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Unemployment and Firm Entry and Exit: An Update on a Controversial Relationship

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Unemployment and Firm Entry and Exit: An Update on a Controversial Relationship

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SANTARELLI E., CARREE M. and VERHEUL I. Unemployment and firm entry and exit: an update on a controversial relationship, *Regional Studies*. The present study explores the relationship between unemployment and subsequent firm entry and exit for 103 Italian provinces for the period 1997–2003. Two models are estimated. The first model concentrates on unemployed individuals starting or closing a business in the province in which they live. The second model incorporates cross-border effects by taking into account possible start-ups by unemployed individuals from adjacent provinces. Findings show that a positive effect of unemployment on net entry is not due to a positive ‘push’ effect on entry, but rather to a negative effect of unemployment on firm exit. This indicates a lack of dynamics in the Italian labour market.

Unemployment Firm entry and exit Italian provinces

SANTARELLI E., CARREE M. and VERHEUL I. 失业和企业的进入与退出：对一个有争议关系的更新研究, *Regional Studies*. 本研究探讨了 1997 至 2003 年间 103 个意大利省失业和因此而导致的企业进入与退出的关系。本文评估了两个模型。第一个模型针对在所居住的省内创立或者关闭业务的失业个人。第二个模型结合了边界效应，这是通过考虑可能存在的来自相邻省的失业个人开办业务。结果表明失业对净进入的正面效应不是由于对进入的正面推对效应，而是由于对公司退出的负面效应。本文结果指出意大利劳动力市场缺乏动态性。

失业 企业进入与退出 意大利省

SANTARELLI E., CARREE M. et VERHEUL I. Le chômage et l'entrée et la sortie des entreprises: une mise à jour d'un rapport controversé, *Regional Studies*. La présente étude cherche à examiner le rapport entre le chômage et l'entrée et la sortie ultérieures des entreprises pour 103 provinces italiennes pendant la période allant de 1997 jusqu'à 2003. On estime deux modèles. Quant au premier modèle, on se concentre sur les chômeurs qui créent ou qui ferment une entreprise dans la province où ils habitent. Pour ce qui est du deuxième modèle, on y inclut des effets transfrontaliers, en tenant compte des créations d'entreprise éventuelles par les chômeurs qui habitent les provinces limitrophes. Il s'avère que l'effet positif du chômage sur l'entrée nette ne s'explique pas par un effet 'moteur' positif au moment de l'entrée mais plutôt par l'effet négatif du chômage sur la sortie des entreprises. Ceci indique un manque de dynamique sur le marché du travail italien.

Chômage Entrée et sortie des entreprises Provinces italiennes

SANTARELLI E., CARREE M. und VERHEUL I. Arbeitslosigkeit und Betriebsgründungen bzw.-schließungen: aktuelle Informationen zu einer kontroversen Beziehung, *Regional Studies*. In dieser Studie wird die Beziehung zwischen Arbeitslosigkeit und anschließenden Betriebsgründungen bzw.-schließungen in 103 italienischen Provinzen im Zeitraum von 1997 bis 2003 untersucht. Wir stellen Schätzungen anhand von zwei Modellen auf. Im ersten Modell konzentrieren wir uns auf arbeitslose Einzelpersonen, die in der Provinz, in der sie leben, einen Betrieb gründen oder schließen. Im zweiten Modell integrieren wir grenzübergreifende Auswirkungen, indem wir mögliche Neugründungen durch arbeitslose Einzelpersonen aus angrenzenden Provinzen berücksichtigen. Aus den Ergebnissen geht hervor, dass eine positive Auswirkung der Arbeitslosigkeit auf die Nettozahl der Firmengründungen nicht auf einen positiven ‘Push’-Effekt auf die Betriebsgründungen zurückzuführen ist, sondern vielmehr auf einen negativen Effekt der Arbeitslosigkeit auf die Betriebsschließungen. Dies weist auf eine mangelnde Dynamik des italienischen Arbeitsmarkts hin.

Arbeitslosigkeit Betriebsgründungen und -schließungen Italienische Provinzen

SANTARELLI E., CARREE M. y VERHEUL I. Desempleo y entrada y salida de empresas: actualización de una relación controvertida, *Regional Studies*. En el presente estudio analizamos la relación entre el desempleo y la posterior entrada y salida de empresas para 103 provincias italianas durante el periodo de 1997 a 2003. Evaluamos dos modelos. En el primer modelo nos centramos en personas desempleadas, que empiezan o cierran un negocio en la provincia en la que viven. En el segundo modelo incorporamos los efectos transfronterizos teniendo en cuenta posibles empresas emergentes por parte de personas en paro de provincias adyacentes. Los resultados indican que un efecto positivo del desempleo en la entrada neta no se debe a un efecto positivo de ‘empuje’ sino a un efecto negativo del desempleo al cerrar las empresas. Esto indica una falta de dinámica en el mercado laboral italiano.

Desempleo Entrada y salida de empresas Provincias italianas

JEL classifications: J60, R11, R23

INTRODUCTION

Substantial variation in unemployment rates can exist between regions within one country. For example, in Belgium the unemployment rate in Wallonia is twice as high as that in Flanders; in Germany the unemployment rates in the eastern *Länder* are three times as high as those of Bayern and Baden-Württemberg; and in Italy the rates in the Southern provinces are about four times as high as those in the Northern provinces. Such regional inequalities in labour market conditions may persist for several decades. Governments can intervene to reduce these regional inequalities by subsidizing new economic activity in the poorer regional or local entities or by raising entrepreneurial skills in society as a whole and stimulating entrepreneurial awareness in young people. Such intervention may be particularly suitable for regions that combine a high level of unemployment with a low propensity to start new businesses.

The relationship between unemployment and new firm formation is of a complex nature. Regions with high unemployment rates may also be characterized by high firm birth rates. This can be explained by the so-called ‘unemployment push’ hypothesis stating that unemployed workers are more likely to become self-employed – as compared with employees – because they are more likely to be dissatisfied with their current labour market position. EVANS and LEIGHTON (1990) provide empirical evidence for the USA and find that unemployed individuals are about twice as likely to start a new business than wage-employed individuals. At the regional level evidence for the unemployment push hypothesis has been more mixed. CARREE (2002) finds little evidence for an effect of the unemployment rate on the net entry of new establishments in retail and consumer service industries in the USA. REYNOLDS *et al.* (1994) find that firm births per population are positively affected by the level of unemployment in France, Sweden and the USA; that there is no effect in Germany and the UK; and that there is a negative effect in Italy.

This study provides further insight into the unemployment push hypothesis by distinguishing between

firm entry and exit rates and by taking into account unemployed individuals from adjacent provinces. It investigates the explanatory power of regional unemployment (next to other regional characteristics) when explaining venture creation and dissolution. By way of disentangling the effects of unemployment on entry and exit the paper is able to indicate the main mechanism (i.e., entry or exit) through which unemployment influences *net* entry. It takes a regional economics perspective to explaining self-employment, focusing on market entry and exit, instead of a labour market perspective, focusing on the individual choice to become self-employed (PFEIFFER and REIZE, 2000). The paper investigates the relationship between regional unemployment and firm entry and exit in Italy, a country that is characterized by considerable variation in unemployment rates across regions and traditionally high self-employment rates (cf. CARREE *et al.*, 2002; CARREE, 2006). It makes use of new data covering firm births and deaths in the 103 Italian provinces for the period between 1997 and 2003.¹ This is an interesting period because there was a deregulation of entry in Italy.²

This paper is structured as follows. The second section discusses the existing literature on the relationship between unemployment and entrepreneurial activity. It pays attention to the different ways in which unemployment relates to firm entry including the ‘unemployment push’ hypothesis, the negative effect of unemployment on entrepreneurial activity and reversed causality. The third section gives an overview of firm birth, exit, and unemployment rates in the Italian provinces and regions. The fourth section introduces the model; and the fifth section presents and discusses the estimation results. Finally, the sixth section concludes by summarizing the main results in the paper.

UNEMPLOYMENT AND NEW FIRM FORMATION

The activities of individuals in the labour force can be divided into wage-employment, unemployment and

self-employment. The vast majority of individuals fall exclusively into one of these three categories instead of combining activities (e.g., part-time engagement in wage- and self-employment). KNIGHT (1921) argues that individuals have to make a decision about how to allocate their time and abilities among these three different types of activity. This occupational decision is shaped by the respective costs and benefits of the activities. HAMILTON (2000) shows that – next to earnings – the occupational decision is affected by non-pecuniary benefits. In general unemployment is perceived as the least desirable employment status. In this respect OXENFELDT (1943) notes that individuals with low prospects of wage-employment tend to become self-employed. The link between unemployment and subsequent entry into self-employment has been referred to as the ‘unemployment push’ hypothesis.³

There are two important counter-arguments to the ‘unemployment push’ hypothesis (CARREE, 2002). First, the ‘push’ effect in a region with a high unemployment rate may be diminished by the ‘pull’ effect of a low unemployment rate (CHOI and PHAN, 2006). Low levels of unemployment suggest economic strength and ample opportunities for new entrepreneurs. It may be difficult to capture negative depressed economy effects of unemployment (such as a decrease in consumer demand) in the analysis.⁴ Second, on average the level of human and entrepreneurial capital of the unemployed may be lower than that of employed workers, inhibiting new firm creation by the unemployed. Indeed, ACS and ARMINGTON (2004) report that in the USA areas with high levels of education are also characterized by high rates of new firm formation.

There may also be reversed causality where self-employment rates influence unemployment rates. ACS and STOREY (2004) find ‘some evidence that geographical areas that experience a rise in new firm formation subsequently experience economic development’ (pp. 873–874). Next to employing themselves, entrepreneurs also provide employment for others. There has been abundant evidence that small and new firms grow faster than their older and larger counterparts (e.g., AUDRETSCH *et al.*, 2004). CAMPBELL (1996) argues that in a situation of unemployment, employment creation is enhanced as it is cheaper to hire new workers. This is important, in particular, for newly started enterprises that rely on labour rather than capital in their production process. Hence, while unemployment rates may stimulate the rate of self-employment, higher entrepreneurial activity rates may in turn reduce unemployment in subsequent periods (AUDRETSCH *et al.*, 2005). Again others argue there is a positive (short-term) effect of entrepreneurial activity on unemployment. FRITSCH and MUELLER (2004) claim that higher competition due to new firm entry in the short run leads to more firm exit and increased unemployment. In the long run increased competition will affect economic performance and employment

positively. This argument relates to the Schumpeterian mechanism of creative destruction.

The above considerations show that the relation between unemployment and self-employment or new firm start-ups is complex. It is not surprising that there has been mixed empirical evidence on the relationship between unemployment and firm birth rates at the regional level. STOREY (1991) reports on this mixed evidence and argues that there is a tendency for time-series studies to find evidence for a positive relationship and for cross-sectional studies to support a reverse relationship (also FOTI and VIVARELLI, 1994, p. 83).⁵ However, a recent time-series analysis by CHOI and PHAN (2006) reveals no significant relationship for the USA. The mixed evidence on the relationship between unemployment and firm entry might also relate to the fact that existing studies use different indicators and are carried out for different industries, countries and geographical units of analysis. AUDRETSCH and FRITSCH (1999) and CARREE (2002) stress the importance of the industrial organization aspect. They find a positive effect of unemployment only for industries with (very) low barriers to entry. In general studies report a significant regional variation in new firm formation and identify various regional determinants to explain this variation (REYNOLDS *et al.*, 1994).⁶ Unemployment is often included as an explanatory variable. Regional studies that find evidence for a negative effect of unemployment on firm births include those by AUDRETSCH and FRITSCH (1994), DAVIDSSON *et al.* (1994), FRITSCH and FALCK (2003), GAROFOLI (1994), GUESNIER (1994), REYNOLDS *et al.* (1995), RITSILÄ and TERVO (2002), and SUTARIA and HICKS (2004). A positive effect is found, for example, by CAMPBELL (1996), CARREE and THURIK (1996), LEE *et al.* (2004), and TAMBUNAN (1992, 1994).

The present study investigates effects of unemployment not only on gross entry, but also on gross exit and net entry rates. Unemployment may not only affect the rate of new entry of firms, but also the extent to which firms exit. BUZZELLI (2005) and LOVE (1996) find that unemployment leads to higher exit rates. Hence, unemployment may be a proxy for a lack of economic strength, producing higher mortality rates. This paper investigates whether this effect holds for Italy when correcting for a range of regional characteristics.

UNEMPLOYMENT, ENTRY AND EXIT IN ITALY

To test for the relationship between unemployment and firm entry and exit, data on unemployment, entry and exit rates for all 103 provinces in Italy are used (UNION-CAMERE, 2002).⁷ Table 1 gives an overview of the lowest and highest provincial unemployment, entry

Table 1. Provincial unemployment and entry and exit rates (average yearly rates)

Province	Unemployment rate (average)	Province	Entry rate (average)	Province	Exit rate (average)
Lecco	2.20	Messina	5.41	Messina	4.10
Bolzano-Bozen	2.23	Biella	6.19	Palermo	4.37
Vicenza	2.84	Bolzano-Bozen	6.33	Reggio Calabria	4.39
Bergamo	2.93	Roma	6.38	Roma	4.46
Reggio Emilia	3.00	Lodi	6.52	Catania	4.74
Mantova	3.15	Sondrio	6.54	Nuoro	4.75
Treviso	3.16	Milano	6.63	Napoli	4.80
Modena	3.31	Enna	6.64	Bolzano-Bozen	5.01
Cremona	3.34	Belluno	6.70	Potenza	5.08
Belluno	3.49	Ascoli Piceno	6.79	Ragusa	5.12
Pordenone	3.62	Trento	6.82	Cosenza	5.16
Biella	3.75	Aosta	6.92	Lecce	5.40
Bologna	3.84	Caltanissetta	6.96	Sassari	5.40
Siena	4.06	Varese	6.99	Salerno	5.40
Como	4.11	Perugia	7.01	Milano	5.42

Taranto	20.16	Brindisi	8.24	Venezia	6.81
Lecce	20.78	Taranto	8.33	Alessandria	6.83
Vibo Valentia	21.03	Novara	8.36	Vercelli	6.90
Crotone	21.19	Crotone	8.39	Pescara	6.93
Caltanissetta	22.88	Massa	8.40	Gorizia	6.93
Cagliari	23.12	Lecce	8.42	Bologna	6.94
Cosenza	23.99	Pescara	8.45	Reggio Emilia	6.95
Catania	24.28	Campobasso	8.54	La Spezia	6.96
Caserta	25.59	Rovigo	8.57	Torino	7.00
Messina	25.79	Prato	8.60	Ferrara	7.04
Catanzaro	26.20	Vibo Valentia	8.60	Livorno	7.07
Palermo	26.63	Caserta	8.75	Udine	7.08
Napoli	26.94	Rimini	8.79	Rimini	7.09
Reggio Calabria	28.58	Livorno	8.84	Savona	7.46
Enna	28.86	Reggio Emilia	9.64	Prato	7.96

Note: The 15 provinces with the lowest unemployment, entry and exit rates are presented in the upper part of the table, while the 15 provinces with the highest rates are presented in the lower part. The averages are for the period 1996–2002 for the unemployment rate, and the period 1997–2003 for the entry and exit rates.

and exit rates in Italy by presenting the top 15 and bottom 15 provinces in Italy. Unemployment is highest in the Southern part of Italy, including provinces in the regions Calabria (i.e., Catanzaro, Reggio Calabria, Cosenza, Crotone, and Vibo Valentia), Sicilia (i.e., Palermo, Enna, Messina, Catania, and Caltanissetta), Campania (i.e., Napoli and Caserta), Puglia (i.e., Lecce and Taranto) and Sardegna (i.e., Cagliari). Provinces with the lowest unemployment rates are located in Northern and Central Italy, covering regions such as Lombardia (i.e., Lecco, Bergamo, Mantova, Cremona, and Como), Veneto (i.e., Vicenza, Treviso, and Belluno), Emilia Romagna (i.e., Reggio Emilia, Modena, and Bologna), Trentino-Alto Adige (i.e., Bolzano-Bozen), Piemonte (i.e., Biella), Friuli Venezia Giulia (i.e., Pordenone), and Toscana (i.e., Siena). The variation in unemployment in Italy is also apparent in Fig. 1.

The distribution of unemployment rates in Italy appears to be in line with the 'division' between Southern and Northern/Central regions. However, the official unemployment rate has been decreasing since 1998, and the decrease appears larger for the

Southern than for the Centre and Northern part of Italy (BANCA D'ITALIA, 2005). It should also be noted that in the Southern regions the shadow economy is larger than elsewhere in the country, possibly resulting in an underestimation of unemployment rates (ISTAT, 2005). According to ISTAT the ratio of irregular to regular jobs varies between 20.9% (Puglia) and 31.0% (Calabria) in the large Southern regions; between 7.3% (Lombardia) and 12.8% (Friuli Venezia Giulia) in the large Northern regions; and between 8.6% (Emilia Romagna) and 14.4% (Lazio) in the large Central regions.

For the entry rates there is more divergence across regions. High entry rates are seen in several provinces in Toscana (i.e., Massa, Prato, and Livorno), Emilia Romagna (i.e., Reggio Emilia, and Rimini), Puglia (i.e., Brindisi, Taranto, and Lecce), and in the Northern region of Piemonte (i.e., Novara). Although several of the provinces with high entry rates are characterized by a low value added per capita (e.g., Vibo Valentia, Crotone, and Lecce), there are also provinces with low entry rates with a relatively low value added per capita (e.g., Enna, Messina, and Caltanissetta). Some

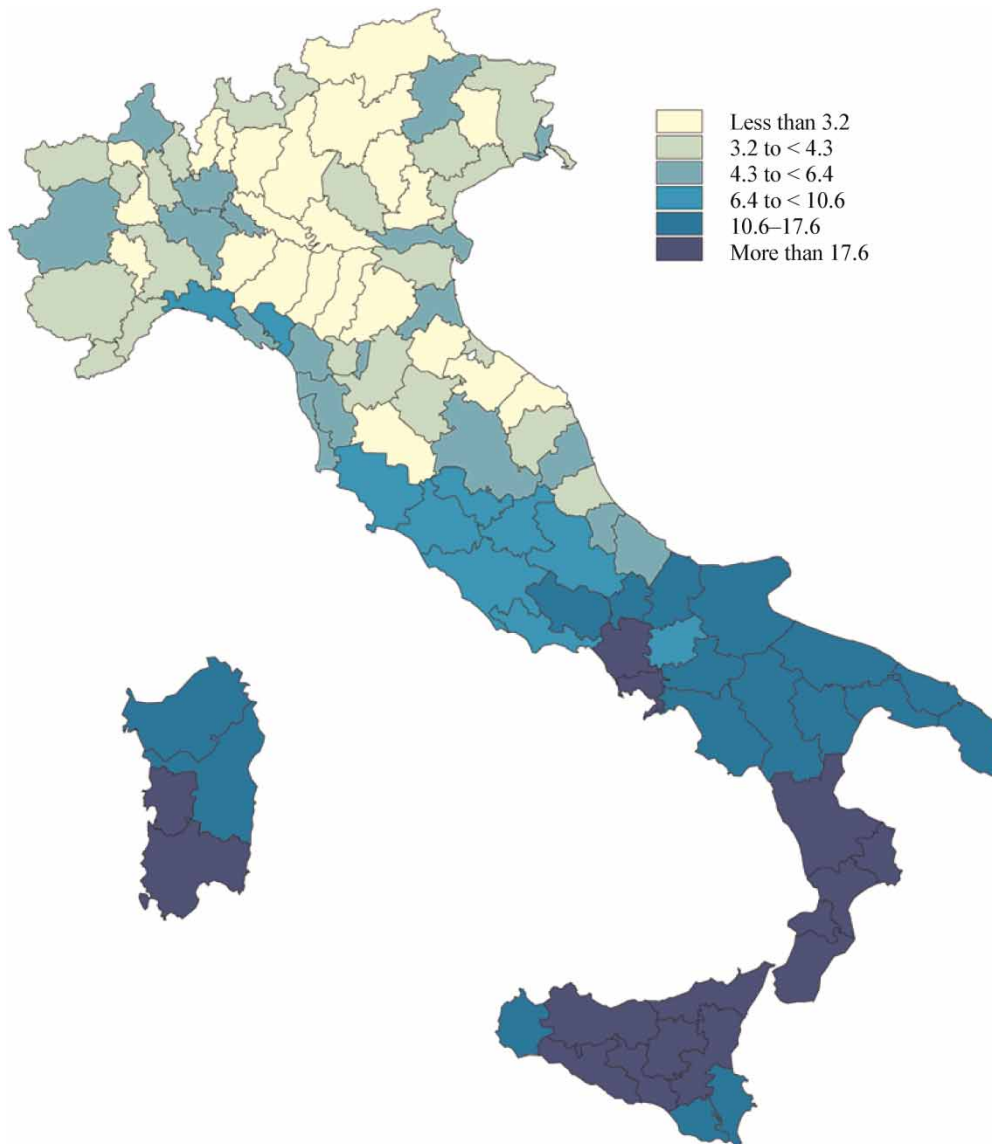


Fig. 1. Unemployment rates in the Italian provinces, 2001

of the provinces 'hosting' the major cities in Italy (e.g., Roma and Milano) are characterized by relatively low entry rates. Again, the size of the shadow economy may play a role in explaining regional differences where firms registering with the Chamber(s) of Commerce may already have been active in the informal sector for a long time and can be considered established rather than new firms, with a disproportional high contribution to bringing down unemployment (AUDRETSCH *et al.*, 1999).

It is interesting to see that the 'poorest' provinces in terms of value added per capita, most of which are situated in the Southern part of Italy, are also characterized by the lowest exit rates. Several of the provinces with high entry rates (such as Pescara, Reggio Emilia, Prato, Rimini, and Livorno) also denote high exit rates. Conversely, provinces 'hosting' the major cities Roma and Milano, but also the medium-sized city Bolzano, are characterized by relatively low entry and

exit rates. The data in Table 1 suggest that there is no obvious relationship between unemployment and entry and/or exit rates in Italy. Indeed, as discussed, Bolzano combines a low unemployment rate with relative low entry and exit rates; the province of Messina is characterized by a relatively high unemployment rate and relatively low entry and exit rates; and Reggio Emilia combines a low unemployment rate with high entry and exit rates.

MODEL SPECIFICATION AND SUMMARY STATISTICS

This section introduces the two models. The first model does not take into account cross-border effects and concentrates only on individuals – unemployed or employed – starting or closing a business in the province in which they live. The second model

incorporates cross-border effects by allowing for the possibility that firms are started by unemployed individuals from adjacent provinces. Index i represents the province ($i = 1, \dots, 103$) and index t represents the year ($t = 1997, \dots, 2003$). Total labour force, i.e., the sum of employed and unemployed individuals, is presented by $L_{i,t}$, while the provincial number of unemployed is presented by $U_{i,t}$. The unemployment rate, $u_{i,t}$, equals the ratio $U_{i,t}/L_{i,t}$. Symbols $E_{i,t}$ and $X_{i,t}$ are used for the numbers of entrants and firm exits, respectively. The entry and exit rates of firms can be measured either in terms of labour, assuming that one firm represents one self-employed individual (labour market approach), or in terms of the number of firms (ecological approach) (ARMINGTON and ACS, 2002). In the present paper the entry and exit rates are relative to the total labour force, i.e., entry and exit rates, can be presented as:⁸

$$e_{i,t} = E_{i,t}/L_{i,t-1}$$

$$x_{i,t} = X_{i,t}/L_{i,t-1}$$

In the *first* model, neglecting cross-border effects, it is assumed that new firms are started by employed or unemployed individuals from within their own province. The question is whether in regions with high unemployment there is a higher (net) entry and a lower exit of firms than in regions with low unemployment. To test this the following model is proposed, where $Z_{i,t}$ refers to a selection of other explanatory variables:

$$E_{i,t} = a_t L_{i,t-1} + b U_{i,t-1} + c Z_{i,t} + \varepsilon_{i,t}^E \quad (1)$$

$$X_{i,t} = d_t L_{i,t-1} + e U_{i,t-1} + f Z_{i,t} + \varepsilon_{i,t}^X \quad (2)$$

$$E_{i,t} - X_{i,t} = g_t L_{i,t-1} + h U_{i,t-1} + j Z_{i,t} + \varepsilon_{i,t}^N \quad (3)$$

The first determinant in equation (1), $L_{i,t-1}$, is the total labour force in the previous year. For each individual in the labour force, employed or unemployed, there is a probability a_t that a person starts an enterprise. This probability is made time-dependent because of the relaxation of entry regulations in Italy in the period under consideration. SCHIVARDI and VIVIANO (2007) discuss the 1998 Bersani Law that reformed the Italian retail trade sector.⁹ The second determinant, $U_{i,t-1}$, represents the number of unemployed individuals. There is an additional probability b for the unemployed (over and above a_t) to start a firm. Unemployment has a positive (push) effect on entry if $b > 0$, which means that unemployed individuals are more likely to start new firms than employed individuals. Similar interpretations are valid for the exit equation (2) and net entry equation (3). The parameter e will be positive when unemployment serves as a proxy for lack of entrepreneurial opportunities for incumbent business. It will be negative when unemployment results in a lack of job alternatives discouraging self-employed individuals to close down their business. The

parameter h is the difference between b and e . Equations (1)–(3) are expressed in absolute numbers. A disadvantage of using absolute numbers is that large provinces in terms of population (e.g., Roma and Milano) tend to dominate the analysis. This is why the equations are estimated in relative terms. In relative terms all variables are divided by the labour force in the previous year ($L_{i,t-1}$). This leads to the following set of equations to be estimated:

$$e_{i,t} = a_t + b u_{i,t-1} + c Z_{i,t}/L_{i,t-1} + \varepsilon_{i,t}^E \quad (1a)$$

$$x_{i,t} = d_t + e u_{i,t-1} + f Z_{i,t}/L_{i,t-1} + \varepsilon_{i,t}^X \quad (2a)$$

$$e_{i,t} - x_{i,t} = g_t + h u_{i,t-1} + j Z_{i,t}/L_{i,t-1} + \varepsilon_{i,t}^N \quad (3a)$$

The following control variables are included in the $Z_{i,t}/L_{i,t-1}$ variable:

- The variable *patents* captures the (potential) effect of technological development on new firm formation and is measured by the number of patents in 2003 per 1000 firms (UNIONCAMERE, 2002). Following ARMINGTON and ACS (2002), firm entry (and exit) rates are allowed to differ between low- and high-technology regions. CHOI and PHAN (2006) find that patent application per capita is negatively associated to new firm formation in the USA. These authors argue that patents are an indicator of venture success rather than a cause of firm formation. However, their research is on nationwide time-series data and not on regional panel data.
- The variable *growth* is measured by the relative change in the provincial value added (*valore aggiunto a prezzi base – al netto dei SIFIM*; ISTAT, 2005) in the previous period. Most studies at the industry level have found a positive and significant effect of profitability and market growth on both gross and net entry (cf. CARREE and THURIK, 1996). The motive was to test whether the same effect arises at the provincial level. This variable should correct (together with *vapc*) for ‘pull’ effects in the unemployment–entry relationship.
- The variable *tourists* measures the extent to which the provincial economy benefits from tourism (high in, for example, Firenze and Venezia; ISTAT, 2005). Regions with high levels of tourism may be characterized by high levels of new firm formation, although new firm formation may diminish when a certain threshold of numbers of visiting tourists is reached. Overexploitation of locally available resources may be a reason for firms to abandon central locations (RUSSO, 2002). Since *tourists* refers to absolute numbers, the analysis divides it by provincial labour force.
- The variable *city* is a dummy variable with a value of 1 for the four largest cities in terms of population (Torino, Milano, Napoli and Roma); and zero

otherwise. The paper controls for the possibility that provinces with large Italian metropolitan cities display relatively high entry rates.¹⁰ This is in line with Reilly's Law (REILLY, 1931) positing that the larger the city, the larger the trade area around it. Large metropolitan areas are likely to attract new firms into the surrounding area (FOTOPOULOS and LOURY, 2000). Other studies have alluded to the attractiveness of urban areas for new firm formation, including the 'inner-city incubator' hypothesis of VERNON (1960) and the 'filtering down' hypothesis of THOMPSON (1968). REYNOLDS *et al.* (1994) find that regional population density has a positive effect on the birth rate of firms (per population) in several countries (including Italy).

- The presence of industrial districts is captured by the dummy variable *inddist* with a value of 1 for provinces with at least one industrial district (UNIONCAMERE, 2002); and zero otherwise. There are 22 provinces with *inddist* equal to 1.¹¹ It is likely that in regions with industrial districts, entry rates are higher. An industrial district can be seen as a local production system stimulating new firm formation by an accelerated process of labour division and specialization (BECATTINI, 1990; BRUSCO, 1982). Industrial districts tend to be characterized by many small firms that in turn subcontract production to other small firms (EUROPEAN COMMISSION, 2002, p. 24; SANTARELLI, 2006).
- The variable *wage* represents the regional (manufacturing) wage level (ISTAT, 2005). This is the only variable that is not available at the provincial level, but it is available at the aggregate level of the 20 Italian regions. High wage levels are expected to have a negative effect on firm entry and a positive effect on firm exit. High wages imply high opportunity costs for the self-employed and also high wage costs when employing workers. Indeed, ASHCROFT *et al.* (1991) show that average annual wages per employee have a negative influence on new firm formation at the county level in Great Britain.
- Value added per capita, *vapc*, is based on provincial value-added data. Including this variable controls for the fact that the North, South and Central parts of Italy differ in terms of the level of development. The level of development may again be a proxy for a range of related factors and might, as such, be linked to new firm formation.
- The provincial sectoral composition of the firm population is measured by the variable *commerce*. This variable is constructed as the ratio of the number of registered incumbent firms in the commercial sector (i.e., retail and wholesale) over the number of registered incumbent manufacturing firms. The commercial sector is characterized by the highest number of firms of all sectors (excluding agriculture) and low barriers to entry (GAROFOLI, 1994). The size of this sector is compared with that

of manufacturing which, on average, has higher barriers to entry as well as a higher average firm size. This is in line with ASHCROFT *et al.* (1991, p. 400) who include the ratio of industries with low barriers to those with high barriers as element of their index of entrepreneurial potential.

The *second* model incorporates the possible effects of unemployment in adjacent provinces.¹² Unemployed individuals in province *i* may start enterprises in the adjacent province *j*, but also the other way around. This means that one should consider not only the adjacent provinces, but also the provinces adjacent to those (adjacent) provinces. The reason is that unemployed individuals in adjacent province *j* may be attracted not only towards province *i*, but also to (competing) provinces adjacent to province *j*. Assume that the relative size of a province – with respect to adjacent provinces – determines the probability of a person starting in his/her home province *i*. The relative size can be expressed as:

$$L_i / (L_i + \sum_{j \in A_i} L_j)$$

where labour force is taken as a size indicator of the province; and A_i is the set of provinces adjacent to province *i*. Likewise, the probability of a person from adjacent province *j* to start a firm in province *i* is determined by the relative size of province *i* for this adjacent province:

$$L_i / (L_j + \sum_{k \in A_j} L_k)$$

where $i \in A_j$. Multiplying this with the number of unemployed U_i of the own province and U_j of the adjacent provinces results in the following model for entry:

$$\begin{aligned} E_{i,t} &= a_t L_{i,t-1} + b^P \frac{U_{i,t-1} L_{i,t-1}}{L_{i,t-1} + \sum_{j \in A_i} L_{j,t-1}} \\ &+ b^{AP} \sum_{j \in A_i} \frac{U_{j,t-1} L_{i,t-1}}{L_{j,t-1} + \sum_{k \in A_j} L_{k,t-1}} + c Z_{i,t} + \varepsilon_{i,t}^E \\ &= a_t L_{i,t-1} + b^P U P_{i,t-1} + b^{AP} U A P_{i,t-1} + c Z_{i,t} + \varepsilon_{i,t}^E \end{aligned} \tag{4}$$

The equations for exit, $X_{i,t}$, and for net entry, $E_{i,t} - X_{i,t}$, are again identical:

$$\begin{aligned} X_{i,t} &= d_t L_{i,t-1} + e^P U P_{i,t-1} + e^{AP} U A P_{i,t-1} \\ &+ f Z_{i,t} + \varepsilon_{i,t}^X \end{aligned} \tag{5}$$

$$\begin{aligned} E_{i,t} - X_{i,t} &= g_t L_{i,t-1} + h^P U A P_{i,t-1} \\ &+ h^{AP} U A P_{i,t-1} + j Z_{i,t} + \varepsilon_{i,t}^N \end{aligned} \tag{6}$$

In contrast to the first model, the second model allows for unemployed from within the province to start-up in adjacent provinces and the other way around. Because it is expected that unemployed individuals are more likely to consider starting up a business in their own province than in adjacent provinces, it is expected that b^P exceeds b^{AP} . Similarly, it is expected that e^P is larger than e^{AP} and h^P is larger than h^{AP} . Again, equations (4)–(6) are estimated in relative terms (relative to $L_{i,t-1}$), resulting into the following set of equations:

$$e_{i,t} = a_t + b^P UP_{i,t-1}/L_{i,t-1} + b^{AP} UAP_{i,t-1}/L_{i,t-1} + cZ_{i,t}/L_{i,t-1} + \varepsilon_{i,t}^E \tag{4a}$$

$$x_{i,t} = d_t + e^P UP_{i,t-1}/L_{i,t-1} + e^{AP} UAP_{i,t-1}/L_{i,t-1} + fZ_{i,t}/L_{i,t-1} + \varepsilon_{i,t}^X \tag{5a}$$

$$e_{i,t} - x_{i,t} = g_t + h^P UP_{i,t-1}/L_{i,t-1} + h^{AP} UAP_{i,t-1}/L_{i,t-1} + jZ_{i,t}/L_{i,t-1} + \varepsilon_{i,t}^N \tag{6a}$$

Table 2 presents summary statistics (i.e., mean and standard deviation) for all variables included in the empirical analysis. Entry, exit, net entry and unemployment are presented both in terms of absolute values (i.e., E , X , $E - X$ and U) and in relative values vis-à-vis the labour force (i.e., e , x , $e - x$ and u). The controls are given in relative terms (i.e., $Z_{i,t}/L_{i,t-1}$). There is a relatively strong correlation between the explanatory variables $u_{i,t-1}$ and $vapc_{i,t-1}$ (-0.825). Unemployment tends to be lower in richer provinces. It was decided to include both variables since excluding value added per capita may lead to misinterpretation of the

Table 2. Summary statistics

Variable	Description	Mean	Standard deviation
E	Number of entrants	3143.70	3778.20
X	Number of exits	2442.40	2810.10
$E - X$	Net number of entrants	701.30	1385.60
U	Number of unemployed	24.52	38.08
L	Labour force	226.86	255.01
e	Entry rate	13.97	3.91
x	Exit rate	11.09	3.28
$e - x$	Net entry rate	2.88	2.67
u	Unemployment rate	0.105	0.075
up	Provincial size-weighted u	0.023	0.031
uap	Adjacent provincial size-weighted u	0.084	0.070
$patents$	Number of patents per firm	0.954	1.392
$growth$	Value-added growth rate	0.045	0.025
$tourists$	Relative number of tourists	3.73	3.91
$city$	Dummy for the four largest cities	0.039	0.193
$vapc$	Value added per capita	16.86	4.29
$inddist$	Industrial district dummy	0.214	0.410
$wage$	Average wage level	15.45	1.65
$commerce$	Ratio of firms in retail/wholesale versus those in manufacturing	2.23	0.76

Note: Averages are presented for a seven-year period.

unemployment effect which may be due to wealth differences between provinces.

EMPIRICAL RESULTS

The results for equations (1a)–(3a), neglecting the possible influence of unemployment in adjacent provinces, are presented in Table 3. The results for equations (4a)–(6a) are presented in Table 4. The technique of seemingly unrelated regressions is used to estimate the gross entry and exit equations. This allows for possible correlation between the error terms of these equations due to omitted variables affecting both entry and exit simultaneously.¹³ The top part of Table 3 ($y1997$ to $y2003$) shows the year-specific fixed effects. Subsequently, the effect of unemployment is presented

Table 3. Estimation results for entry and exit models (1a) to (3a)

Model	(1a)	(2a)	(3a)
Dependent	Entry rate	Exit rate	Net entry rate
$y1997$	16.41* (1.94)	14.45* (1.69)	1.96* (0.99)
$y1998$	16.43* (1.97)	13.11* (1.72)	3.32* (1.01)
$y1999$	19.62* (2.02)	12.99* (1.76)	6.62* (1.03)
$y2000$	20.71* (2.06)	13.06* (1.80)	7.65* (1.05)
$y2001$	20.97* (2.12)	12.92* (1.85)	8.05* (1.08)
$y2002$	20.91* (2.17)	13.65* (1.89)	7.27* (1.11)
$y2003$	20.05* (2.21)	12.79* (1.93)	7.26* (1.13)
$unempl$	-11.24* (3.77)	-12.91* (3.29)	1.67 (1.92)
$patents$	-0.174 (0.124)	-0.158 (0.108)	-0.016 (0.063)
$growth$	4.082 (5.869)	-2.401 (5.129)	6.483* (2.994)
$tourists$	-0.001 (0.039)	-0.024 (0.034)	0.023 (0.020)
$city$	1.142 (0.760)	-0.056 (0.664)	1.198* (0.388)
$inddist$	0.995* (0.358)	0.623* (0.312)	0.372* (0.182)
$wage$	-0.651* (0.116)	-0.517* (0.101)	-0.134* (0.059)
$vapc$	0.203* (0.083)	0.299* (0.072)	-0.096* (0.042)
$commerce$	0.987* (0.298)	1.042* (0.260)	-0.055 (0.152)
Adjusted R^2	0.229	0.167	0.580
Mean dependent	13.97	11.09	2.88

Note: Standard errors are given in parentheses. The number of observations is 721. *5% level of significance. Entry and exit equations are estimated using seemingly unrelated regressions.

Table 4. Estimation results for entry and exit models (4a) to (6a)

Model	(4a)	(5a)	(6a)
Dependent	Entry rate	Exit rate	Net entry rate
<i>y1997</i>	17.80* (1.83)	16.21* (1.57)	1.59 (0.94)
<i>y1998</i>	17.94* (1.85)	15.03* (1.59)	2.91* (0.95)
<i>y1999</i>	21.19* (1.90)	15.01* (1.63)	6.19* (0.97)
<i>y2000</i>	22.32* (1.93)	15.12* (1.66)	7.20* (0.99)
<i>y2001</i>	22.56* (1.99)	14.97* (1.71)	7.59* (1.02)
<i>y2002</i>	22.50* (2.04)	15.71* (1.75)	6.79* (1.05)
<i>y2003</i>	21.67* (2.08)	14.91* (1.79)	6.76* (1.07)
<i>unempl(P)</i>	-24.99* (5.73)	-37.57* (4.92)	12.58* (2.93)
<i>unempl(AP)</i>	-15.53* (2.88)	-15.45* (2.47)	-0.08 (1.47)
<i>patents</i>	-0.127 (0.122)	-0.119 (0.105)	-0.008 (0.062)
<i>growth</i>	5.921 (5.769)	-0.132 (4.947)	6.053* (2.953)
<i>tourists</i>	-0.024 (0.039)	-0.045 (0.033)	0.021 (0.020)
<i>city</i>	1.647* (0.791)	1.134 (0.679)	0.513 (0.405)
<i>inddist</i>	1.037* (0.352)	0.701* (0.302)	0.335 (0.180)
<i>wage</i>	-0.646* (0.115)	-0.550* (0.010)	-0.096 (0.059)
<i>vacp</i>	0.118 (0.077)	0.211* (0.066)	-0.093* (0.039)
<i>commerce</i>	1.183* (0.288)	1.350* (0.247)	-0.166 (0.147)
Adjusted R^2	0.255	0.224	0.592
Mean dependent	13.97	11.09	2.88

Note: Standard errors are given in parentheses. The number of observations is 721. *5% level of significance. Entry and exit equations are estimated using seemingly unrelated regressions.

(i.e., parameters b , e and h). The bottom part of Table 3 shows the results for the eight other explanatory variables. Table 4 has a similar structure, but here the effect of unemployment is divided into own-province (P) and adjacent-province (AP) effects.

First, the results of Table 3 are discussed. The year-specific effects of entry increase over the years, starting at a low level in 1997 and 1998, and increasing to a higher level in the period after 1999. This time effect cannot be observed for exit. Hence, the increased (gross) entry in the period between 1997 and 2003 may be an indication of a range of policy changes in the 1990s. There has been deregulation and the introduction of entry subsidies (mostly soft loans) as reported by, for example, SANTARELLI and VIVARELLI (2002). In

addition, investment subsidies were granted in disadvantaged areas as specified in Law 488 of 1992 (cf. BARCA and PELLEGRINI, 2002).¹⁴

The degree of unemployment in a province appears to have a *negative* effect on the rate of new firm formation. This result is in line with REYNOLDS *et al.* (1994) who report a negative effect of unemployment on the firm birth rate in Italy. Also seen is a clear *negative* effect of unemployment on exit (X or x). Combining the two effects results in a *positive* overall effect on net entry (significant in Table 4). This effect is not due to a 'push' effect of unemployment on new firm formation in the Italian provinces but can rather be attributed to the fact that provinces with high unemployment rates, all things being equal, are characterized by low subsequent firm exit rates. Ignoring the effect of unemployment on (gross) exit erroneously would have led one to believe that the positive effect of unemployment on net entry is caused by increased (gross) entry.

With respect to the other variables in the model, it is found that if there is an effect of the number of patents on entry, it is a negative one. There is some indication that entry and exit are lower in provinces characterized by high rates of patenting. Because most patenting activity is undertaken by a limited number of large firms in specific industries, the variable may not adequately reflect technological opportunities available to (very) small firms (CHOI and PHAN, 2006). Note that the effect of patents on entry and exit fails to be significant.

Growth in provincial value added (in the previous period) has the expected positive effect on net entry. There is an (insignificant) positive effect on gross entry and an (insignificant) negative effect on firm exit. In thriving (provincial) economies more firms tend to start or survive. Tourism has no significant effect on gross entry and exit, and net entry. Entry tends to be higher in the four largest cities. The net result of entry and exit is positive, i.e., there is a significant effect of *city* on net entry. It seems that in the period under consideration there were (still) important agglomeration effects. According to the writings of William Petty (PETTY, 1683/1963), and following Reilly's Law, large metropolitan areas can be seen as typical attractors of new firms (PRED, 1966; ZHANG and ZHAO, 2004). The economies of specialization and those of labour division, both favouring firm entry, are intrinsically linked with the emergence of cities and the growth of metropolitan areas.

The presence of industrial districts has a significant positive effect on gross and net entry, suggesting that these are fruitful areas for new and small firms. The wage variable has the expected negative effect on firm entry. Surprisingly, it also has a negative effect on exit. Hence, high regional wages appear to have a strong negative effect on firm dynamics (entry and exit combined). However, the net effect is significantly negative. The last two control variables are the provincial value added per capita and the sectoral composition. Rich

provinces show more entry and exit with the net effect being negative. As expected higher rates of entry and exit are found in provinces characterized by a high ratio of commercial versus manufacturing activities. The barriers to entry and exit are usually lower in commercial activities than in the manufacturing sector.

Table 4 shows that unemployment in adjacent provinces has a smaller effect on firm entry and exit rates than unemployment in their own province. Separating the unemployment effect in own-province and adjacent-province effects results in a significant negative effect of own-province unemployment on entry. The other variables in Table 4 show similar effects as those in Table 3. The only exception is the *city* dummy. The results in Table 4 suggest more gross entry but not more net entry in the four largest cities in Italy. The contribution of incorporating unemployment effects of adjacent provinces to explain entry and exit can be seen by the rise in the adjusted R^2 . It rises from 0.229 to 0.255 for the gross entry rate equation, and from 0.167 to 0.224 for the exit equation.

CONCLUSIONS

This paper investigates the relationship between unemployment and firm entry and exit across Italian provinces. Findings indicate that it is important to take into account the effect of unemployment on firm exit, in addition to that on firm entry, to interpret adequately findings on the relationship between unemployment and the development of the number of firms. Ignoring the effect of unemployment on firm exit may erroneously lead to an interpretation of the positive effect on net entry as a 'push' effect of unemployment. In fact, no evidence is found for the 'unemployment push' hypothesis. Rather, it appears that a positive effect on net entry is caused by a negative effect on firm exit, indicating a lack of dynamics in the Italian labour market where individuals are not able or willing to switch between occupations. Nevertheless, the results suggest that there is some room for policy initiatives that help increase firm entry. First, an increase is seen in the entry rate in the period 1997–2003, which may be connected to deregulation in that period. Second, regions with industrial districts appear to have more entry (and firm dynamics), suggesting that institutions promoting the development of such districts may enhance (net) entry rates. Third, it appears that the unemployed are less likely to start firms than employees. To the extent that this is not related to lower entrepreneurial abilities, it might suggest that the unemployed are blind to entrepreneurial opportunities in other regions of the country. A policy of stimulating awareness may, at least to some extent, promote labour mobility.

The relatively short panel used in the present study does not allow for an adequate study of the inter-

temporal dynamics of entry and exit over time (cf. JOHNSON and PARKER, 1996). In addition, it may be that the effect of unemployment on the start-up of new firms is dependent on its composition in terms of educational background, gender and age distribution. This possible compositional effect has not been taken into consideration in this study. These can be considered important issues for further research.

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NOTES

1. Earlier work on Italy includes studies by AUDRETSCH and VIVARELLI (1995, 1996), GAROFOLI (1994), and SANTARELLI and PIERGIOVANNI (1995).
2. An example is the 1998 Bersani Law deregulating the retail trade sector (SCHIVARDI and VIVIANO, 2007).
3. Unemployment may also affect those who are not yet officially part of the labour force. DI PIETRO (2006) finds a negative relation between youth unemployment rates and university dropout rates in Italian regions. Low unemployment rates apparently are an incentive to drop out of university education which is very low cost and without selection mechanisms in Italy.
4. One way of coping with the negative effect of unemployment on firm formation is by including business cycle and average income level variables in the model.
5. AUDRETSCH and JIN (1994) propose to reconcile these seemingly contradicting relationships.
6. For an overview of recent developments from the new economic 'geography' approach, see ARMINGTON and ACS (2002).
7. Although the authors are aware that analysis of inactivity rates by region (cf. FAGGIO and NICKELL, 2005) might also prove useful to understand the relationship between employment dynamics and rates of new firm formation, this paper focuses only on the unemployment issue.
8. The results including entry and exit rates relative to the number of incumbent firms (in the previous period) were also examined. These results are very similar to those including entry and exit rates relative to the total labour force.
9. Before the Bersani Law retail establishments were required to have a permit from the town council. The Bersani Law abolished this permit for smaller firms,

which now only have to give notice of their activity. For the estimated effects of a similar deregulation on entry and exit rates in Dutch retailing, see CARREE and NIJKAMP (2001).

10. The authors are aware that studies by GAROFOLI (1994) and SANTARELLI and PIERGIOVANNI (1995) found contrasting evidence.
11. Provinces with at least one important 'traditional' (according to the definition used by Unioncamere) industrial district are: Ascoli Piceno (shoes), Arezzo (golden jewellery), Avellino (leather), Bari (footwear), Biella (textiles – wool), Brescia (metal household artefacts and machinery for the textile industry), Como (silk), Ferrara (mechanical engineering), Macerata (leather products), Mantova (stockings), Modena (knitwear, biomedical industry and ceramics), Pisa (leather), Pordenone (cutlery), Prato (textiles), Parma (ham), Pesaro–Urbino (furniture), Pavia (machinery for the footwear industry), Siena (furniture), Treviso (sporting footwear), Vicenza (leather), Verona (furniture). and Viterbo (ceramics). Note that the definition of industrial district used here excludes local systems dominated by 'focal' or leading firms occupying strategic and central positions due to their extensive network of customers and suppliers (for a further specification, cf. LAZERSON and LORENZONI, 1999).
12. The number of adjacent provinces in Italy varies between one for Sassari and Trieste to eight for Mantova, Milano and Perugia, and even nine for Firenze (Florence). The average number of adjacent provinces is 4.46.
13. JOHNSON and PARKER (1996, p. 684) recommend constructing a vector autoregressive (VAR) system including lags of firm entries and exits. The short time-series dimension of the present panel does not allow for several lags. However, ran each of the regressions was run, including the one-period lagged entry and exit rates in both the entry and exit equations. The results leave the general conclusions unaltered.
14. Whereas interpretation of the impact of entry subsidies on entry rates is straightforward (also DEL MONTE and SCALERA, 2001), the role of regional capital incentives in attracting plants to low-income areas is more complex. For a discussion of the latter effect, see, for example, FAINI and SCHIANTARELLI (1987).

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