Economic Studies
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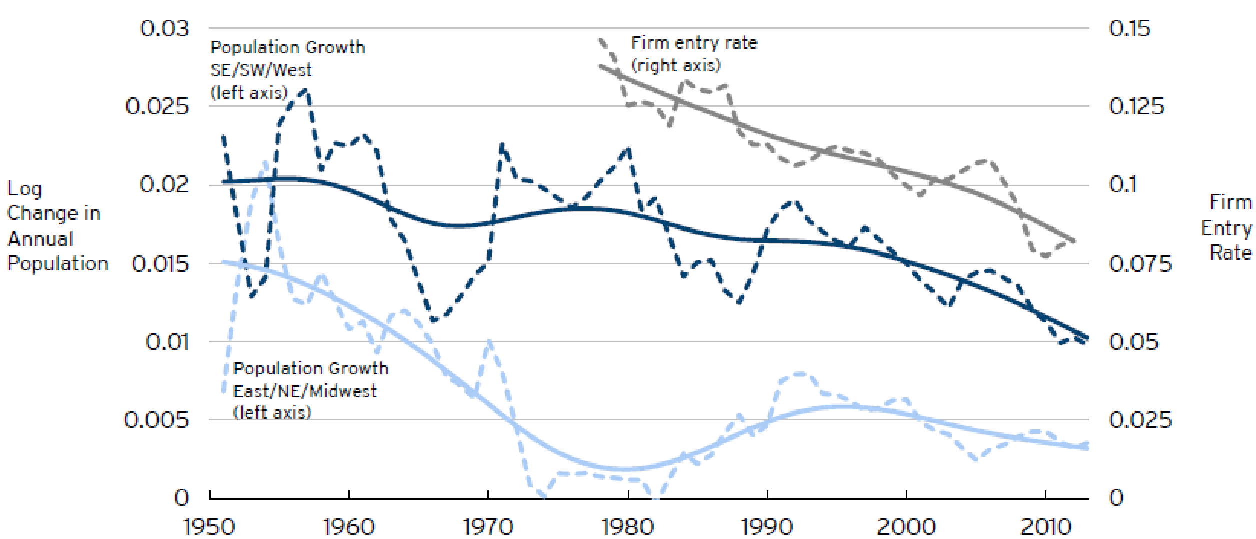
Decline in Entrepreneurship Could be Reversed by Allowing More High-Skilled Immigrants into the US, New Brookings Research Finds

Population decline, business consolidation causes of drop in entrepreneurship

Allowing more high-skilled immigrants into the US could help increase entrepreneurship and thus raise economic growth given that high-skilled immigrants are twice as likely to start businesses as native-born Americans, especially in the high-tech sector, where immigrants are not only more likely to start firms, but also to patent new high-tech discoveries, according to a new Brookings paper released today. As a result, the policy discussion should focus on this immigrant group first.

As economists try to understand what is causing "secular stagnation," one reason for the slow growth of the current US economy might be due to the decades-long decline in entrepreneurship, which has been at least partially caused by a slowdown in population growth, particularly in the South and West, as well as an increase in business consolidation, according to Nonresident Senior Fellow Robert Litan and Managing Director of Ennsyte Economics Ian Hathaway in their new paper, "What's Driving the Decline in the Form Formation Rate? A Partial Explanation."

Annual Population Growth (Regional) vs. Firm Entry Rate (National)



Source: U.S. Census Bureau, Bureau of Economic Analysis; author's calculations
Note: Dotted lines indicate actual growth rates; solid lines are rates that have been smoothed with an HP filter

The new paper, building on their recent research, brings a new perspective -- the importance of entrepreneurs -- to an older economic idea first put forward in the 1930s, and again more recently by Larry Summers: the link between greater population growth and economic expansion. Litan and Hathaway's prior research found that the US passed a dangerous threshold: more firms are dying than being created every year. They found this pervasive decline in the rate of firm formation and economic dynamism -- two measures indicative of future economic growth -- in a broad range of sectors and geographies throughout the US during the last three decades, even in the high-tech sector and so-called high-growth firms, the small group of (often young) businesses that are responsible for substantially all net job creation in the economy. The US wasn't alone -- this decline was observed in other economies of the OECD -- suggesting that large global factors are at play, they note.

Litan and Hathaway find a positive correlation between stronger population growth and higher rates of startup activity. Specifically, the slowing population growth in the West, Southwest, and Southeast regions since the early 1980s (which expanded rapidly in the decade prior and is likely to have helped push-up the firm entry rate by the time the data on startups begins in 1978), as well as increased business consolidation (a measure of the amount of overall economic activity occurring in firms with multiple establishments), are largely responsible for the decline in US entrepreneurship. They also find that the ageing of the population has impacts because prime-entrepreneurship age tends to be in the early-to-middle years of one's career (35-44 years old on average).

The authors analyze variations in startup rates across the US metropolitan areas during a three-decade period. These metropolitan areas cover a large portion of national firm formations (more than 80 percent), making them good proxies for analyzing changes in firm formation over time for the entire United States, and also allowed the authors to exploit differences across metros which provides a much larger sample size than a simple national time series, allowing for a more robust statistical analysis.

They find that states with the highest firm formation rates are located in the highest population growth regions of the Western, Southwestern, and Southeastern United States, with the exception of Vermont and New Hampshire, which had the 24th and 25th highest firm formation rates among states in the late-1970s -- making them the only states in the top 25 from outside of West, Southwest, or Southeast.

The response to their first finding of declining entrepreneurship, "which seems at first blush to be so counter-intuitive, clearly touched a nerve," they write. "How could it be that the American economy, built on the sweat and ingenuity of some of history's greatest entrepreneurs, now has more businesses closing each year than new ones opening doors? And with all of the seeming technological disruption and popularity of entrepreneurship around, how could it be that mature firms are more entrenched than at any point in at least the last couple of decades?"

Litan and Hathaway note the importance of policy in entrepreneurship, such as immigration, which they believe is the key to stopping America's entrepreneurial downslide. High-skilled immigrants in particular are twice as likely to start businesses as native-born Americans, which is especially true in high-tech sectors, where immigrants are not only more likely to start firms, but also to patent new high-tech discoveries. They suggest giving green cards to foreign students completing STEM degrees at US universities and to many more immigrant entrepreneurs, which would increase income and employment opportunities for American workers across the board.

Greater regulations on business formation likely result in fewer new firms being created, as well as other factors such as exit laws (bankruptcy), corporate governance, employment, credit markets, and regulatory compliance costs, they also note in discussion of public policy. However, their paper does not analyze those factors due to empirical and methodological limitations. Regardless, their research is able to explain a substantial portion of the decline and variation in the firm formation rate without those policy factors.