James Fallows
Ta Nehisi Coates

Welfare Makes America More Entrepreneurial "The Atlantic"

Research shows that when governments provide citizens with economic security, they embolden them to take more risks.

A man wearing a U.S. flag necktie stands in line at the National Capital Region Job Fair Jonathan Ernst/Reuters

- WALTER FRICK

In 1988, Ronald Reagan traveled to the Soviet Union and gave a speech at Moscow State University, making the case for capitalism. America's secret, he argued, was its entrepreneurs, whose "courage to take risks" was responsible "for almost all the economic growth in the United States" and much of its technological edge. This risk-taking was made possible, he continued, by economic freedom, which he associated with "limited, unintrusive" government.

Reagan was right about the link between startups and growth, but wrong in assuming that small government was the way to encourage them.

His belief in a tradeoff between taking care of citizens and promoting innovative new businesses is at odds with the evidence. In fact, one way to get more people to start companies, according to a growing body of research, is to expand the welfare state.

Pundits and researchers often note the negative correlation between government spending and entrepreneurship, both within the U.S. and internationally, and conclude that growth requires trimming social welfare programs. Jim Manzi of the *National Review*, for example, a thoughtful commenter on economic policy, wrote last year that, "we must accept some amount of social dislocation in return for innovation." But correlations can be misleading. A series of more recent studies challenge the view that larger or more activist government necessarily threatens entrepreneurship. In fact, that may get the relationship precisely backwards.

Entrepreneurs are actually more likely than other Americans to receive public benefits, after accounting for income, as Harvard Business School's Gareth Olds has documented. And in many cases, expanding benefit programs helps spur new business creation.

Take food stamps. Conservatives have long argued that they breed dependence on government. In a 2014 paper, Olds examined the link between entrepreneurship and food stamps, and found that the expansion of the program in some states in the early 2000s increased the chance that newly eligible households would own an incorporated business by 16 percent. (Incorporated firms are a better proxy for job-creating startups than unincorporated ones.)

Interestingly, most of these new entrepreneurs didn't actually enroll in the food stamp program. It seems that expanding the availability of food stamps increased business formation by making it less risky for entrepreneurs to strike out on their own. Simply knowing that they could fall back on food stamps if their venture failed was enough to make them more likely to take risks.

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Food stamps are not an isolated case. In another paper, Olds looked at the creation of the Children's Health Insurance Program (CHIP), which offers publicly funded health insurance for kids whose families don't qualify for Medicaid. By comparing the rate of entrepreneurship of those who just barely qualified for CHIP to those whose incomes just barely exceeded the cutoff, he was able to estimate the program's impact on new business creation. The rate of incorporated business ownership for those eligible households just below the cutoff was 31 percent greater than for similarly situated families that could not rely on CHIP to care for their children if they needed it.

The same is true of recent immigrants to the United States. Contrary to claims by the right that welfare keeps immigrants from living up to their historic role as entrepreneurs, CHIP eligibility increased those households' chances of owning an incorporated business by 28 percent.

The mechanism in each case is the same: publicly funded insurance lowers the risk of starting a business, since entrepreneurs needn't fear financial ruin. (This same logic explains why more forgiving bankruptcy laws are associated with more entrepreneurship.)

A 2010 study by RAND found a similar effect with Medicare. American men were more likely to start a business just after turning 65 and qualifying for Medicare than just before. Here again, government can make entrepreneurship more appealing by making it less risky. By this logic, Obamacare doubles as entrepreneurship policy by making it easier for individuals to gain health insurance without relying on an employer.

Sometimes, though, a robust safety net may serve to discourage entrepreneurship. The best path in such cases, however, may not be to cut the program, but rather, to reform it. When France lowered the barriers to receiving unemployment insurance, it actually increased the rate of entrepreneurship.. Until 2001, citizens on unemployment insurance had little incentive to start businesses, since doing so would terminate their benefits. Instead of gutting the program, the state simply decided to let anyone who founded a business keep drawing benefits for a limited period, and guaranteed that they would be eligible again if that business failed. The result: a 25 percent increase in the rate of new-firm creation.

In the United States, though, many social welfare benefits still function like the old French system, disincentivizing entrepreneurship, and some popular reform proposals would actually worsen the situation. With food stamps, for instance, there has been a push to tie benefits to finding and holding a job, which actually does raise a barrier to starting a business.

Of course benefits are only one side of the ledger. Taxes are just as often held up as a threat to entrepreneurship and a dynamic economy. A lower capital gains tax rate does seem to be associated with a greater supply of entrepreneurs. But keeping the capital gains rate low to help startups is incredibly inefficient, since only a small portion of realized capital gains are from entrepreneurial activity. As Harvard Business School professors Paul Gompers and Josh Lerner write, "policies that increase the relative attractiveness of becoming an entrepreneur and promote technology innovation probably would have more of an effect on venture capital investments than an across the board cut in the capital gains tax rate."

Instead of preserving low tax rates, entrepreneur-friendly tax reform would encourage startup investment by shifting the tax code away from its current bias for debt over equity, and could preserve or expand key tax credits like the exemption for long-term investment in small businesses.

Even the assumption that bureaucratic "red tape" holds back startups is less obvious than it sounds. Professors at George Mason created a novel measure of federal regulation in the U.S. and compared the amount of federal regulation to the number of new business establishments in each industry. They found a slightly positive correlation: more regulation was actually associated with more new establishments. (Though the number of "new establishments" correlates with entrepreneurship, they're not quite the same thing since the former counts expansion by existing firms.)

That's not to say regulations don't hamper entrepreneurs; of course, they often do. It may even be the case that a better measure of entrepreneurship would correlate negatively with the amount of regulation. But what evidence we do have squarely challenges the intuition that it's government that holds back startups.

It would be silly to argue that bigger government is always and everywhere good for startups. But the standard critique of big government throttling economic growth appears increasingly at odds with the available evidence. So why do pundits and politicians, on both sides of the aisle, so often assume the opposite?

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In truth, the *what* matters more than the *how much*. Some government programslikely boost entrepreneurship, while others hold it back. The same is true of taxation, and of regulation.

This argument is particularly important today for two reasons. First, despite the headlines coming out of Silicon Valley, American has actually become less entrepreneurial over the past few decades. The research described above suggests that reversing that decline need not include cuts to the welfare state. Second, entrepreneurship is central to the ongoing debate over stagnating economic growth. Just as mainstream institutions like the IMF and OECD have publicly questioned the assumption that growth requires tolerating income inequality, we must revisit the idea that an expanded welfare state comes at the expense of entrepreneurs and innovation.

The evidence simply does not support the idea of a consistent tradeoff between bigger government and a more entrepreneurial economy. At least in some cases, the reverse is actually true. When governments provide citizens with economic security, they embolden them to take more risks. Properly deployed, a robust social safety net encourages more Americans to attempt the high-wire act of entrepreneurship.