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Puzzlingly Divergent Trends in Household Wealth and Business Formation

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Economic theory suggests wealthier households are more likely to start businesses—but the rate of new business formation has declined sharply even as household wealth has increased.

The rate of new business formation has declined sharply in recent decades, raising concerns among economists about job and productivity growth. This observed decline in business formation is likely to be juxtaposed to changes in characteristics such as household wealth that affect households' propensity to become entrepreneurs. Economic theories of business formation suggest that wealthier households are more likely to start a business because wealth allows them to more easily reach a profitable scale.

Justin Barnette and Andrew Glover use data from the Panel Study of Income Dynamics from 1989 to 2015 to estimate the effect of wealth on the probability of a household starting a business while taking other observable characteristics into account. They find a puzzling divergence: business formation declined over the past three decades even as household wealth increased. However, they find no evidence that the relationship between business formation and household wealth has changed in the cross section. Instead, changes in other characteristics—most notably, previous entrepreneurial experience—likely explain the decline. Their findings suggest a dynamic relationship between wealth accumulation, past experience, and new business formation that deserves further study.

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