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Entrepreneurship

Tight labour markets and stagnation

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WAS Silicon Valley in the 1990s a hotbed of entrepreneurship? Not exactly, according to a new [paper](http://ftp.iza.org/dp5726.pdf) (<http://ftp.iza.org/dp5726.pdf>) by Robert Fairlie and Aaron Chatterji:

“ Estimates indicate that hi-tech entrepreneurship rates were lower in Silicon Valley than the rest of the United States during the period from January 1996 to February 2000. Examining the post-boom period, we find that entrepreneurship rates in Silicon Valley increased from the late 1990s to the early 2000s. Although Silicon Valley may be an entrepreneurial location overall, we provide the first evidence that the extremely tight labor market of the late 1990s, especially in hi-tech industries, may have suppressed business creation during this period. ”

During the 1990s, Silicon Valley's labour market was extremely tight. By 2000, the unemployment rate in both the San Francisco and San Jose metropolitan areas had fallen to about 2.5%. Tight labour market conditions made it a good time for employees of area firms, who were able to obtain high wages and generous stock options. High levels of compensation increased the opportunity cost of entrepreneurship

—while you're starting a business, you're not collecting a big salary at an established firm—and the authors of the above paper find that the effect was strong enough in the late 1990s to hold Silicon Valley's entrepreneurship rate below that of the nation as a whole. In the wake of the tech crash, entrepreneurship rates in the Valley actually rose while the national average held steady.

One big question is: why was the Silicon Valley labour market so tight? Why weren't more skilled workers available to Valley employers?

Two potential explanations spring to mind. One is that there was a structural shortage of skilled workers at the national level, and immigration rules prevented movement from abroad to clear the market. Another is that housing markets responded insufficiently to the demand for shelter in the Silicon Valley area, causing housing costs to rise too high to accommodate new workers. At the height of the tech boom, in 1999, the entire San Francisco-Oakland-San Jose metroplex approved permits for just 26,000 new housing units. In the same year, tiny Las Vegas approved 28,000. Atlanta approved over 60,000. Tight supply fueled high prices. From 1996 to 2001, home prices in San Francisco rose by more than they did during the 2002-2006 bubble. With housing costs soaring, it took very high wages to attract scarce workers. Entrepreneurship seems to have suffered as a result.

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