“Surging Business Formation in the Pandemic: Causes and Consequences”

by Decker and Haltiwanger

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Discussion
Brookings Papers on Economic Activity
The impact of the pandemic on firm formation

• The effect of the pandemic on startups was poised to be a very negative one

• Young firms are the first to be impacted in time of uncertainty.

• While there were a lot of federal programs for small businesses, none were targeted at new firms.
COVID in 2020: New York State Registrations

Number of New Firms Registered Per Day

School and Restaurant Closure Begins

Jan 1 Jan 16 Jan 31 Feb 15 Mar 1 Mar 16 Mar 31 Apr 15 Apr 30 May 15 May 30

2019 2020
Yet, there was a surprising huge recovery. There is a **boom** in entrepreneurship after COVID.
The boom in entrepreneurship after COVID

- After a reduction in entrepreneurship since the great recession there has been a boom!

1. Quick: Starting in June, 2020
2. Massive
   (increases of 30 – 50% of firms. Larger than COVID drop, and most policy interventions.)
3. Permanent.
Replicates across multiple datasets

What appeared to be presaging the death of the U.S. entrepreneurial economy now looks like the largest boom in entrepreneurship of our lifetimes.
• What is driving these changes?

• What do they mean?

• Research path forward.

• Conclusion
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A few causes to discard..

1. Is there an issue with the data?
   - No. The finding replicates across multiple datasets from different administrative agencies, and most of the data processes are done overarchingly online since a decade ago.

2. Necessity entrepreneurship?
   - Probably not. This happened in one of the strongest labor markets in decades.

3. Only self-employment?
   - No. While the change is larger for self employed (50%) vs likely employer firms (30%) the increase occurs on both.
   - In quantity, self employed size >> employer.
Evidence on a changing nature of entrepreneurship the U.S. economy

• But we don’t know why, or what it means.
1. Changes in industry composition: both COVID and non-COVID related

Initial boom in E-commerce

More permanent boom in professional services
2. Changes in geography and race

Boom is largest in the traditional south, which is not the highest livability areas.

Not typically considered high amenity locations.
The increase is particularly concentrated on ZIP Codes (neighborhoods) with a high share of Black residents.
Racial Disparities in the Paycheck Protection Program

Sergey Chernenko & David S. Scharfstein
Facts we know

There is boom in entrepreneurship

1. Industry composition changed
2. Geography and race changed
3. Finance availability
• What is driving these changes?

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We are facing the biggest increase in entrepreneurship of our lifetimes.

Huge optimism?
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Huge optimism?

*The entrepreneurship-driven economic model.*

Entrepreneurship \rightarrow \text{Dynamism} \quad \text{Innovation} \quad \text{Efficiency} \rightarrow \text{GDP Growth}

Schumpeter on innovation. Adam Smith on efficiency.

Why is this increase not presaging a GDP boom?
How much will an increase of 50% in entrepreneurship impact productivity / GDP?

- SVAR models of entrepreneurship to GDP (t+2): 10% - 20%
  Koellinger and Thurik (REStat, 2012).

- Increase of GDP flow by 5% to 10%? Unrealistic.

*The entrepreneurship-driven economic model.*
Once-in-a-lifetime shocks shape agendas for decades. Macroeconomics and the great depression.
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the heterogeneous impact of entrepreneurship

• Idea: you can use the dispersion in responses to identify the relationship between two variables.

• Across regions, the COVID shock should’ve led to an increase in variance of firm formation.

• Which should allow identifying fundamental parameters such as:
  a) The correlation between startup formation and business dynamism.
  b) The correlation between startup formation and innovation.
Is there a behavioral change in entrepreneurial propensity?

• The typical model of economics assumes characteristics that drive startup formation (optimism, talent, financial capital, social networks) are sort-of fixed in the short term.

• But how do so many people choose to start firms all of a sudden?
The canonical model will both be tuned and potentially updated.

Entrepreneurship → Dynamism → Innovation → Productivity → GDP Growth

?
• What is driving these changes?

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Conclusion

1. Very important phenomenon documented on the (massive) changes in entrepreneurship after COVID.

2. Tracing out the impact and evolution of these changes will be a big opportunity for entrepreneurship research.
   • We do not understand its causes, or can predict its consequences, beyond broad theoretical models and comparative statics (Akcigit and Kerr, 2018; Aghion and Howitt, 1992)
   • Creating huge opportunities for future research.

3. However, there are policies ready to be enacted based on the facts we know, even if we don’t have all the answers.
   • Industry allocation, racial disparities, and financial access.
Thank you!