
Entrepreneurship in the UK

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Abstract

This paper examines the causes and consequences of changes in the incidence of entrepreneurship in the UK. Self-employment as a proportion of total employment is high by international standards in the UK, but the share has fluctuated over time. We examine the time series movements in self-employment, which are principally driven by financial liberalization and changes in taxation rules, especially as they relate to the construction sector which is the dominant sector. We document that the median earnings of the self-employed is less than for employees. We show that in comparison with employees the self-employed are more likely to be males; immigrants; work in construction or financial activities; hold an apprenticeship; work in London; work long hours; have high levels of job satisfaction and happiness. Consistent with the existence of capital constraints on potential and actual entrepreneurs, the estimates imply that the probability of self-employment depends

positively upon whether the individual ever received an inheritance or gift. Evidence is also found that rising house prices have increased the self-employment rate. There appears to be no evidence that changes in self-employment are correlated with changes in real GDP, nor national happiness.

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1

Introduction

This paper examines the causes and consequences of changes in the incidence of entrepreneurship in the UK. But an initial question must be: how many entrepreneurs are there? The answer is not straightforward. There are several ways of counting them. The simplest is to count the number of self-employed workers, but even that is difficult. We could count those that self-report their employment status, such as in the Labour Force Survey (LFS).¹ Or we could count the number of individuals who declare self-employment income for taxation purposes. It would be useful to do both and see if the numbers equate. They do not. In fact, the number of people who declare taxable income from self-employment in the UK is roughly 50% greater than the number that say they are self-employed. Her Majesty's Revenue and Customs (HMRC) records just over 4.5 million individuals declaring some income from

¹The definition of self-employment in the Labour Force Survey is left entirely to the respondent, and with no guidance or prompt. This could result in a lack of coherence with other measures of the self-employed, such as the Inland Revenue's Survey of Personal Incomes (SPI) or with measures of jobs based largely on employer surveys, such as workforce jobs. There is currently a consistency check to the LFS, carried out by the ONS, which recodes some respondents' employment status to employee if the occupation they claim to do is inconsistent with self-employment (for example, self-employed policeman).

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self-employment in 2003/2004, but the LFS records just over 3 million self-employed workers. This is not that surprising.

It is clear that many individuals have more than one job, so the number of individuals reporting self-employed earnings for taxation purposes should be expected to be higher than the number that say they are self-employed. It is also likely that in some instances individuals will struggle to identify whether they are principally an employee or self-employed. They could base their decision on hours worked or income earned. Or it could reflect the timing of survey responses. A classic example is that of a free-lancing actor. Fifty-one weeks of the year they work for a wage waiting tables in a restaurant. But by the survey reference week they have quit their job as a waiter and they star in a film for which they are paid one hundred times the wages they earned as a waiter over the previous 51 weeks. Are they self-employed or employed?

In this paper, we focus primarily on the characteristics of the self-employed and how self-employment has changed over time, principally in the UK, using the LFS. Unfortunately these data do not record self-employed earnings. Consequently, we also make use of the HMRC data as well as information from various Family Resources Surveys to compare earnings of the self-employed with the wages and salaries earned by employees.

The most entrepreneurial individuals in the UK, such as Lakshmi Mittal, Sir Richard Branson and Sir Alan Sugar, are generally not included in our surveys. A very small number of the most entrepreneurial individuals are very important both in terms of wealth and job creation. What distinguishes them from everyone else? As far as we can, with the limited data available, we examine their characteristics too.

In what follows we first consider time series trends in self-employment in the UK and elsewhere. Second, we compare the earnings of the self-employed with those of wage and salary workers. Third, we examine the characteristics of the self-employed. Fourth, we perform a series of econometric analyses of the determinants of self-employment and draw comparisons with the US and the EU. Fifth, we consider the importance of liquidity constraints and the role of inheritances and

gifts and rising house prices in overcoming these credit constraints. Sixth, we examine macro-economic consequences and correlates of self-employment and draw a series of conclusions. The aim of this paper is thus to identify the characteristics of the self-employed and try to explain how and why their numbers have changed over time.

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