

# PartnersUpdate

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## Self-Employment as Economic Development Strategy: What Does It Mean for Metro and Nonmetro Counties in the Southeast?

### Introduction

Unemployment is a serious economic problem for many communities, especially in the rural areas of the southeastern United States. With manufacturing plants closing and farm population declining because of long-term structural changes in agriculture, rural families are facing a choice between outmigration to urban areas or remaining where they are and starting their own businesses. The data show that more rural families are choosing to start their own businesses.

A key feature of past trends in the Southeast labor market<sup>1</sup> is the rising share of self-employment. More and more Southerners depend on self-employment as opposed to employment in the formal job market. These are people who work for themselves and who may employ others. They assemble resources, take risks, turn ideas into viable businesses, and make profits or incur losses.

### Methodology: How to measure self-employment

This study uses nonfarm proprietorships (NFP) data compiled by the Bureau of Economic Analysis (BEA) as a measure of self-employment. NFP data are derived from filings of federal tax forms 1040 (Schedule C) and 1065. Like the BEA wage and salary employment numbers, these data include both full- and part-time workers, including workers who work as regular employees and are also self-employed to supplement those wage-and-salary earnings.

The BEA classifies total full- and part-time employment into two broader areas: *wage and salary jobs* and *proprietorships*. While wage and salary workers are employed by others, proprietors are self-employed and may even hire workers. The BEA further classifies proprietors into *farm proprietors* and

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<sup>1</sup> The region considered here as southeastern United States is one of the eight Bureau of Economic Analysis regions that includes the following states: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia.

*nonfarm proprietors*. Nonfarm proprietors include sole proprietors and individual business partners (excluding limited partners).

### **Self-employment during the past decade**

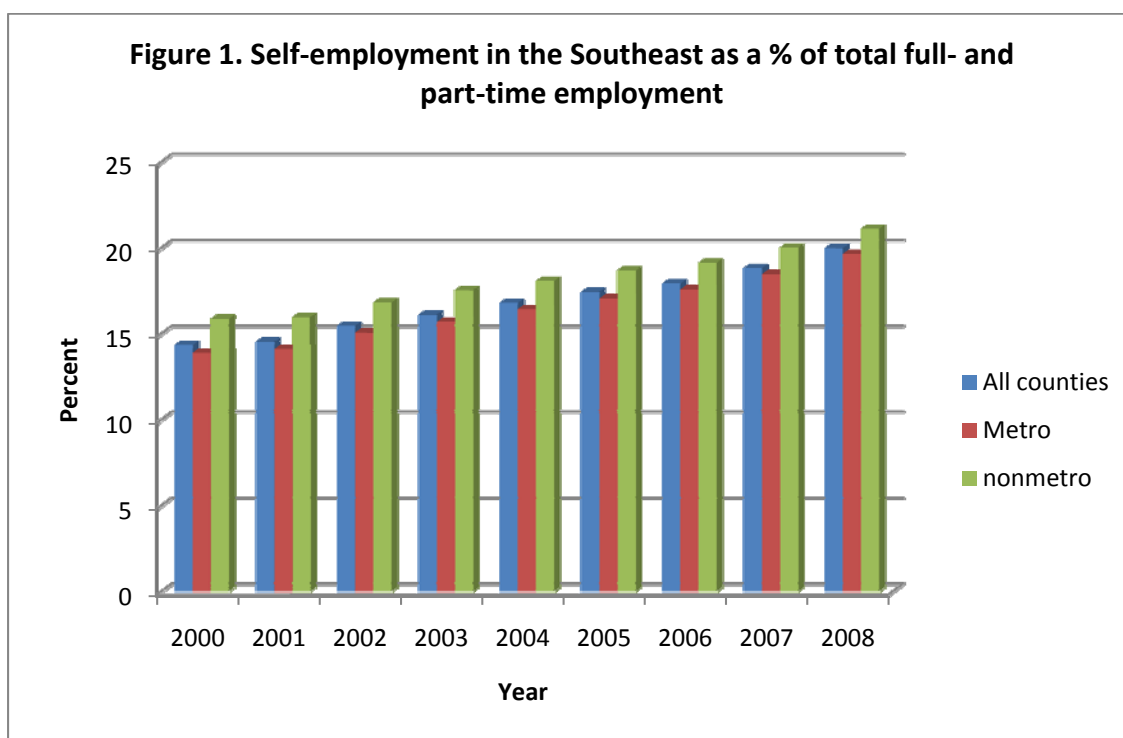
The data show that the number of nonfarm proprietors increased in the Southeast by 56 percent between 2000 and 2008, from 5.2 million to 8.2 million. As a percentage of total full- and part-time employment, this number has increased from 14 percent to 20 percent over the nine-year period (see the table). While the share of self-employment in total employment varies across counties, metro and nonmetro areas, and states in the Southeast, the upward trend is generally applicable to all counties and states over this time period.

**Table: Self-employment as a percent of total full- and part-time employment, 2000–8**

Year	2000	2002	2004	2006	2008
All counties	14.3	15.5	16.8	17.9	20.0
Metro counties	13.9	15.1	16.4	17.6	19.6
Nonmetro counties	15.9	16.8	18.1	19.1	21.1
Alabama	14.3	15.0	16.3	17.5	19.4
Arkansas	15.6	15.5	16.0	16.9	18.4
Florida	15.3	16.5	17.7	18.6	21.4
Georgia	13.8	15.6	17.7	19.4	21.6
Kentucky	13.3	14.2	15.1	15.6	17.1
Louisiana	14.3	15.8	16.6	18.9	20.1
Mississippi	13.8	14.6	15.6	17.0	18.8
North Carolina	14.3	15.3	16.7	17.7	19.5
South Carolina	12.6	15.5	17.7	18.5	20.4
Tennessee	15.9	16.9	17.9	19.0	21.2
Virginia	12.1	12.2	13.4	14.3	16.0
West Virginia	14.6	14.4	14.7	15.3	16.6

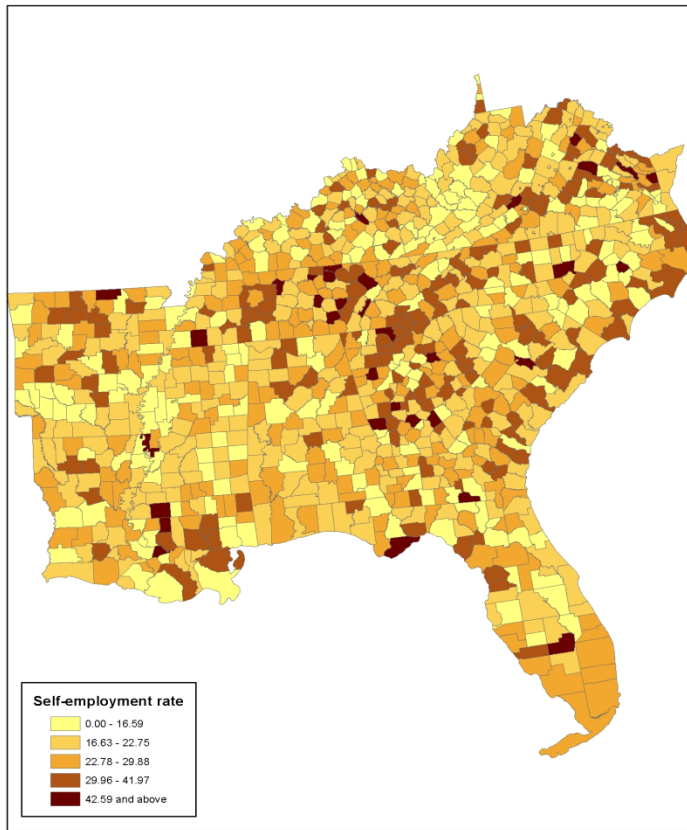
Source: Author's calculations based on data from the U.S. Bureau of Economic Analysis

Nonmetro counties report a slightly higher share of self-employment than do metro counties (see the table and figure 1). Among the southeastern states, the highest share of self-employment (as a percent of total employment) was reported in Georgia and the lowest was in Virginia in 2008. Data also show that some counties have a significantly higher rate of nonfarm proprietorships than others (figure 2). This variation ranges from 3 percent in Chattahoochee County, Ga., to 69 percent in Jackson County, Tenn. The significant growth in nonfarm proprietorships over time may have been due to a decline in farming, job losses in manufacturing, new opportunities created by information technology, and a growing preference for natural amenities (Goetz and Rupasingha, 2009).



Source: Author's calculations based on data from the U.S. Bureau of Economic Analysis

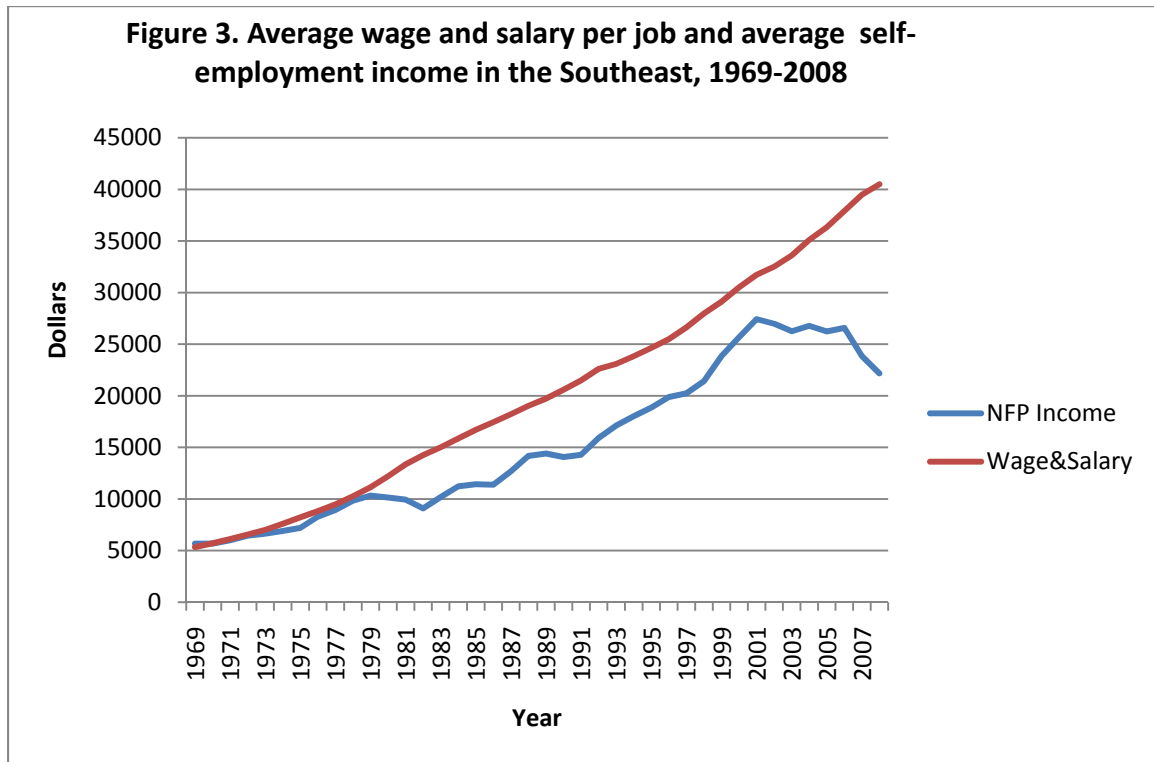
**Figure 2. County-level variation of self-employment rate in the Southeast, 2008**



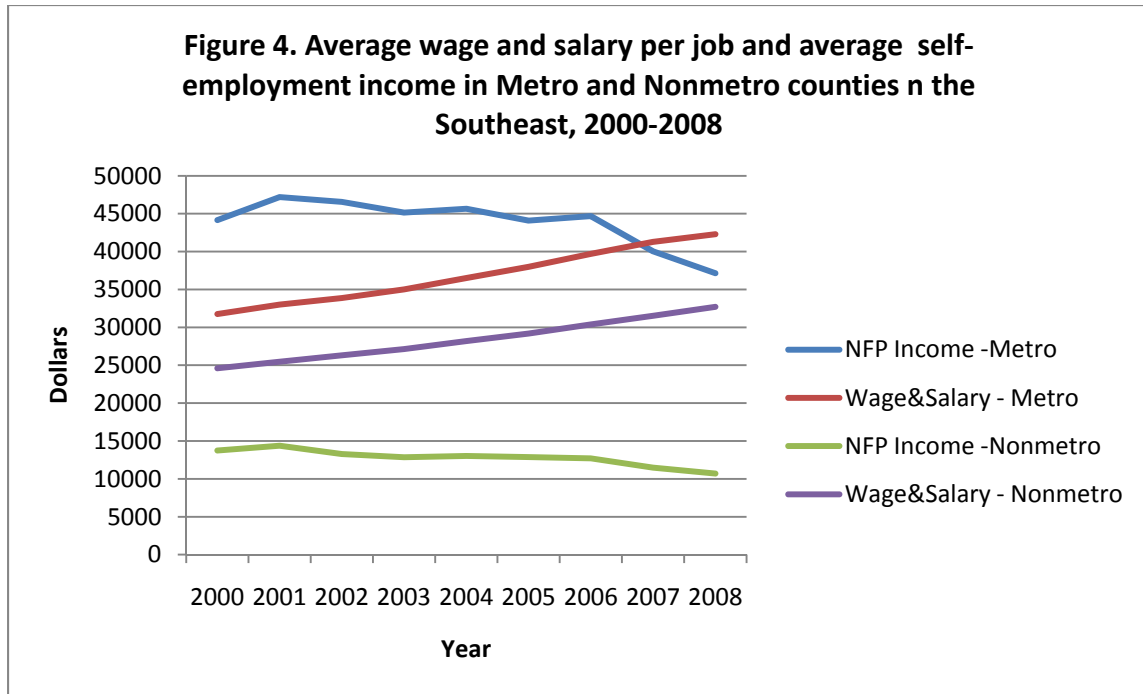
Source: Author's calculations based on data from the Bureau of Economic Analysis

In contrast to the upward trend in self-employed workers, data show that the returns or earnings per self-employed worker lag behind the returns for wage-and-salary employment (figure 3), resulting in a significant gap between the two income streams. In 1969, the average self-employed worker earned \$5,675, whereas the average wage-and-salary job paid \$5,337. By 2008, the average self-employed worker earned \$22,177, whereas the average payroll worker earned \$40,509. While this trend varies across counties in the region, aggregate trend has taken a downward trajectory over the last eight years. This decline may be due to the stark differences in metro and nonmetro counties between two groups of earnings (figure 4). Although self-employment earnings have been stagnating of late, they were higher than wage and salary earnings in metro counties until 2007, when they were overtaken by wage and salary earnings. In comparison, self-employment earnings in nonmetro counties stagnated, lagging behind the upward trending wage and salary earnings during the time period between 2000 and 2008. The gap between wage and salary earning and self-employment earnings may be attributable to any of the following reasons:

- The self-employed are underreporting their true incomes.
- Proprietors are providing goods and services that allow wage and salary workers to become more productive, thereby raising the gap.
- Residents in rural areas have fewer options to self-employment, and rural areas are falling further behind urban areas over time.



Source: Author's calculations based on data from the U.S. Bureau of Economic Analysis



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### **Self-employment significantly affects local economic performance**

A recent study by Rupasingha and Goetz (2011) indicates that the effect of self-employment is statistically significant and positive on income and employment growth and negative on change in poverty in nonmetro counties. They find similar effects on metro county income and employment dynamics, but not on poverty.

Income growth, employment growth, and change in poverty are used as measures of local economic performance, and the share of NFPs in total full- and part-time employment is used as the measure of the relative size of the self-employment sector in a county. By replicating the same econometric model for the counties in the southeastern United States, this study confirms the findings for income and employment growth but not for change in poverty. The results for the Southeast show that self-employment has no significant effect on change in poverty in nonmetro areas but has negative and significant effects on change in poverty in metro counties. Overall, self-employment is very favorable for income and employment growth and poverty reduction in communities in the Southeast.

## **Growth in self-employment brings important policy implications**

The emergence of self-employed workers in the rural Southeast has important policy implications for the following reasons:

- The increase in self-employed workers likely lessened the decline in quality of life caused by higher unemployment and poverty and lower incomes.
- For many rural counties, local entrepreneurship, or self-employment, is the only viable source of economic growth and development available. The alternative is unemployment or population loss from outmigration.
- The self-employed could become crucial stakeholders for community and economic development practitioners in the field.

The traditional approach to local economic development has been to attract existing firms from other communities by offering incentives such as tax subsidies, low-rent land, and job training subsidies. This policy has led to firm relocation or expansion of existing firms. It has also resulted in fierce competition among communities to attract large employers to their respective areas. Governments have also taken steps to improve the general business climate of their jurisdictions by, for example, using fiscal incentives that benefited all firms. Government incentives have resulted in numerous local level business retention and expansion programs.

In contrast to the traditional approach to economic development, an approach based on local entrepreneurship is increasingly gaining traction in the research and policy sphere. The development of local entrepreneurship can lead to a diversified economic structure that can protect the local economy from being overly dependent on one firm, increase trade within the local economy, and improve quality of life. Locally based business development is especially favorable for economically underserved rural areas where it is difficult to attract outside businesses.

Future economic growth in the southeastern United States will depend partly on the success of these self-employed workers. Goetz and Rupasingha's 2009 study on the determinants of growth in self-employment rates provides important initial clues about areas that can be influenced in both the short and the long term. For example, the authors find that access to capital via banks along with higher collateral enhances the growth of self-employment, especially in the current economic climate of

lagging employment recovery. This situation offers an opportunity for public intervention. The same study also finds that high school completion—but not necessarily college graduation—rates are important. Although the high school completion rate is a nearly universal recommendation for economic growth, it is noteworthy that raising these rates may also benefit entrepreneurship.

Other research (Muske and Stanforth, 2000) finds that another factor that can predict business success is the education and training of small business owners. Research shows that approximately 60 percent of small businesses fail within five years because entrepreneurs lack sufficient business management skills, and that participation in relevant and effective training has been shown to reduce the failure rate and help business owners avoid costly mistakes. Much of that training has come from continuing education programs, sometimes offered by community and economic development practitioners in the field.

The Kauffman Foundation is investing heavily in the promotion of entrepreneurship, with the underlying notion that entrepreneurs are made and not just born. Local and state decision-makers should understand whether and how state- and county-level policies and socioeconomic characteristics foster self-employment, and then supply self-employed workers with the tools necessary to grow and prosper through programs specifically targeted for entrepreneurs.

In sum, it appears that government policy can influence self-employment activities. In addition, the importance of education and training programs, or raising awareness, could be explored in future research.

## **Conclusion**

Self-employment is increasingly important for the economic well-being of the southeastern United States, especially for rural areas. Likewise, economic development policies that foster self-employment are growing in importance—for example, understanding how the self-employed succeed and then delivering educational and training programs that allow people to develop those skills and behaviors.

Policies that support self-employment may also include:

- providing support for existing businesses
- help creating new businesses
- feasibility studies and cost-benefit analyses



- marketing plans
- use of information technology
- access to capital
- training economic development professionals

Close collaboration and partnerships among various federal, state, local, and nonprofit business and economic development programs will increase the effectiveness of these policies.

*This article was written by Anil Rupasingha, PhD, community and economic development research economist at the Federal Reserve Bank of Atlanta.*

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