

Entrepreneurship in Black and White

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Abstract

White males are two-and-a-half times more likely to be entrepreneurs as compared to black males, and this gap begins at the start of their career and widens over their life-cycle. We write down a model of life cycle occupational choice in which individuals can opt for paid-employment, self-employment or not working. Starting from their initial levels of human capital and wealth, individuals make occupational choices to generate income, accumulating wealth and human capital along the way until retirement. Individuals are risk-averse, have non-pecuniary preferences for self-employment, and face a borrowing constraint. We estimate the model separately for black and white males using data from the PSID. The estimates from a static benchmark of the model show that the lower returns to capital for black businesses, which governs the scale of a business, can explain upto 70% of the differences in the profitability of black-white businesses and more than 90% of the gap in self-employment rates in blacks and whites. While both whites and blacks face tight collateral constraints, lower assets explain more than 60% of the differences in business profitability but a modest 11% of self-employment differences between blacks and whites, in presence of large differences in returns to capital.

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