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Small Business Research Summary

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A Spatial Model of the Impact of State Bankruptcy Exemptions on Entrepreneurship

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Purpose

The Office of Advocacy tracks the market conditions in which small businesses operate, which includes the regulatory policies, business formation practices and market entry approach. The focus of this paper is on the U.S. personal bankruptcy law, and in particular, the effect that state bankruptcy exemptions have on entrepreneurship.

The homestead exemption is an exemption for equity in owner-occupied housing. This varies widely among the states, with some states having no exemption and others having unlimited exemptions. Most states also have exemptions for household belongings, equity in vehicles, retirement accounts, and a wildcard category that can be applied to any type of asset. These exemption levels have changed over time in many states.

Given these differences in state bankruptcy exemptions, businesses might opt for a business location based on the conditions in surrounding states. In an effort to better understand the effect of such state exemptions on entrepreneurship, the Office of Advocacy contracted with Aparna Mathur, a graduate student at the University of Maryland, for this study.

Overall Findings

Entrepreneurs choose the location of their businesses in response to competing business conditions in and outside the state, making state bankruptcy laws a significant determinant of entry and exit decisions by small firms.

Highlights

- The bankruptcy exemption in one's own state has a significant and positive impact on entrepreneurship. The paper finds that higher bankruptcy exemptions in neighboring states lower the probability of starting a business in the state of residence.
- Lower taxes in neighboring states increase the probability of business closure, as entrepreneurs may decide to relocate to these states to take advantage of better conditions.
- According to the findings, state unionization rates significantly reduced the probability of business closures.
- The study discovered that states with Self-Employment Assistance (SEA) programs for people receiving unemployment benefits encourage transitions to entrepreneurship, and businesses in these states are less likely to shut down. This voluntary program currently exists in seven states.
- Individuals with employer-provided health insurance are less likely to leave their existing jobs to start a business. In contrast, those with self-purchased insurance are more likely to become self-employed.
- Individuals who owned a business in the past are 40 percent more likely to start a business, while individuals who did not own a business before are more likely to end a business.

Scope and Methodology

This two-part study uses longitudinal data from the Survey of Income and Program Participation (SIPP) dataset. SIPP is a multi-panel longitudinal survey that measures economic and demographic characteristics over roughly a three-year period. The related panel data used for this study are: 1993-1995 and 1996-1998. The first part focuses on job creation through the birth of small businesses, and the second focuses on job destruction through the death of small businesses.

The report examines the the influence of state-bankruptcy exemptions and other business and macroeconomic variables in the resident and neighboring states on entrepreneurs' decisions to begin or end a business in their own state.

There are some limitations to the data—some questions relevant for the study are not asked across different panels. For instance, the survey lacks information on whether the spouse of the business owner had health insurance.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the Director of Economic Research at advocacy@sba.gov or (202) 205-6533.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at ***www.sba.gov/advo/research***. Copies are available for purchase from:

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