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Does Job Protection Encourage Entrepreneurship?

By Joshua D. Gottlieb

The largest financial decisions most people make revolve around what jobs they take. When Ben Silbermann abandoned Google to found Pinterest—now worth \$11 billion—he gave up a stable, lucrative career for a new venture that could have easily failed. And for every Silbermann and Jeff Bezos, who left Wall Street to start Amazon.com, there are numerous unidentified risk-takers whose gambles didn't pay off. And even more potential entrepreneurs—filled with creative possibilities—choose the safe *status quo* and never even take the risks that would have had enormous potential to advance society.

A wave of new research is enabling us to measure and

understand how people choose between the safe, stable route and new risky ventures. How important is the risk of failure when deciding whether to become an entrepreneur? Could a flexible labor market mitigate that risk? In many industries, workers face a stark choice: Follow a standard, rigid career path or find a new line of work. If you step off that traditional path, there is often no easy way to return. Those who try going a different direction, and fail, may face substantially worse job opportunities—and even unemployment.

What would happen if workers had the flexibility to try something new without abandoning all hope of returning

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About The Author

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to the ordinary job market? A Canadian policy reform from 2000 provides an opportunity to answer that question.

The Canadian government's employment insurance (EI) system guarantees new parents a full 12 months of leave from work following the birth of their child. During this period, for those who take the leave, EI pays around half—55 percent—of the parent's previous income. More importantly, it also guarantees them the right to return to their previous job when the leave ends.

In my research with Richard Townsend and Ting Xu¹, we hypothesize that new mothers may use this substantial period of job-protected leave to experiment with a new business idea. Of course, parenthood is a busy time and new parents have numerous other demands beyond a potential new business.

But the Canadian reform expanded the period of leave from an average of seven months to one full year—giving mothers five additional months to settle into parenthood and perhaps dabble in

entrepreneurship.

The United States, in contrast, requires many companies to provide only three months of leave for new mothers. So, relative to the U.S., Canadian parents have an extra nine months of job protection. Given that U.S. workers are expected to return to work full time after three months, some Canadian parents could plausibly have more time to start a business.

By investing some initial time and possibly some money during this extended-leave period, a potential entrepreneur can begin to gauge whether her business idea is likely to succeed. If the outlook is promising, then it may be worth continuing to pursue the venture. But if she learns during the job-protected period that her idea is less promising than anticipated, she hasn't sacrificed her former career in the experiment: Her previous job is still waiting for her when the one-year leave ends. By protecting the entrepreneur from the costs of failure, the policy may induce more people to try starting a business.

To test this hypothesis, we take advantage of the very sharp timing of the policy reform. The new, longer job-protected leave was available only to parents of children born on or after December 31, 2000. If the child arrived even one day earlier, the parents were subject to the previous policy and received approximately five months less protected leave. By comparing parents of children born just slightly after that cutoff date with those whose kids were born slightly before, we can determine whether they used the extended job protection to experiment with a new business venture. This style of research, taking advantage of a sharp discontinuity in how a policy applies, has become extremely popular and productive in modern economic research.²

This comparison reveals a statistically significant and economically large increase in entrepreneurship among mothers who benefited from the full-year leave opportunity. Using data from the Canadian census, which are linked to tax returns, we find that 5 percent



of mothers are self-employed five years after the child's birth. This number increases by 1.8 percentage points for those whose kids arrived just after the reform.

We measure the number of entrepreneurs in one of two ways: by counting those who identify as “self-employed” on the census, or by counting those who report substantial self-employment income in tax returns. The results are similar with either measure.

We next examine whether these new businesses make meaningful contributions to the economy. The increase in self-employment that we measure persists for five years and is driven by those who report having other paid employees in the firm. So, at the very least, these businesses generate additional employment and don't die out immediately when the 12-month leave is over.

The effects are also driven by college-educated entrepreneurs and those above age 29 at childbirth. The new businesses arise in industries that, according to other data,

require above-average capital to start a new business. By every indication, these firms are well-poised to provide meaningful economic benefits.

Do these same forces operate in the United States? On the one hand, U.S. labor markets are less regulated and more flexible³, so perhaps they already provide the safety net that potential entrepreneurs need in order to experiment without risking their future employment. On the other hand, even a bit of unemployment can be a big hindrance to finding another job⁴, so some job protection could augment U.S. workers' willingness to take risks.

Our results comport well with other recent research on the importance of experimentation. This research^{5,6} considers workers' transitions between self-employment and paid employment. It argues that these switches represent repeated efforts to experiment: People try entrepreneurship for a while and return to paid employment if the business doesn't thrive as they had hoped.

In addition to protecting parents' previous jobs while on leave, the Canadian EI reform also provided modest financial benefits—workers received 55 percent of their previous wage up to a maximum of \$275 USD per week. In principle, the financial support could facilitate entrepreneurship: It takes money to make money. But for three reasons, this is unlikely to be a significant factor.

First, the level of these EI payments is likely too low to provide much surplus capital for business investments.

Second, we can take advantage of differences across Canadian provinces to distinguish between the impact of extended job protection and extended EI payments. Even prior to the reform, the province of Quebec already required that employers offer 70 weeks of job protection. But, since EI is administered nationally, the financial payments ended after 25 weeks—just like the rest of Canada. So, in Quebec alone, the reform at the end of 2000 extended EI financial payments without increasing

job protection. And when we analyze Quebec data separately, we don't find any effect of the reform on entrepreneurship in that province.

Third, other recent work⁷ studies a French reform similar to our example in Quebec. To encourage the unemployed to try starting a business, France decided to continue paying its unemployment insurance benefits while the recipients started a business, and even beyond if the business were to fail. This research found that the French reform expanded the pool of entrepreneurs, but that the newer businesses were smaller than existing startups. In contrast, the businesses spurred by the Canadian reform are more likely to have paid employees and, in general, seem higher quality. This suggests that our effects operate through different forces—most likely protection against the risk of failures, rather than through direct monetary transfers.

Certain industries already have systems in place to encourage risk-taking. Some technology firms allow their

employees to devote a portion of their time to separate projects, not part of their normal workload, to encourage experimentation. Within academia, tenure allows faculty members to undertake risky research ventures.

But the scope of these industry-specific arrangements is inherently limited. And our research can give policymakers some ideas to help foster more widespread entrepreneurship.

Broader risk-taking can benefit from safety nets, including the one that parental leave provides. Although our research relies on the Canadian leave expansion, these results don't have specific implications about the merits or costs of these policies. Parental leave has a wide range of other costs and benefits, and our research is not designed to measure or trade off those numerous effects.

But they do teach a meaningful lesson about the importance of a well-functioning labor market in the background. As Gromb and Scharfstein⁸ hypothesized, better options in the ordinary

labor market make it safer to experiment. So the best way to encourage valuable entrepreneurship is to take away unnecessary risk. A flexible labor market, with low unemployment risk for people whose new business ventures fail, is the ideal safety net.

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