/journals/ucpress.html>.

---

*Journal of Labor Economics*  
©1999 The University of Chicago Press

JSTOR and the JSTOR logo are trademarks of JSTOR, and are Registered in the U.S. Patent and Trademark Office. For more information on JSTOR contact [jstor-info@umich.edu](mailto:jstor-info@umich.edu).

©2002 JSTOR

<http://www.jstor.org/>  
Mon Jul 1 12:26:35 2002

# The Absence of the African-American Owned Business: An Analysis of the Dynamics of Self-Employment

Robert W. Fairlie, *University of California, Santa Cruz*

Estimates from the Panel Study of Income Dynamics indicate that African-American men are one-third as likely to be self-employed as white men. The large discrepancy is due to a black transition rate into self-employment that is approximately one-half the white rate and a black transition rate out of self-employment that is twice the white rate. Using a new variation of the Blinder-Oaxaca decomposition technique, I find that racial differences in asset levels and probabilities of having self-employed fathers explain a large part of the gap in the entry rate, but almost none of the gap in the exit rate.

## I. Introduction

The difference between the percent of African-Americans and whites who are self-employed in the United States is striking. Approximately, 11.6% of white workers are self-employed, whereas only 3.8% of black workers are self-employed (U.S. Bureau of the Census 1993). The three-to-one ratio in the self-employment rate holds for both men and

I would like to thank Joseph Altonji, Rebecca Blank, Christopher Jencks, Bruce Meyer, Paula Worthington, and seminar participants at Northwestern University; the Federal Reserve Bank of Chicago; University of Chicago; University of California, Santa Cruz, University of California, Los Angeles; the Milken Institute; Syracuse University; and the 1995 Winter Meetings of the Econometric Society for their comments.

[*Journal of Labor Economics*, 1999, vol. 17, no. 1]  
© 1999 by The University of Chicago. All rights reserved.  
0734-306X/99/1701-0002\$02.50

women and, for men, has remained roughly constant over the past 80 years (Fairlie and Meyer 1997). Apparently, Booker T. Washington's plea to black Americans near the turn of the century that "every member of the race should strive to be successful in business, however humble that business might be" has not been realized (Washington 1907, p. 270).

The relative absence of African-American owned businesses in the United States is a major concern among policy makers.<sup>1</sup> The growing tensions between Koreans and African-Americans in cities, such as Los Angeles, Chicago, and New York, are inextricably linked to the relative success of Koreans and the failure of blacks to establish and maintain businesses in many communities of these cities.<sup>2</sup> In addition, Lieberman and Silverman (1971) provide evidence suggesting that racial business patterns contributed to past ghetto riots in the United States. Another reason for concern among policy makers is that business ownership is viewed as a potential source of economic advancement for disadvantaged groups.<sup>3</sup> Currently, there exist a number of government programs aimed at promoting minority business ownership.<sup>4</sup>

The potential benefits from promoting African-American self-employment are numerous. However, the first step in addressing this issue, identifying the causes of the low black self-employment rate in the United States, has been taken in only a few studies. In this article, I contribute to this scant literature by examining racial patterns in transitions between self-employment and wage/salary work among prime-age men.<sup>5</sup> Past research on self-employment typically analyzes either the determinants of who becomes self-employed or the determinants of who exits from self-

<sup>1</sup> Self-employment as defined in this study is similar to the definition of business ownership used in the Census Bureau's Survey of Minority-Owned Business Enterprises. The two main differences are that self-employment as defined here includes all incorporated business owners and excludes small or "casual" businesses owned by wage/salary workers. See Bates (1990a) and U.S. Bureau of the Census (1996).

<sup>2</sup> See In-Jin Yoon (1991) for a description of the causes and character of the racial tensions between Koreans and African-Americans in Chicago.

<sup>3</sup> Glazer and Moynihan (1970, p. 36) argue that "business is in America the most effective form of social mobility for those who meet prejudice."

<sup>4</sup> See Balkin (1989) for a description of many of the programs promoting self-employment among low-income people. Also, see Guy, Doolittle, and Fink (1991) for a description of a program linked to Aid to Families with Dependent Children, and see Benus et al. (1992) for a program linked to Unemployment Insurance.

<sup>5</sup> I do not include women in this analysis because several important questions were not asked of married women during the first eight years of the Panel Study of Income Dynamics.

employment. Furthermore, these studies generally do not focus on racial patterns in these processes.

Using 22 years of data from the Panel Study of Income Dynamics (PSID), I examine the causes of racial differences in both the transition rate into self-employment and the transition rate out of self-employment. The causes of racial differences in these two transition rates ultimately create the large disparity between the black and white self-employment rates. One natural place to search for explanations is in differences between blacks and whites in characteristics that are important determinants of self-employment transitions. Previous research, both theoretical and empirical, suggests a few characteristics that may be important. Specifically, I examine the extent to which racial differences in education, asset levels, parental financial resources, and parental self-employment contribute to the black/white gap in the entry rate, exit rate, and self-employment rate.<sup>6</sup>

To answer these questions, I estimate logit regressions for both types of transitions using separate samples of black and white men. The estimates from these regressions allow me to identify important racial differences in the processes of entry into and exit from self-employment. I also use the estimated coefficients from these regressions along with the black and white samples to decompose the racial gaps in both types of transition rates into two parts. These are the part due to racial differences in the transition process and the part due to racial differences in the distribution of characteristics affecting the transition decision. I use a novel procedure to calculate the contribution of specific variables to the racial gaps because of the nonlinearity of the equation predicting transition probabilities.

Estimates from the PSID indicate that the black self-employment rate is slightly less than one-third the white rate. The discrepancy is created by a black transition rate into self-employment that is approximately one-half the white rate and a black transition rate out of self-employment that is more than twice the white rate. Lower levels of assets and lower probabilities of having a self-employed father contribute to the lower average probability of entering self-employment for black men than white men. Through their effect on the entry rate, these factors also contribute to the current underrepresentation of blacks in self-employment. Racial differences in these and other variables, however, do not appear to explain a substantial amount of the black/white gap in the exit rate.

<sup>6</sup> These factors are not intended to represent a comprehensive list of the potential causes of the low black self-employment rate. Other potentially important causes, such as consumer discrimination, lending discrimination, and lack of access

## II. Past Research

The literature on self-employment has grown fairly rapidly in the last few years. Currently, there exist a number of theoretical and empirical studies that examine the potential determinants of self-employment.<sup>7</sup> In this section, I summarize the major results and findings from these studies. I later use these results to create the self-employment transition equations that are discussed in Section IV.

There are several theoretical models of self-employment in the economics literature. Each of these models emphasizes a different aspect of the individual's choice between self-employment and wage/salary work. Lucas (1978) assumes that there exists a distribution of managerial talent across individuals in the work force. Those who become entrepreneurs are the ones with the most managerial ability. Kihlstrom and Laffont (1979) model the entrepreneurial decision as one in which an individual's aversion to risk plays a prominent role. The decision to become an entrepreneur is based on a comparison of the risky return of self-employment to the less risky return of wage/salary work. Evans and Jovanovic (1989) create a static model of the individual's decision to enter self-employment or remain in wage/salary work. The individual chooses the work sector that provides the highest expected net income.<sup>8</sup> In addition, they assume that the individual faces a potentially binding liquidity constraint in which the level of capital that he/she can invest in the new business is less than or equal to a proportion of his/her initial level of assets. Finally, Jovanovic (1982) creates a dynamic model of firm growth and survival. In this model, firms learn about their efficiency over time. Firms discovering that they are efficient survive and expand output, while firms discovering that they are not efficient fail.

There also exist a number of empirical studies of self-employment. Many of these studies estimate equations of the self-employment decision that are based on the theoretical models presented above. Blau (1987) identifies changes in tax laws and technology as two major causes of the rise in nonagricultural self-employment over the 1970s. Borjas (1986), Borjas and Bronars (1989), Evans and Leighton (1989), Meyer (1990), and Fairlie and Meyer (1996, 1997) use U.S. microdata, while Rees and Shah (1986) and Blanchflower and Oswald (1990) use British microdata, to identify the characteristics of individuals who are

---

to coethnic resources, cannot be analyzed using data from the PSID and are beyond the scope of this article.

<sup>7</sup> See Aronson (1991) for a review.

<sup>8</sup> Wage/salary income is a function of education, past wage/salary work experience, and asset levels, and self-employment income is a function of entrepreneurial ability, the level of invested capital, and asset levels.

self-employed in a cross section. These studies generally find that the self-employed are more likely to be male, of white race, older, more educated, married, have children, and have higher levels of assets than wage/salary workers.

Several studies, including Fuchs (1982), Evans and Jovanovic (1989), Evans and Leighton (1989), Meyer (1990), Holtz-Eakin, Joulfaian, and Rosen (1994*a*), and Dunn and Holtz-Eakin (1996) examine the characteristics of individuals who switch into self-employment from wage/salary work over a fixed period of time. A major advantage of analyzing transitions into self-employment is that the independent variables are measured before the time of the decision. This is an important issue when estimating the effect of potentially endogenous variables, such as asset levels, on the transition probability.<sup>9</sup> The studies that examine the effect of assets find that they are significant and positive in determining who transits into self-employment.<sup>10</sup> One exception is Meyer (1990) who finds that assets play only a small role in predicting who becomes self-employed.

Theoretically, we might expect that there is a strong intergenerational link in self-employment due to the transmission of informal business or managerial experience, the inheritance of family businesses, and/or the correlation among family members in preferences for entrepreneurial activities. Past empirical research supports this conjecture. Lentz and Laband (1990) find that 53% of a sample of self-employed proprietors from the National Federation of Independent Businesses had self-employed parents. Dunn and Holtz-Eakin (1996) examine the effect of parental self-employment and asset levels on the probability of a transition into self-employment. They find a strong positive effect for parental self-employment, but only a weak positive effect for parental wealth. Parental wealth is included in the transition equation because it potentially improves the individual's access to start-up capital.

A few studies exist that analyze the characteristics of individuals who leave self-employment. Bates (1990*b*), Meyer (1990), and Holtz-Eakin, Joulfaian, and Rosen (1994*b*) identify the causes of transitions out of self-employment. In general, the findings from these studies suggest that

<sup>9</sup> In a cross-sectional study, discovering a correlation between assets and self-employment may simply represent the ability of self-employed workers to accumulate more assets than wage/salary workers through operating and owning their own businesses.

<sup>10</sup> Blanchflower and Oswald (1990) use cross-sectional data and find that young workers who have received inheritances are more likely to be self-employed. They assume that their measure of assets is exogenous because of the unanticipated nature of inheritances. Holtz-Eakin, Joulfaian, and Rosen (1994*a*) also use inheritances as their measure of assets.

more-educated business owners are less likely to fail over a specified period of time. The findings for the effects of other variables on the probability of a transition out of self-employment are mixed. Meyer (1990) finds that net worth has an insignificant effect on determining who leaves self-employment among individuals who recently became self-employed. Bates (1990b) discovers that firms with large amounts of financial start-up capital have higher probabilities of surviving. Finally, Holtz-Eakin, Joulfaian, and Rosen (1994b) find that self-employed individuals who receive inheritances over a 4-year period are more likely to remain self-employed than comparable individuals who do not receive inheritances over this period.

In addition to these studies of the determinants of self-employment, a few studies exist that specifically examine the causes of racial patterns in self-employment. Using microdata from the 1980 Census, Borjas and Bronars (1989) provide evidence that the large observed variance in self-employment rates across racial groups (Asians, blacks, Hispanics, and whites) is partly due to consumer discrimination. In contrast, Meyer (1990) does not find evidence supporting the consumer discrimination hypothesis. Using data from the 1987 Characteristics of Business Owners (CBO), he finds that black businesses are relatively more common in industries in which white customers more frequently patronize black businesses.

A few studies examine the role that racial differences in personal characteristics, such as education and asset levels, play in explaining racial patterns in self-employment.<sup>11</sup> Using data from the 1990 Census, Fairlie and Meyer (1996) find that controlling for group differences in age, education, year of immigration, and other demographic variables reduces only a small portion of the large gap between black ethnic groups and the U.S. rate. Bates (1989) estimates that black, nonminority, and Asian male-owned businesses have failure rates between 1982 and 1986 of 29.6%, 26.0%, and 21.7%, respectively.<sup>12</sup> He argues that these racial patterns in failure rates are partly due to the fact that Asian owners tend to be more educated, whereas black owners have less education.

Meyer (1990) examines whether low black asset levels explain much of the racial gap in self-employment. Using the 1984 wave of the Survey

<sup>11</sup> Older studies such as Frazier (1957) point to the absence of the African-American tradition in the field of business enterprise as a main cause of the lack of self-employment among this group.

<sup>12</sup> It is likely that the difference between the failure rate of black-owned businesses and white-owned businesses is understated. This is because Bates excludes smaller and older firms. If blacks are overrepresented in smaller firms and underrepresented in older firms then the failure rate of all black-owned businesses is higher than his reported estimates.

of Income and Program Participation (SIPP), he finds that net worth is insubstantial in explaining transitions into self-employment from wage/salary work. Therefore, he argues that differences in net worth between blacks and whites cannot explain a considerable part of the difference in self-employment rates between the two groups. In comparison, Bates (1989) finds that racial differences in levels of financial capital partly explain racial patterns in business failure rates, and Fairlie and Meyer (1996) find that ethnic/racial groups with higher levels of unearned income have higher levels of self-employment.

The theoretical and empirical studies reviewed in this section identify several variables that are potentially important in the individual's decision between self-employment and wage/salary work. Large racial differences in many of these variables, including education, asset levels, parental financial resources, and parental self-employment, may contribute to the black/white differences in the entry, exit, and self-employment rates. Furthermore, the findings from the literature suggest that the explanatory power of racial differences in some of these variables may differ markedly by the type of transition.

The other main causes of racial differences in transition rates are differences between blacks and whites in the entry and exit processes. Factors such as lending and consumer discrimination against blacks decrease the return to working in self-employment relative to the return in wage/salary work.<sup>13</sup> In addition, labor-market discrimination against blacks alters the returns to wage/salary work relative to self-employment.<sup>14</sup> These factors cannot be measured directly, but suggest that other variables such as assets and personal characteristics may have different effects on the probability of a transition into or out of self-employment for blacks and whites.<sup>15</sup> The contributions from racial differences in measurable

<sup>13</sup> Another factor that may decrease the relative returns to self-employment for blacks is crowding out due to immigration. Although self-employment rates are high among immigrants, Fairlie and Meyer (1998) do not find evidence of a large negative effect of immigration on the probability of self-employment among blacks.

<sup>14</sup> Light (1972) argues that labor market discrimination pushes minorities into self-employment. However, Coate and Tennyson (1993) argue that labor market discrimination can reduce the incentive for minorities to enter self-employment.

<sup>15</sup> For example, the relationship between assets and the probability of entering self-employment for blacks is likely to be different than for whites if blacks face lending discrimination. The existence of lending discrimination, however, does not necessarily imply that the effect of assets is stronger for blacks. This is because there are two forces at work. First, blacks have a higher probability of facing a liquidity constraint because of lending discrimination. This increases the strength of the relationship between assets and the probability of choosing self-employment for blacks relative to whites. However, because blacks face lending discrimi-



characteristics and racial differences in the transition processes to the black/white gaps in the transition rate into and out of self-employment are analyzed in Section IV.

### III. Data

This article uses 22 years of data on male heads of family units from the 1968 through 1989 waves of the PSID. I include respondents from both the Survey of Economic Opportunity (SEO) and the Survey Research Center (SRC) subsamples.<sup>16</sup> The SEO subsample contains a disproportionate number of blacks because of its inclusion of low-income households. The total sample is representative of the U.S. population when sample weights provided by the PSID are used.

Self-employed workers are defined as individuals who identify themselves as being self-employed only or as working for both someone else and self. Wage/salary workers are defined as those individuals who identify themselves as working for someone else only.<sup>17</sup> I remove all workers who do not report working at least 1 week last year and at least 1 hour on average per week last year. In addition, workers who have an agricultural occupation or who are not between the ages of 16–54 are removed from the sample for the year in question. Older workers are excluded from the analysis to avoid the potential problem of counting self-employment transitions that are actually partial retirement decisions. The restrictions stated above create a sample of 6,417 employed men who have an average of 8.2 years of data.

### IV. Results

#### Racial Self-Employment Patterns

There exist large differences between black and white self-employment rates, transition rates into self-employment, and transition rates out of self-employment in the United States. Table 1 reports estimates of self-employment rates and 1-year transition rates by race from the PSID. Only observations in which individuals are classified as workers (self-employed or wage/salary) in both years of a consecutive 2-year period are included in the sample. Therefore, transitions into self-employment from other work statuses and transitions out of self-employment to other

---

nation, small increases in their asset levels cannot be utilized to borrow substantially more money for start-up capital. This effect decreases the strength of the relationship between asset levels and the probability of choosing self-employment for blacks relative to whites.

<sup>16</sup> See Hill (1992) for a more detailed description of the PSID.

<sup>17</sup> I check many of the results reported below classifying those working for both someone else and self as wage/salary workers.

**Table 1**  
**Self-Employment and One-Year Transition Rates by Race: PSID (1968–1989), in %**

|   | Black           | White          | White/Black<br>Difference |
|---|-----------------|----------------|---------------------------|
| Self-employment rate                      | 4.61<br>(.39)   | 15.23<br>(.22) | 10.62<br>(.45)            |
|   | 14,781          | 37,613         |                           |
| Transition rate into<br>self-employment   | 2.02<br>(.27)   | 3.95<br>(.13)  | 1.93<br>(.30)             |
|   | 14,093          | 32,365         |                           |
| Transition rate out of<br>self-employment | 36.64<br>(3.99) | 18.51<br>(.66) | -18.13<br>(4.04)          |
|   | 688             | 5,248          |                           |

NOTE.—The sample consists of male non-agricultural workers (ages 16–54) who are heads of family units. All rates are calculated using sample weights provided by the PSID. The self-employment rate is the percentage of all those working who are self-employed. The transition rate into (out of) self-employment is the percentage of wage/salary workers (self-employed) who switch into self-employment (wage/salary work). Standard errors and sample sizes are reported below estimates.

work statuses are removed from the sample.<sup>18</sup> The self-employment rate is defined as the number of self-employed workers divided by the total number of self-employed and wage/salary workers. The estimates reported in this table suggest that black men have a substantially lower self-employment rate than white men. The white self-employment rate is 15.23%, whereas the black self-employment rate is only 4.61%: a ratio of more than three to one. Estimates of black and black male self-employment rates using census data are slightly lower but imply a similar black/white ratio.<sup>19</sup>

The self-employment rate at a given point in time is created by two dynamic processes: entry into and exit from self-employment. Therefore, racial differences in the transition rates into and out of self-employment

<sup>18</sup> This is the standard approach taken in the self-employment literature and effectively separates the work-sector decision from the work decision. Furthermore, the bulk of transitions into or out of self-employment are from or to wage/salary work. Estimates from the PSID indicate that 84.4% of black men and 88.9% of white men who enter self-employment are from wage/salary work and 79.3% of black men and 88.3% of white men who exit from self-employment switch into wage/salary work.

<sup>19</sup> Using data from the 1980 Census, Fairlie and Meyer (1996) report rates of 3.5% and 11.1% for black and white men, respectively. Estimates from the PSID are higher mainly because only heads of family units are included in the PSID sample. Therefore, the PSID sample excludes many younger men who are likely to have low probabilities of being self-employed.

are the underlying causes of the large black/white gap in the self-employment rate. Estimates from the PSID indicate that transition rates differ substantially by race. Black men enter self-employment from wage/salary work at a much lower rate than white men (2.02% compared to 3.95%). In addition, black men exit from self-employment at a much higher rate than white men (36.64% compared to 18.51%).<sup>20</sup> The estimates indicate that blacks are approximately one-half as likely to enter self-employment as whites and are twice as likely to exit from self-employment.<sup>21</sup> By assuming a steady state equilibrium in which entry and exit rates are constant over time, it is easy to show that these racial differences in transition rates contribute equally to creating the self-employment rate gap.<sup>22</sup> Therefore, factors that contribute to the racial difference in either of the transition rates ultimately create the black/white gap in the self-employment rate.

#### Racial Differences in the Entry Decision

To identify the determinants of entry into and exit from self-employment, I estimate several logit regressions for the probability of a work-sector transition. Specifically, I estimate separate regressions for each race and each type of transition. The coefficient estimates from these logit regressions are used to determine whether there are racial differences in the processes generating self-employment transitions and to calculate the contribution of racial differences in individual characteristics to the racial gaps in the transition rates.

The logit regressions estimated in this section represent reduced forms of the self-employment transition decision functions. The dependent variable is equal to one if the individual makes a transition from wage/salary work (self-employment) to self-employment (wage/salary work) and is equal to zero otherwise. The theoretical models reviewed above suggest a number of independent variables to include in the logit regressions.<sup>23</sup> These include measures of the individual's managerial or

<sup>20</sup> The one-year transition rates for white men are similar to estimates reported in Evans and Leighton (1989). They estimate entry rates of 4.0% and 2.5% and exit rates of 13.8% and 21.6% using data from the National Longitude Survey and Current Population Survey, respectively.

<sup>21</sup> The black/white ratios in the self-employment rate, entry rate, and exit rate are similar when classifying those working for both someone else and self as wage/salary workers.

<sup>22</sup> In steady state, the predicted self-employment rate is equal to  $E_j/(E_j + X_j)$ , where  $E_j$  is the entry rate and  $X_j$  is the exit rate for race  $j$ . For both races, I find that the substitution of either  $E_g$  or  $X_g$ , where  $g \neq j$ , results in approximately the same change in the predicted self-employment rate.

<sup>23</sup> These variables are measured before the point in time when the work-sector decision is made. This approach follows previous studies of self-employment transitions and removes the problem of endogeneity for many variables.

entrepreneurial ability, risk aversion, education, and asset levels (if the individual faces a liquidity constraint). Past empirical studies indicate that measures of parental self-employment and wealth should also be included. In addition to these variables, a large number of demographic controls commonly used in the literature are included in the regressions (see table A1 for a complete list). Some of these variables may serve as proxies for unmeasurable variables such as entrepreneurial ability and/or risk aversion.

I first present the findings for estimating the probability of a transition from wage/salary work into self-employment (reported in table 2).<sup>24</sup> Specifications 1 and 2 are estimated with the black and white samples, respectively. Mean values of all included variables are listed in table A1. I focus on the results for the variables of interest to this analysis.<sup>25</sup> Education enters the regressions in the form of three dummy variables indicating each of the main levels of educational attainment (the left-out category is attended high school). For whites, graduating from college relative to dropping out of high school increases the probability of entry, whereas it decreases the probability for blacks. In comparison, college graduation increases the probability relative to high school graduation for both races. Overall, the size of the coefficient estimates and the their statistical insignificance suggests that the relationship between education and entry into self-employment is weak for both races.

In the absence of a measure of parental wealth, I include the education level of the individual's father as a crude proxy. The relationship between father's education and the transition probability appears to be somewhat stronger than the relationship for the individual's education level. The coefficients suggest that the probability of entry into self-employment increases with each level of father's education, although they are imprecisely measured. This result is consistent with the finding in Dunn and Holtz-Eakin (1996) of a positive effect of parental wealth on the transition probability.

Whether an individual had a self-employed father while growing up is important in determining who is likely to switch into self-employment. The coefficients on the dummy variable indicating whether the individual's father was self-employed are large and statistically significant for both races. Having a self-employed father increases the sample transition probability by 0.0275 for blacks and 0.0199 for whites.<sup>26</sup> The

<sup>24</sup> Coefficient estimates are similar when classifying those working for both someone else and self as wage/salary workers.

<sup>25</sup> The coefficient estimates for other variables generally have expected signs.

<sup>26</sup> The effect of a 1-unit increase in each independent variable (average derivative) on the transition probability can be calculated by multiplying its coefficient by the adjustment factor reported at the bottom of table 2. The adjustment factor is equal to the sample average of  $e^{x\beta}/(1 + e^{x\beta})^2$ .

**Table 2**  
**Logit Equations for Transitions into Self-Employment by Race: PSID**  
**(1968-1989)**

|   | Specification       |                     |
|---|---------------------|---------------------|
|   | (1)                 | (2)                 |
| Race                                      | Black               | White               |
| Graduated from high school                | -.36825<br>(.25469) | -.04813<br>(.12845) |
| Attended college                          | -.07532<br>(.25120) | -.02516<br>(.12144) |
| Graduated from college                    | -.11386<br>(.37509) | .10997<br>(.13537)  |
| Age                                       | .25617<br>(.07680)  | .10166<br>(.03982)  |
| Age squared/100                           | -.31151<br>(.10217) | -.14262<br>(.05407) |
| Number of children                        | .02677<br>(.04848)  | -.01015<br>(.03140) |
| Disability                                | .03579<br>(.29109)  | .08088<br>(.14237)  |
| Currently married                         | -.77629<br>(.30743) | -.16050<br>(.15796) |
| Previously married                        | -.69683<br>(.38367) | -.07069<br>(.20427) |
| Military veteran                          | -.04310<br>(.18621) | -.16459<br>(.09287) |
| Years in current position                 | -.06768<br>(.02078) | -.04886<br>(.01203) |
| Years in current position squared         | .00095<br>(.00044)  | .00095<br>(.00038)  |
| Father graduated from high school         | .08358<br>(.23446)  | .04339<br>(.09770)  |
| Father attended or graduated from college | .61311<br>(.46113)  | .19146<br>(.14958)  |
| Father self-employed                      | 1.30284<br>(.49826) | .53340<br>(.16171)  |
| Interest income/1,000                     | .60413<br>(.17482)  | .04845<br>(.01140)  |
| Interest income/1,000 squared             | -.06140<br>(.02563) | -.00028<br>(.00012) |
| Cash payments received/1,000              | .18353<br>(.20018)  | .03330<br>(.01721)  |
| Cash payments received/1,000 squared      | -.03081<br>(.02924) | -.00043<br>(.00048) |
| Sample transition rate                    | .0219               | .0392               |
| Average derivative adjustment factor      | .0211               | .0374               |
| Sample size                               | 9,868               | 26,113              |
| Log likelihood                            | -989.68             | -4,226.55           |

NOTE.—The sample consists of male nonagricultural workers (ages 16-65) who are heads of family units. The dependent variable is equal to 1 if the individual switches from wage/salary work to self-employment. Standard errors are in parentheses below coefficient estimates and are corrected for the possibility of including multiple observations per individual. All equations include a constant, the county unemployment rate, and year, region, and urban dummies. All asset and income variables are in 1988 dollars. Cash payments received include inheritances and insurance settlements (2-year average). Interest income includes income from dividends, interest, trust funds, royalties, and rent. The average derivative is equal to the adjustment factor multiplied by the coefficient.

finding of a large effect for both races is similar to that of Lentz and Laband (1990) and Dunn and Holtz-Eakin (1996). Although the increases in probability are large for both races, the percentage increase for blacks (126%) is substantially larger than for whites (51%). The intergenerational link in self-employment appears to be stronger for blacks than for whites.

The role of assets in the self-employment decision has taken center stage in the literature, however, racial differences in the effect of assets have not been studied extensively. I include two different measures of assets in the logit regressions determining transition probabilities. Interest income is defined as total income from dividends, interest, trust funds, royalties and rent, and lump-sum cash payments is defined as the average amount of cash received from insurance settlements and inheritances over the past two years. Both variables enter the regressions in a quadratic form.<sup>27</sup> Assets have a positive effect on the transition probability for both races, however, the size of the effect differs notably by race. The coefficient on interest income in the black regression is much larger than the coefficient in the white regression. An increase of \$1,000 in interest income for blacks ( $M = \$193$ ) increases the average transition probability by 0.0122. (All amounts reported in this article are in 1988 dollars.) The same increase for whites ( $M = \$845$ ) increases the average transition probability by 0.0018.<sup>28</sup> In addition, the coefficient estimates imply that a \$1,000 increase in cash payments increases the transition probability by 0.0037 for blacks and 0.0012 for whites (evaluated at mean values).<sup>29</sup>

The positive coefficients reported above provide evidence that both black and white men face liquidity constraints (Evans and Leighton 1989). In addition, the relationship between assets and entry into self-employment appears to be much stronger for blacks than for whites. As mentioned in Section III, this racial difference may be due to lending discrimination against blacks.

The coefficient estimates reported in table 2 identify a number of characteristics that are important in the process generating transitions into self-employment. In addition, the comparisons between the black

<sup>27</sup> The theoretical model posited by Evans and Jovanovic (1989) implicitly assumes that the probability of a transition into self-employment is a concave function of asset levels.

<sup>28</sup> The elasticity evaluated at the average is approximately three times larger for blacks than for whites.

<sup>29</sup> There remains the possibility that interest income is partly endogenous in the transition equation due to personal saving in preparation for entry into self-employment. However, cash payments should not suffer from this problem as they are typically unanticipated.

and white coefficients indicate that there are both similarities and dissimilarities between the two processes. A likelihood ratio test rejects the null hypothesis that the two specifications are the same providing some evidence that racial differences in the overall entry process exist. These racial differences may account for part of the gap in the transition rate into self-employment. The remaining part of the gap is due to racial differences in the distributions of variables important to the entry decision.

Estimates from the PSID indicate that black and white men have different distributions of many of the variables included in the logit regressions reported in table 2 (see table A1). The variables with the most striking racial differences are graduating from college, having a self-employed father, and the two included measures of assets. The percent of blacks who graduated from college is roughly one-third the percent of whites. In addition, blacks are one-sixth as likely to have a self-employed father when they were growing up. Finally, black asset levels are slightly less than 25% of white asset levels. In the following section, I estimate the contribution of these differences to the racial gap in the transition rate into self-employment.

#### Decomposing the Racial Gap in the Transition Rate into Self-Employment

The large gap between the black and the white transition rate into self-employment reported in table 1 can be decomposed into two parts. One part of the black/white gap is due to racial differences in the distributions of individual characteristics, and the other part is due to racial differences in the processes generating transitions into self-employment. Racial differences in the processes include both racial differences in the importance of certain variables in determining transition probabilities and the racial difference that is unexplained because of the inability to include unmeasurable variables. In this section, I use a novel procedure to decompose the racial gap into these two parts because of the nonlinearity of the equation that predicts the probability of a transition into self-employment.

For a linear regression, the standard Blinder-Oaxaca decomposition of the black/white gap in the average value of the dependent variable,  $Y$ , can be expressed as

$$\bar{Y}^W - \bar{Y}^B = [(\bar{X}^W - \bar{X}^B)\beta^B] + [\bar{X}^W(\beta^W - \beta^B)], \quad (4.1)$$

where  $\bar{X}^j$  is a row vector of average values of the independent variables

and  $\beta^j$  is a vector of coefficient estimates for race  $j$ .<sup>30</sup> For a nonlinear equation, such as  $Y = F(X\beta)$ , the decomposition can be written as

$$\begin{aligned} \bar{Y}^W - \bar{Y}^B = & \left[ \sum_{i=1}^{N^W} \frac{F(X_i^W \beta^B)}{N^W} - \sum_{i=1}^{N^B} \frac{F(X_i^B \beta^B)}{N^B} \right] \\ & + \left[ \sum_{i=1}^{N^W} \frac{F(X_i^W \beta^W)}{N^W} - \sum_{i=1}^{N^W} \frac{F(X_i^W \beta^B)}{N^W} \right], \end{aligned} \quad (4.2)$$

where  $N^j$  is the sample size for race  $j$ . This alternative expression for the decomposition is used because  $\bar{Y}$  does not necessarily equal  $F(\bar{X}\beta)$ . In both (4.1) and (4.2), the first term in brackets represents the part of the racial gap that is due to group differences in distributions of  $X$ , and the second term represents the part due to differences in the group processes determining levels of  $Y$ . To calculate the decomposition, I substitute the average probability of a transition into self-employment for  $\bar{Y}$ , the logistic function for  $F$ , and the coefficient estimates reported in table 2 for  $\beta$ .<sup>31</sup>

The first term in (4.2) provides an estimate of the contribution of racial differences in the entire set of independent variables to the racial gap. An additional calculation, however, is needed to identify the contribution of racial differences in specific variables to the gap.<sup>32</sup> For example, assume that  $X$  includes two variables,  $X_1$  and  $X_2$ .<sup>33</sup> I can then express the independent contribution of  $X_1$  to the racial gap as

$$\frac{1}{N^B} \sum_{i=1}^{N^B} F(X_{1i}^W \beta_1^B + X_{2i}^B \beta_2^B) - F(X_{1i}^B \beta_1^B + X_{2i}^B \beta_2^B). \quad (4.3)$$

<sup>30</sup> The racial gap can also be written as  $\bar{Y}^W - \bar{Y}^B = (\bar{X}^W - \bar{X}^B)\beta^W + \bar{X}^B(\beta^W - \beta^B)$ . These two methods of calculating the decomposition are equally valid and typically provide different estimates of the contribution of each component to the racial gap. See Blinder (1973) and Oaxaca (1973) for more details.

<sup>31</sup> A useful property of the logit regression that includes a constant term is that the average of the predicted probabilities must equal the proportion of ones in the sample. In contrast, the predicted probability evaluated at the means of the independent variables is not necessarily equal to the proportion of ones, and in the sample used here it is likely to be smaller because the logit function is convex for values less than 0.5.

<sup>32</sup> I present the process for the racial decomposition that uses coefficients estimated with the black sample. The process for the racial decomposition using the white coefficients is similar.

<sup>33</sup> The calculation of the independent contributions is similar when there are more than two variables in  $X$ .



Similarly, the contribution of  $X_2$  can be expressed as

$$\frac{1}{N^B} \sum_{i=1}^{N^B} F(X_{1i}^W \beta_1^B + X_{2i}^W \beta_2^B) - F(X_{1i}^W \beta_1^B + X_{2i}^B \beta_2^B). \quad (4.4)$$

The contribution of each variable to the gap is thus equal to the change in the average predicted probability from replacing the black distribution with the white distribution of that variable while holding the distribution of the other variable constant.<sup>34</sup> The calculation of (4.3) and (4.4), however, is not possible without first matching the white distribution of  $X_1$  and the black distribution of  $X_2$ .

One possible procedure for matching these distributions is as follows. First, I estimate a logit regression using the black sample. Using these coefficient estimates, I then calculate predicted probabilities for all observations in the black sample and all observations in a random subsample of whites with a sample size equal to  $N_B$ . I rank each member of the two samples by the value of this predicted probability and match them by their respective ranks. This procedure assigns low transition probability blacks the same characteristics as low transition probability whites.

The decomposition estimates obtained from this procedure depend on the randomly chosen subsample of whites. Therefore, to obtain estimates that use the entire white sample, I draw a large number of random white subsamples with replacement. I then calculate the mean value of estimates from all of these samples. In the decompositions reported below, I use 1,000 random subsamples of whites to calculate these means.

Table 3 reports estimates from this procedure for decomposing the black/white gap in the transition rate into self-employment. The black coefficients from table 2 are used in specification 1 and the white coefficients are used in specification 2. Row 6 of specification 1 provides an estimate of the reduction in the black/white transition rate gap resulting from giving blacks the same distribution of all included variables as whites. The contribution estimate indicates that racial differences in all included variables account for nearly 30% of the gap. The estimate of the total contribution using the white coefficients is smaller (14.2%). This estimate represents the reduction in the racial gap caused by giving whites the black distributions of all variables.

<sup>34</sup> Unlike in the linear case, the independent contributions of  $X_1$  and  $X_2$  depend on the value of the other variable. This implies that the choice of a variable as  $X_1$  or  $X_2$  (or the order of switching the distributions) is potentially important in calculating its contribution to the racial gap.

**Table 3**  
**Decomposition of Difference between White and Black Transition Rates**  
**into Self-Employment: PSID (1968–1989)**

|   | Specification |        |
|---|---------------|--------|
|   | (1)           | (2)    |
| Sample used to estimate coefficients and transition rates                   | Black         | White  |
| Transition rate (gap = .0201)   | .0193         | .0394  |
| Contribution to the gap from racial differences in the following variables: |               |        |
| 1. Controls   | -.0010        | -.0034 |
|   | -5.0%         | -17.1% |
| 2. Education level  | .0001         | .0012  |
|   | .5%           | 5.8%   |
| 3. Asset levels   | .0031         | .0028  |
|   | 15.2%         | 13.9%  |
| 4. Father's education level   | .0010         | .0008  |
|   | 4.8%          | 4.2%   |
| 5. Father's self-employment status  | .0027         | .0015  |
|   | 13.6%         | 7.5%   |
| 6. All variables  | .0058         | .0029  |
|   | 29.1%         | 14.2%  |

NOTE.—The sample consists of male nonagricultural workers (ages 16–65) who are heads of family units. Contribution estimates are mean values of the decomposition using 1,000 random subsamples of whites. Sample weights provided by the PSID are used in all calculations. Controls include all variables included in the logit regressions but not listed separately in this table.

Table 3 also reports estimates of the contributions of racial differences in specific subsets of variables to the transition rate gap.<sup>35</sup> The negative estimates reported in row 1 indicate that racial differences in the controls (all independent variables not listed in other rows of the table) actually reduce the black/white gap in the transition rate. The controls include year dummies and variables that have a small effect on the transition probability or have small racial differences in distributions.

The large difference between blacks and whites in education levels explains only a small part of the gap in specification 2 and virtually none of the gap in specification 1. The lack of explanatory power is mainly due to the weak relationship between education and the entry probability. In contrast, the notable disparity between black and white asset levels explains a substantial portion of the gap. Differences in asset levels explain 15.2% of the gap in specification 1 and 13.9% in specification 2. In contrast to the finding in Meyer (1990), these results suggest that racial

<sup>35</sup> The estimates of contributions of specific subsets of variables to the gap do not appear to be overly sensitive to their ordering in the procedure of switching black and white distributions.

differences in asset levels play an important role in explaining the racial gap in the entry rate.

The two measures of the characteristics of the individual's father provide different results. Racial differences in the distribution of the education level of the individual's father do not explain much of the gap, whereas racial differences in the probability of having a self-employed father explain a large portion of the gap. This is especially true if the coefficients from the black regression are used to perform the racial decomposition. The positive contribution estimates for this variable suggest that the lack of self-employment among previous generations of blacks is partly responsible for the low entry rate among the current generation of blacks. This finding is consistent with the lack of traditions in business ownership argument (see Frazier 1959).

The results from the decompositions indicate that estimates of the contributions from racial differences in specific variables are somewhat sensitive to the use of black or white coefficients. This is inevitable as the processes determining transitions into self-employment differ by race. Oaxaca and Ransom (1994) suggest an alternative set of coefficients to use in the decompositions. These are the coefficients estimated from a pooled sample of blacks and whites. As a sensitivity check, I perform the decompositions using these coefficients and find contribution estimates that are very similar to those reported in specification 2.

The results from this section demonstrate that differences in the distributions of characteristics between blacks and whites explain part of the racial gap in the transition rate into self-employment. In addition, racial differences in specific variables, such as levels of assets and the likelihood of having a self-employed father provide important contributions to the gap. The remaining part of the gap is large and is due to racial differences in the coefficients. Unfortunately, we know much less about the causes of these differences. They may be partly caused by lending or consumer discrimination against blacks, and/or the omission of important unmeasurable factors such as risk aversion.

#### Racial Differences in the Exit Decision

I now analyze the determinants of the probability of a transition out of self-employment. Several logit regressions are estimated in which the dependent variable is equal to 1 if the individual switches into wage/salary work from self-employment or equal to 0 if the individual remains in self-employment. I report the estimates for these regressions in table 4.<sup>36</sup> In general, comparisons between the black and white coefficient esti-

<sup>36</sup> The coefficient estimates when classifying those working for both someone else and self as wage/salary workers are similar for whites but differ somewhat for blacks.

**Table 4**  
**Logit Equations for Transitions out of Self-Employment by Race: PSID**  
**(1968-1989)**

|   | Specification       |                     |
|---|---------------------|---------------------|
|   | (1)                 | (2)                 |
| Race                                      | Black               | White               |
| Graduated from high school                | .42618<br>(.34773)  | -.31333<br>(.17145) |
| Attended college                          | .24667<br>(.35752)  | -.24089<br>(.15792) |
| Graduated from college                    | -.26775<br>(.48120) | -.18047<br>(.16867) |
| Age                                       | -.06767<br>(.15561) | -.27597<br>(.05982) |
| Age squared/100                           | .01886<br>(.20352)  | .30990<br>(.07865)  |
| Number of children                        | -.17669<br>(.09224) | .01016<br>(.04435)  |
| Disability                                | .69356<br>(.43138)  | -.08149<br>(.19257) |
| Currently married                         | .94082<br>(.50648)  | -.20091<br>(.23275) |
| Previously married                        | .26442<br>(.61293)  | -.01290<br>(.28794) |
| Military veteran                          | -.38333<br>(.33394) | .24983<br>(.12140)  |
| Years in current position                 | -.00260<br>(.05211) | -.06472<br>(.01642) |
| Years in current position squared         | -.00050<br>(.00209) | .00093<br>(.00055)  |
| Father graduated from high school         | .66572<br>(.36578)  | -.12459<br>(.12621) |
| Father attended or graduated from college | -.35684<br>(.53647) | -.27281<br>(.18973) |
| Father self-employed                      | .86983<br>(.91054)  | -.39247<br>(.18897) |
| Interest income/1,000                     | -.20180<br>(.13268) | -.02853<br>(.01119) |
| Interest income/1,000 squared             | .00740<br>(.00744)  | .00007<br>(.00004)  |
| Cash payments received/1,000              | -.31618<br>(.31887) | .02538<br>(.01475)  |
| Cash payments received/1,000 squared      | .02006<br>(.03194)  | -.00022<br>(.00019) |
| Sample transition rate                    | .3595               | .1803               |
| Average derivative adjustment factor      | .1928               | .1363               |
| Sample size                               | 484                 | 4,447               |
| Log likelihood                            | -274.51             | -1,932.89           |

NOTE.—The sample consists of male nonagricultural workers (ages 16-65) who are heads of family units. The dependent variable is equal to 1 if the individual switches from self-employment to wage/salary work. Standard errors are in parentheses below coefficient estimates and are corrected for the possibility of including multiple observations per individual. All equations include a constant, the county unemployment rate, and year, region, and urban dummies. All asset and income variables are in 1988 dollars. Cash payments received include inheritances and insurance settlements (2-year average). Interest income includes income from dividends, interest, trust funds, royalties, and rent. The average derivative is equal to the adjustment factor multiplied by the coefficient.

mates are difficult to make because many of the black coefficients are imprecisely measured.

The relationship between education and the exit probability is not monotonic for either race. Graduating from college decreases the transition probability relative to not finishing high school for both races. However, graduating from high school increases the probability relative to not finishing high school for blacks, and graduating from college increases the probability relative to graduating from high school for whites. Overall, the results indicate a weak negative relationship. This result is somewhat consistent with past studies of self-employment which find that more educated business owners are less likely to leave self-employment. Father's education appears to be negatively correlated with the exit probability for whites. Among blacks the relationship is less clear.

Having a self-employed father decreases the average probability of a transition by 0.0535 for whites. In comparison, the black coefficient is large and positive suggesting that blacks with self-employed fathers are more likely to exit from self-employment, all else being equal. Interestingly, these findings are different than the findings for the entry regressions. In those regressions, the effects of having a self-employed father on the transition probability were the same sign, with the effect being much larger for blacks. These results suggest that the intergenerational link in self-employment is important for entry into self-employment among blacks, but not for exit from self-employment. However, some caution is warranted as this result is based on an imprecisely measured coefficient estimate in the black regression.

There exist important racial differences in the effect of assets on the exit decision. First, the effect of interest income on the probability of a transition is much stronger in the black regression than the white regression. An increase of \$1,000 in interest income for blacks ( $M = \$520$ ) decreases the average transition probability from 0.3595 to 0.3221. The same increase for whites ( $M = \$3,778$ ) decreases the average probability of a transition from 0.1803 to 0.1765. The negative effect of interest income on the exit probability for both races is consistent with the finding in Bates (1990*b*). Second, cash payments have a negative effect on the transition probability for blacks, but have a positive effect for whites. The result for whites is surprising and differs from previous findings of a negative relationship between receiving inheritances and leaving self-employment (see Holtz-Eakin, Joulfaian, and Rosen 1994*b*).

Similar to the results for the entry regressions, I find important similarities and dissimilarities between the black and white processes determining exits from self-employment. Using a likelihood ratio test, I reject the null hypothesis that the black and white logit regressions are the same suggesting that racial differences in the processes contribute to the gap in the transition rate out of self-employment. The large racial differences

**Table 5**  
**Decomposition of Difference between Black and White Transition Rates out of Self-Employment: PSID (1968 to 1989)**

|   | Specification |        |
|---|---------------|--------|
|   | (1)           | (2)    |
| Sample used to estimate coefficients and transition rates                   | Black         | White  |
| Transition rate (gap = .1583)   | .3317         | .1734  |
| Contribution to the gap from racial differences in the following variables: |               |        |
| 1. Controls   | -.0151        | .0196  |
|   | -9.5%         | 12.4%  |
| 2. Education level  | .0036         | .0087  |
|   | 2.3%          | 5.5%   |
| 3. Asset levels   | .0176         | .0028  |
|   | 11.1%         | 1.8%   |
| 4. Father's education level   | -.0262        | .0057  |
|   | -16.5%        | 3.6%   |
| 5. Father's self-employment status  | -.0117        | .0046  |
|   | -7.4%         | 2.9%   |
| 6. All variables  | -0.0317       | 0.0414 |
|   | -20.1%        | 26.1%  |

NOTES.—The sample consists of male nonagricultural workers (ages 16–65) who are heads of family units. Contributions estimates are mean values of the decomposition using 1,000 random subsamples of whites. Sample weights provided by the PSID are used in all calculations. Controls include all variables used in the logit regressions but not listed in this table.

in characteristics for this sample, however, may also contribute to the gap (see table A2).

### Decomposing the Racial Gap in the Transition Rate out of Self-Employment

In this section, I perform a decomposition of the black/white gap in the transition rate out of self-employment. I use the same procedure described above to identify the contribution of several subsets of variables to the racial gap. The results for this decomposition are reported in table 5. Using the white coefficients, 26.1% of the gap is explained by racial differences in all of the included variables. Controlling for racial differences actually widens the gap when the black coefficients are used.

Racial differences in education explain a small part of the gap in both specifications. The racial difference in education levels and the weak negative relationship between education and the exit probability are responsible for these findings. The estimates reported in row 3 indicate that racial differences in asset levels explain a large part of the gap in specification 1, but only a small part in specification 2. The combination of the importance of assets in the black exit regression and the large racial difference in asset levels explains the result in specification 1. The contribution estimate using the white coefficients is smaller because of the partly off-

setting effects of the negative effect of interest income and the positive effect of cash payments in specification 2 of table 4. Interestingly, racial differences in asset levels explain much less of the exit rate gap than the entry rate gap. This is mainly due to the stronger effect of assets on the probability of transitions into self-employment. Apparently, low black levels of assets restrict entry into self-employment among blacks relative to whites, but do not substantially increase the probability of blacks leaving self-employment relative to whites. Overall, the findings for racial differences in education and assets are weakly consistent with those in Bates (1989).

Racial differences in the education level of the individual's father provide a negative contribution to the gap in specification 1 and a very small positive contribution in specification 2. The findings for the contributions of racial differences in the probability of having a self-employed father are very similar. In contrast to the result reported in table 4, the large racial difference in parental self-employment does not explain a significant portion of the gap in the transition rate out of self-employment. The low probability of having a self-employed father may hurt blacks in the entry process, but not necessarily in the exit process.

The results reported in table 5 indicate that the decomposition estimates are sensitive to the coefficients used. Part of the discrepancy is due to actual differences between blacks and whites in the processes generating transitions out of self-employment, however, another part is simply due to the imprecision of many of the coefficient estimates in the black regressions. Unfortunately there is no solution to this problem. The black sample sizes in these regressions are small because of the low overall black self-employment rate. As a sensitivity check, however, I calculate the decompositions using coefficients from a pooled sample of blacks and whites. The contribution estimates from this decomposition are very similar to those from the decomposition using the white coefficients.

The results presented in table 5 suggest that racial differences in the distributions of all included variables explain part of the gap in the transition rate out of self-employment in specification 2 but actually reduce the gap in specification 1. In contrast to their effect on the racial gap in the entry rate, racial differences in assets and father's self-employment status do not provide large contributions to the exit rate gap. Again, the part of the gap due to racial differences in the coefficients is large.

### Decomposing the Racial Gap in the Self-Employment Rate

Using estimates of the contributions of racial differences in specific variables to the racial gaps in the entry and exit rates, I estimate the contribution of these variables to the self-employment rate gap. Assuming a steady state equilibrium, I calculate the predicted black/white self-

**Table 6**  
**Decomposition of Difference between White and Black Predicted Self-Employment Rates: PSID (1968–1989)**

|   | Specification |       |
|---|---------------|-------|
|   | (1)           | (2)   |
| Sample used to estimate coefficients and transition rates                   | Black         | White |
| Predicted self-employment rate (gap = .1302)                                | .0551         | .1853 |
| Contribution to the gap from racial differences in the following variables: |               |       |
| 1. Controls   | -.0054        | .0039 |
|   | -4.2%         | 3.0%  |
| 2. Education level  | .0009         | .0107 |
|   | .7%           | 8.2%  |
| 3. Asset levels   | .0117         | .0117 |
|   | 9.0%          | 9.0%  |
| 4. Father's education level   | -.0028        | .0067 |
|   | -2.2%         | 5.1%  |
| 5. Father's self-employment status  | .0045         | .0081 |
|   | 3.5%          | 6.2%  |
| 6. All variables  | .0088         | .0410 |
|   | 6.7%          | 31.5% |

NOTE.—The sample consists of male nonagricultural workers (ages 16–65) who are heads of family units. The predicted self-employment rate is equal to  $E/(E + X)$ , where  $E$  is the transition rate into self-employment and  $X$  is the transition rate out of self-employment. Contribution estimates are mean values of the decomposition using 1,000 random subsamples of whites. Sample weights provided by the PSID are used in all calculations. Controls include all variables used in the logit regressions but not listed in this table.

employment rate gap and estimate the contributions of racial differences in variables to this gap. These results are reported in table 6.

Racial differences in all of the variables included in the transition regressions explain 6.7% of the gap using the black coefficients and 31.5% of the gap using the white coefficients. The small contribution estimate using the black coefficients is mainly due to the negative contribution reported in row 6 of table 5. The magnitudes of individual contributions of variables to the self-employment rate gap reported in table 6 generally reflect the magnitudes of their average contributions to the gaps in the transition rate into self-employment and the transition rate out of self-employment.

Racial differences in education levels explain part of the black/white self-employment rate gap in specification 2 due to their positive contributions to the racial gaps in both the entry rate and the exit rate. In both specifications, racial differences in asset levels explain an important part of the gap. This is mainly due to the large contribution of asset levels to the racial gap in the transition rate into self-employment. The positive but small effect for education, and the positive and large effect for assets, is consistent with cross sectional findings in Fairlie and Meyer (1996). Racial differences in the probability of having a self-employed father make a small contribution to the racial gap in the self-employment rate primarily through their contribution to the gap in the entry rate.



## V. Conclusion

African-American men are one-third as likely to be self-employed as white men in the United States. Estimates from the PSID indicate that this large discrepancy is due to a black transition rate into self-employment that is approximately one-half the white rate and a black transition rate out of self-employment that is twice the white rate. A better understanding of the causes of racial differences in both types of transition rates is needed to design or modify existing policies that promote minority business ownership.

Estimates from the PSID also indicate that there exist considerable differences between black and white men in levels of education, levels of assets, and probabilities of having a self-employed father. Using a new variation of the Blinder-Oaxaca decomposition technique, I find that racial differences in the distributions of these variables and other measurable demographic and personal characteristics explain part of the black/white gap in the transition rate into self-employment. Specifically, lower levels of assets and lower probabilities of having a self-employed father provide important contributions to the lower average probability of entering self-employment for black men than white men. Through their effect on the entry rate, racial differences in these variables also explain part of the racial gap in the self-employment rate. Racial differences in these variables and others, however, do not appear to contribute substantially to the gap in the transition rate out of self-employment.

Past research finds that blacks have substantially lower levels of wealth than whites in the United States (see Blau and Graham 1990, for example). The results of this study support this conclusion and demonstrate that racial differences in asset levels provide an important contribution to the black/white gap in the entry rate into self-employment. This finding suggests that increasing funding for programs intended to assist potential minority business owners in acquiring start-up capital may reduce the racial disparity in self-employment.<sup>37</sup> The amount of this reduction given realistic changes in the funding for these programs, however, is likely to be small. The estimate presented here imply that quadrupling current black asset levels would result in only a 15% reduction in the racial gap in the entry rate. The policy implications of the findings for racial differences in parental self-employment are less obvious. Certainly, they imply that improvements in self-employment among the current generation of blacks will result in increases in self-employment among future generations of African-Americans.

<sup>37</sup> See Bates (1981) for an assessment of the Small Business Administration's efforts to promote minority business development through loan and procurement programs.

## Appendix

Table A1  
Means of Analysis Variables in Samples Used to Estimate Logit Equations for Transitions into Self-Employment

| Variable                        | Black Men |               |             | White Men          |        |               |             |                    |
|---------------------------------|-----------|---------------|-------------|--------------------|--------|---------------|-------------|--------------------|
|                                 | N         | Weighted Mean | Sample Mean | Standard Deviation | N      | Weighted Mean | Sample Mean | Standard Deviation |
| Transition into self-employment | 14,093    | .020          | .022        | .147               | 32,365 | .040          | .039        | .195               |
| Graduated from high school      | 13,958    | .292          | .269        | .443               | 32,140 | .202          | .219        | .413               |
| Attended college                | 13,958    | .287          | .269        | .443               | 32,140 | .355          | .356        | .479               |
| Graduated from college          | 13,958    | .081          | .056        | .229               | 32,140 | .246          | .225        | .418               |
| Age                             | 14,093    | 35.106        | 33.401      | 8.886              | 32,365 | 35.523        | 34.211      | 9.025              |
| Number of children              | 14,093    | 1.385         | 1.759       | 1.788              | 32,365 | 1.345         | 1.364       | 1.365              |
| Disability                      | 13,566    | .078          | .063        | .243               | 31,214 | .076          | .072        | .258               |
| Currently married               | 14,093    | .721          | .805        | .396               | 32,364 | .838          | .879        | .326               |
| Previously married              | 14,093    | .121          | .086        | .281               | 32,364 | .069          | .051        | .220               |
| SMSA                            | 14,047    | .761          | .728        | .445               | 32,148 | .643          | .630        | .483               |
| North East                      | 14,090    | .152          | .074        | .261               | 32,357 | .229          | .203        | .402               |
| North Central                   | 14,090    | .217          | .143        | .351               | 32,357 | .311          | .292        | .455               |
| South                           | 14,090    | .561          | .708        | .455               | 32,357 | .276          | .315        | .464               |
| Military veteran                | 13,792    | .313          | .301        | .459               | 31,959 | .411          | .392        | .488               |
| County unemployment rate        | 14,093    | 6.390         | 6.392       | 2.604              | 32,365 | 6.270         | 6.274       | 2.789              |
| Years in current position       | 13,486    | 6.359         | 5.385       | 6.005              | 31,151 | 5.835         | 5.275       | 6.158              |
| Father/high school graduate     | 12,499    | .199          | .160        | .366               | 31,229 | .320          | .347        | .476               |
| Father/college                  | 12,499    | .034          | .026        | .159               | 31,229 | .093          | .094        | .292               |
| Father/self-employed            | 14,071    | .008          | .010        | .098               | 32,339 | .050          | .049        | .215               |
| Interest income/1,000           | 14,091    | .193          | .109        | .797               | 32,297 | .845          | .753        | 3.250              |
| Cash payments/1,000             | 11,391    | .155          | .129        | .953               | 27,686 | .630          | .598        | 3.355              |

NOTE.—The sample consists of nonagricultural workers (ages 16–65) who are heads of family units.

**Table A2**  
**Means of Analysis Variables in Samples Used to Estimate Logit Equations for Transitions out of Self-Employment**

| Variable                          | Black Men |               |             | White Men          |       |               |             |                    |
|-----------------------------------|-----------|---------------|-------------|--------------------|-------|---------------|-------------|--------------------|
|                                   | N         | Weighted Mean | Sample Mean | Standard Deviation | N     | Weighted Mean | Sample Mean | Standard Deviation |
| Transition out of self-employment | 688       | .366          | .368        | .483               | 5,248 | .185          | .193        | .395               |
| Graduated from high school        | 688       | .147          | .145        | .353               | 5,239 | .176          | .183        | .387               |
| Attended college                  | 688       | .245          | .283        | .451               | 5,239 | .345          | .337        | .473               |
| Graduated from college            | 688       | .242          | .097        | .297               | 5,239 | .329          | .310        | .463               |
| Age                               | 688       | 38.797        | 37.996      | 8.912              | 5,248 | 38.591        | 37.300      | 8.208              |
| Number of children                | 688       | 2.024         | 1.879       | 1.821              | 5,248 | 1.536         | 1.504       | 1.335              |
| Disability                        | 659       | .103          | .085        | .279               | 5,073 | .075          | .075        | .264               |
| Currently married                 | 688       | .813          | .834        | .372               | 5,248 | .875          | .906        | .292               |
| Previously married                | 688       | .112          | .094        | .293               | 5,248 | .071          | .050        | .219               |
| SMSA                              | 688       | .755          | .725        | .447               | 5,232 | .630          | .599        | .490               |
| North East                        | 688       | .209          | .060        | .237               | 5,247 | .263          | .232        | .422               |
| North Central                     | 688       | .150          | .119        | .324               | 5,247 | .253          | .251        | .434               |
| South                             | 688       | .579          | .747        | .435               | 5,247 | .276          | .315        | .465               |
| Military veteran                  | 665       | .350          | .367        | .482               | 5,198 | .408          | .387        | .487               |
| County unemployment rate          | 688       | 6.330         | 6.379       | 2.559              | 5,248 | 6.250         | 6.307       | 2.798              |
| Years in current position         | 652       | 5.669         | 6.531       | 6.946              | 5,051 | 7.807         | 7.049       | 7.182              |
| Father/high school graduate       | 624       | .119          | .144        | .352               | 5,107 | .332          | .348        | .476               |
| Father/college                    | 624       | .244          | .059        | .236               | 5,107 | .105          | .128        | .334               |
| Father/self-employed              | 685       | .013          | .016        | .126               | 5,242 | .121          | .103        | .303               |
| Interest income/1,000             | 687       | .520          | .586        | 2.553              | 5,223 | 3.778         | 3.239       | 12.046             |
| Cash payments/1,000               | 569       | .144          | .176        | .881               | 4,665 | 1.012         | 1.363       | 13.809             |

NOTE.—The sample consists of nonagricultural workers (ages 16–65) who are heads of family units.

## References

- Aronson, Robert L. *Self-Employment: A Labor Market Perspective*. Ithaca, NY: ILR Press, 1991.
- Balkin, Steven. *Self-Employment for Low-Income People*. New York: Praeger, 1989.
- Bates, Timothy. "Black Entrepreneurship and Government Programs." *Journal of Contemporary Studies* 4 (Fall 1981): 59–69.
- . "The Changing Nature of Minority Business: A Comparative Analysis of Asian, Nonminority, and Black-Owned Businesses." *Review of Black Political Economy* 18 (Fall 1989): 25–42.
- . "The Characteristics of Business Owners Data Base." *Journal of Human Resources* 25 (Fall 1990): 752–56. (a)
- . "Entrepreneur Human Capital Inputs and Small Business Longevity." *Review of Economics and Statistics* 72 (November 1990): 551–59. (b)
- Benus, Jacob M.; Wood, Michelle L.; Napierala, Christopher J.; and Johnson, Terry R. "Massachusetts UI Self-Employment Demonstration." In *Self-Employment Programs for Unemployed Workers*. Unemployment Insurance Occasional Paper no. 92-2. Washington, DC: U.S. Department of Labor, Employment and Training Administration, Unemployment Insurance Service, 1992.
- Blanchflower, David G., and Oswald, Andrew J. "What Makes an Entrepreneur?" *Journal of Labor Economics* 16, no. 1 (January 1998): 26–60.
- Blau, David M. "A Time-Series Analysis of Self-Employment in the United States." *Journal of Political Economy* 95 (June 1987): 445–67.
- Blau, Francine, and Graham, David. "Black-White Differences in Wealth and Asset Composition." *Quarterly Journal of Economics* 105 (May 1990): 321–39.
- Blinder, Alan S. "Wage Discrimination: Reduced Form and Structural Variables." *Journal of Human Resources* 8 (Fall 1973): 436–55.
- Borjas, George. "The Self-Employment Experience of Immigrants." *Journal of Human Resources* 21 (Fall 1986): 487–506.
- Borjas, George, and Bronars, Stephen. "Consumer Discrimination and Self-Employment." *Journal of Political Economy* 97 (June 1989): 581–605.
- Coate, Stephen, and Tennyson, Sharon. "Labor Market Discrimination, Imperfect Information and Self-Employment." *Oxford Economic Papers* 44 (April 1992): 272–88.
- Dunn, Thomas, and Holtz-Eakin, Douglas. "Financial Capital, Human Capital, and the Transition to Self-Employment: Evidence from Intergenerational Links." Working paper. Syracuse, NY: Syracuse University, 1996.
- Evans, David, and Jovanovic, Boyan. "An Estimated Model of Entrepreneurial Choice under Liquidity Constraints." *Journal of Political Economy* 97 (August 1989): 808–27.
- Evans, David, and Leighton, Linda. "Some Empirical Aspects of Entrepreneurship." *American Economic Review* 79 (June 1989): 519–35.

- Fairlie, Robert W., and Meyer, Bruce D. "Ethnic and Racial Self-Employment Differences and Possible Explanations." *Journal of Human Resources* 31 (Fall 1996): 757-93.
- . "Trends in Self-Employment among White and Black Men: 1910-1990." Working paper. Santa Cruz: University of California, Santa Cruz, 1997.
- . "Does Immigration Hurt African-American Self-Employment?" In *Help or Hindrance? The Economic Implications of Immigration for African-Americans*, edited by Daniel S. Hamermesh and Frank D. Bean. New York: Russell Sage Foundation, 1998.
- Frazier, E. Franklin. *The Negro in the United States*. 2d ed. New York: McMillan, 1957.
- Fuchs, Victor R. "Self-Employment and Labor Force Participation of Older Males." *Journal of Human Resources* 17 (Fall 1982): 339-57.
- Glazer, Nathan, and Moynihan, Daniel P. *Beyond the Melting Pot*. 2d ed. Cambridge, MA: MIT Press, 1970.
- Guy, Cynthia; Doolittle, Fred; and Fink, Barbara. *Self-Employment for Welfare Recipients: Implementation of the SEID Program*. New York: Manpower Demonstration Research Corporation, 1991.
- Hill, Martha. *The Panel Study of Income Dynamics: A User's Guide*. Newbury Park, CA: Sage, 1992.
- Holtz-Eakin, Douglas; Joulfaian, David; and Rosen, Harvey. "Entrepreneurial Decisions and Liquidity Constraints." *Rand Journal of Economics* 23 (Summer 1994): 334-47. (a)
- . "Sticking It Out: Entrepreneurial Survival and Liquidity Constraints." *Journal of Political Economy* 102 (February 1994): 53-75. (b)
- Jovanovic, Boyan. "Selection and the Evolution of Industry." *Econometrica* 50 (May 1982): 649-70.
- Kihlstrom, Richard, and Laffont, Jean-Jacques. "A General Equilibrium Entrepreneurial Theory of Firm Formation Based on Risk Aversion." *Journal of Political Economy* 87 (August 1979): 719-48.
- Lentz, Bernard, and Laband, David. "Entrepreneurial Success and Occupational Inheritance among Proprietors." *Canadian Journal of Economics* 23 (August 1990): 563-79.
- Lieberson, Stanley, and Silverman, Arnold R. "The Precipitants and Underlying Conditions of Race Riots." In *The Black Revolts*, edited by James A. Geschwender. Englewood Cliffs, NJ: Prentice-Hall, 1971.
- Light, Ivan. *Ethnic Enterprise in America*. Berkeley: University of California Press, 1972.
- Lucas, Robert E. "On the Size Distribution of Firms." *Bell Journal of Economics* 9 (Autumn 1978): 508-23.
- Meyer, Bruce. "Why Are There So Few Black Entrepreneurs?" Working Paper no. 3537. Cambridge, MA: National Bureau of Economic Research, 1990.
- Oaxaca, Ronald L. "Male-Female Wage Differentials in Urban Labor Markets." *International Economic Review* 14 (October 1973): 693-709.

- Oaxaca, Ronald L., and Ransom, Michael R. "On Discrimination and the Decomposition of Wage Differentials." *Journal of Econometrics* 61 (March 1994): 5-21.
- Rees, H., and Shah, A. "An Empirical Analysis of Self-Employment in the U.K." *Journal of Applied Econometrics* 1 (January 1986): 95-108.
- U.S. Bureau of the Census. *1990 Census of the Population, Social and Economic Characteristics, United States*. Washington DC: U.S. Government Printing Office, 1993.
- . *1992 Economic Census: Survey of Minority-Owned Business Enterprises*. Washington DC: U.S. Government Printing Office, 1996.
- Washington, Booker T. *The Negro in Business*. Boston: Hertel, Jenkins, 1907.
- Yoon, In-Jin. "Immigrant Entrepreneurship: Korean Business in Chicago." Working paper. Chicago: University of Chicago, 1991.