

The Entrepreneurial Society: A Reform Strategy for the European Union

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Joint work with Mark Sanders, Utrecht University



Financial and Institutional Reforms for the Entrepreneurial Society

Funded by the European Commission as part of the European Union's *Horizon 2020* research and innovation program. 46 researchers from 9 European institutions

European Commission 2010: "Innovation emergency" in Europe.

<https://www.youtube.com/watch?v=oMy8V7k3vL4#action=share>

SPRINGER BRIEFS IN ECONOMICS

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Institutional Reform for Innovation and Entrepreneurship

An Agenda for Europe

Feedback

More than 10 000 downloads to date
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margin)

Follow-ups:

Suse and Hachez (2018).

*Identification and Assessment of the
Legal Implications of an
Entrepreneurial Reform Agenda.*

Sanders (2018). *Financial and
Institutional Reforms for the
Entrepreneurial Society
Part I.*

SPRINGER BRIEFS IN ECONOMICS

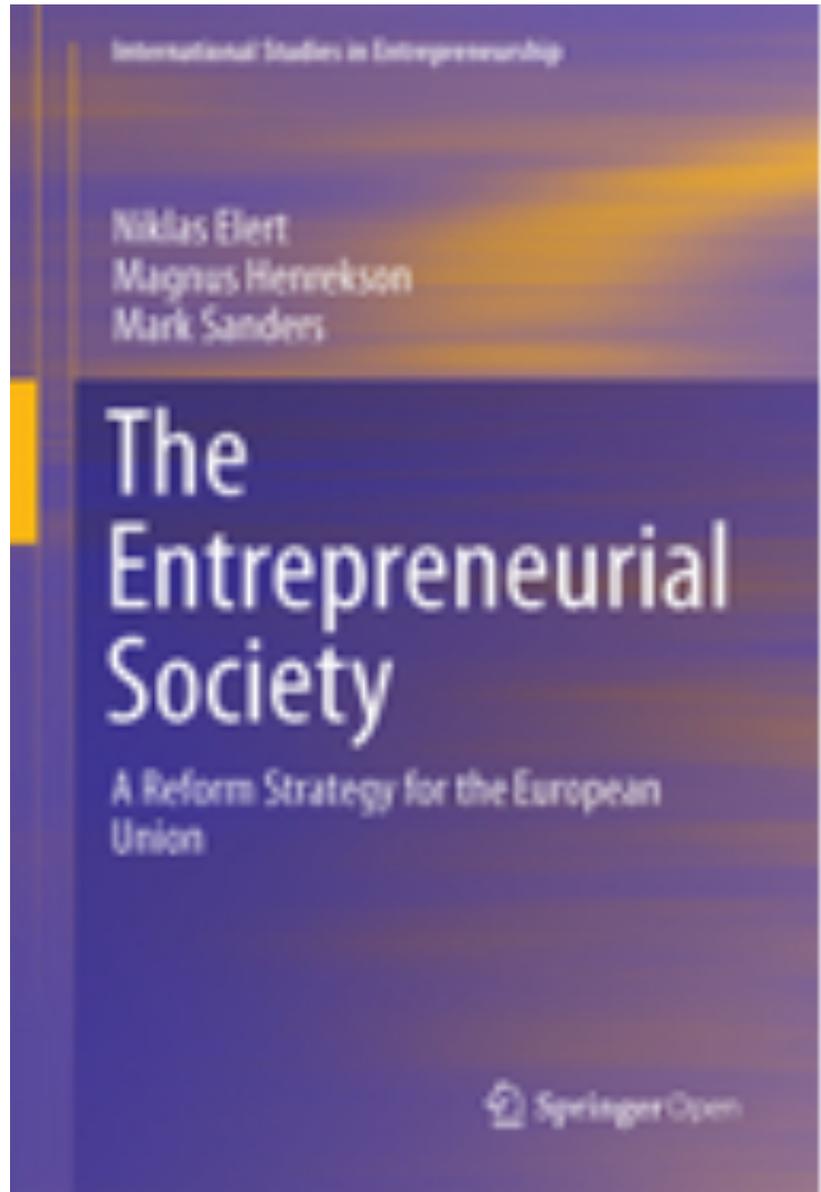
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Institutional Reform for Innovation and Entrepreneurship An Agenda for Europe

The Sequel

A sequel to our previous book and to Mark's final report, incorporating Suse and Hachez's legal work.

The Entrepreneurial Society: A Reform Strategy for the European Union



Background & motivation

European Commission: “innovation emergency”

Table 1.1 Top-twenty country rankings according to five commonly used measures of national innovativeness

Rank	IMD World Competitiveness Ranking 2017	WEF Global Competitiveness Index 2017–18	Global Innovation Index 2017 (INSEAD, Cornell, WIPO)	No. of Triadic Patents per Capita 2013*	R&D Spending as a Share of GDP 2015
1	Hong Kong	Switzerland	Switzerland	Switzerland	Israel
2	Switzerland	USA	Sweden	Japan	South Korea
3	Singapore	Singapore	Netherlands	Germany	Switzerland
4	USA	Netherlands	USA	Sweden	Japan
5	Netherlands	Germany	UK	Denmark	Sweden
6	Ireland	Hong Kong	Denmark	South Korea	Austria
7	Denmark	Sweden	Singapore	Austria	Taiwan
8	Luxembourg	UK	Finland	Netherlands	Denmark
9	Sweden	Japan	Germany	Israel	Germany
10	UAE	Finland	Ireland	USA	Finland
11	Norway	Norway	South Korea	Finland	USA
12	Canada	Denmark	Luxembourg	Belgium	Belgium
13	Germany	New Zealand	Iceland	France	France
14	Taiwan	Canada	Japan	Luxembourg	Slovenia
15	Finland	Taiwan	France	UK	Iceland
16	New Zealand	Israel	Hong Kong	Norway	Singapore ¹
17	Qatar	UAE	Israel	Ireland	Australia ²
18	China	Austria	Canada	Canada	China
19	UK	Luxembourg	Norway	Australia	Netherlands
20	Iceland	Belgium	Austria	Italy	Czech Rep.

¹ 2014. ² 2013. *Triadic patent families are a set of patents filed at three of the major patent offices: the European Patent Office (EPO), the Japan Patent Office (JPO) and the United States Patent and Trademark Office (USPTO). Patents included in the triadic family are typically of higher economic value.

Sources: IMD World Competitiveness Yearbook 2017; World Economic Forum, *Global Competitiveness Report 2017–2018*; *The Global Innovation Index 2017 – Innovation Feeding the World* (INSEAD, Cornell University and WIPO); *OECD Factbook 2015*; *OECD Factbook 2016: Economic, Environmental and Social Statistics*; OECD Statistics.



Background & motivation

European Commission: “We need to do much better at turning our research into new and better services and products if we are to remain competitive in the global marketplace and improve the quality of life in Europe”.

- Impediment to inclusive, sustainable growth
- Interestingly, EC does not mention the word entrepreneurship once.
- Our view: Innovation needs entrepreneurship to translate into valuable goods and services. Entrepreneurship depends on institutions.

Background & motivation

(Schumpeterian) entrepreneurship: the ability and willingness of individuals, independently and within organizations

- to discover and/or create new economic opportunities
- to introduce their ideas in the market under uncertainty, making decisions regarding the localization, product design, use of resources and reward systems
- to create value (often means entrepreneur aims to expand firm to its full potential)

Background & motivation

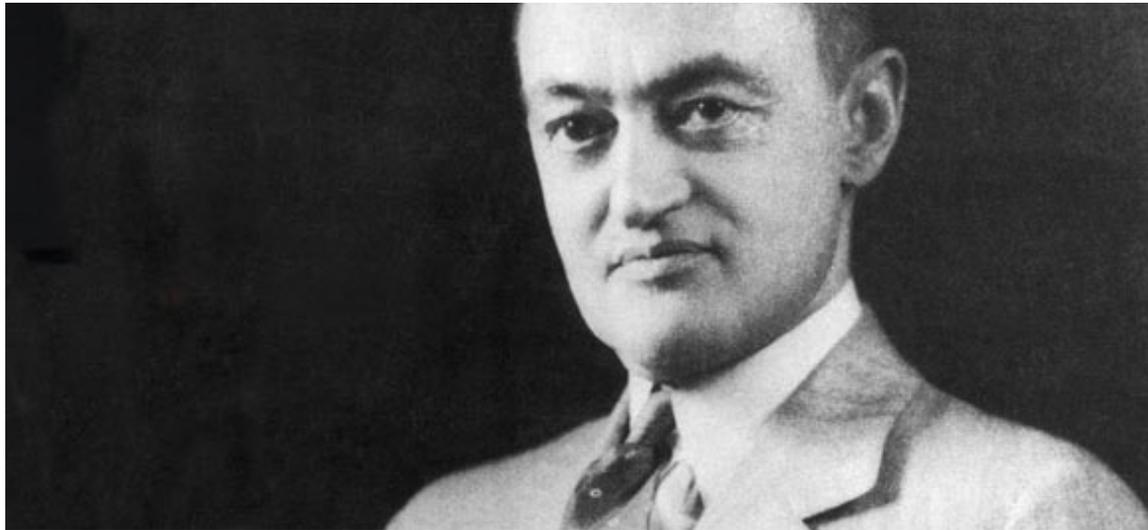
	Billionaire entrepreneurs, #	Billionaire entrepr. per million	Unicorns #	Large firms founded since 1990, #	VC share of GDP, %
USA	432	1.37	115	60	0.30
China	228	0.17	47	22	0.06
East Asia	118	0.55	8	19	0.06
Eastern Europe	14	0.13	1	2	0.01
Western Europe	194	0.47	22	18	0.06

The US “beats” Western and Eastern Europe on all four Schumpeterian entrepreneurship measures.

Western Europe on par with East Asia on some measures.

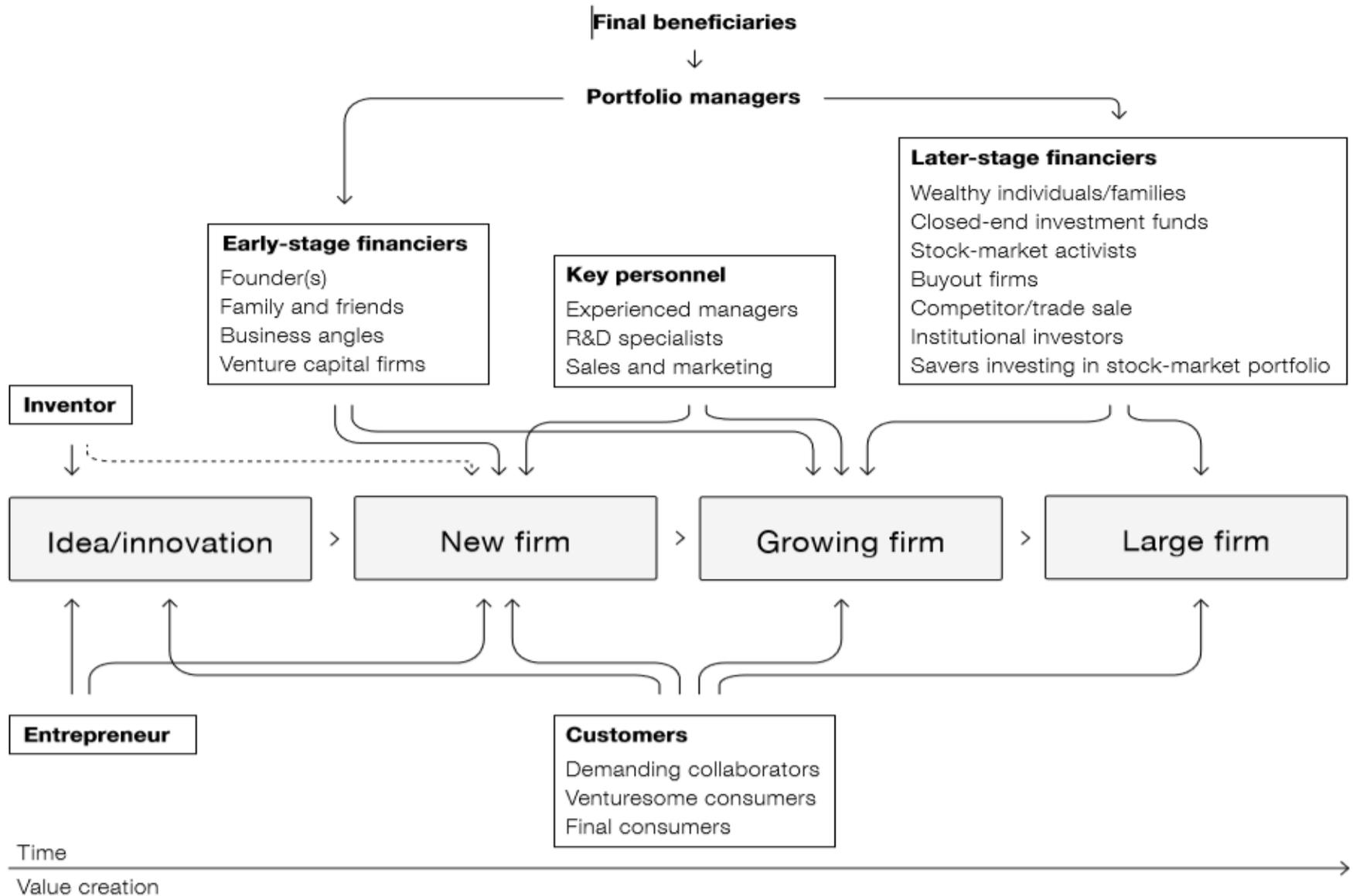
Entrepreneurship is collaborative

Schumpeter (1949): the entrepreneurial function “may be and is often filled cooperatively.”



Experimentally Organized Economy (EOE): To pursue innovative projects, entrepreneurs must cooperate with a number of actors.

The collaborative innovation bloc



A reform agenda

Should focus on the collaborative innovation bloc and its agents

- Not sufficient to point out what is lacking; explain why the relevant agents are either absent or not incentivized to collaborate in a value-creating way
- Innovation hampered if some link weak or missing

No one "owns" the innovation bloc

- Experimentally self-organized
- Top-down policy approaches likely to fail

Book outline

Six reform areas and 50 proposals:

- I. Rule of law, protection of property rights
- II. Taxation
- III. Savings, capital, and finance
- IV. Labor markets and social security
- V. Contestable markets for entry and exit
- VI. Mobilizing human capital for e-ship

Approach to each area

- i) Identify core problems w.r.t collaborative innovation bloc
- ii) Formulate 2–3 principles to guide proposals
(The principles underlying proposals in this book are: *neutrality, transparency, moderation, contestability, legality, and justifiability.*)
- iii) Make proposals

I. Rule of law, protection of property rights

Problem: Large differences among EU countries. When weak, entrepreneurs are discouraged from making discoveries and creating value. Division and specialization of labor also hampered in such instances, to the detriment of entire collaborative innovation blocs.

Principles to guide reform:

- 1) *Consider de facto rather than de jure institutions*
- 2) *Balance protection and flexibility*

I. Rule of law, protection of property rights

Table 2.3 Summary of reform proposals regarding rule of law and property rights protection.

No.	Principle(s)	Policy Area	Proposal
1	Consider de facto rather than de jure institutions	The rule of law and property rights	Strengthen monitoring and enforcement mechanisms to improve and safeguard the performance of all member states on rule of law and protection of property rights,
2	Balance protection and flexibility	Patents and intellectual property	Limit the breadth, width and span of patent protection to cover working prototypes and market ready innovations only for a short period of time.
3	Balance protection and flexibility	Patents and intellectual property	To promote the use of knowledge, economic actors should have the right to infringe upon patents that are not actually commercialized.
4	Balance protection and flexibility	Patents and intellectual property	Require patent applicants to set the price for the license before commercial application is known instead of allowing them to negotiate the terms of a license contract afterwards.
5	Balance protection and flexibility	Patents and intellectual property	Introduce and support existing experiments with open source patent registration.

II. Taxation

Problem: No particular tax on entrepreneurship. Tax systems often discourage entrepreneurship and startup activity. Fundamentally affects incentives of the entrepreneur and other actors in collaborative innovation bloc.

Principles to guide reform:

- 1) *Moderation*: tax rates should (preferably) be low.
- 2) *Neutrality*: small bias across owner categories, sources of finance, and economic activities.
- 3) *Transparency*: system less opaque and exception-riddled.

II. Taxation

Table 3.3 Summary of reform proposals regarding taxation.

No.	Principle(s)	Policy Area	Proposal
6	Neutrality and Transparency	Labor taxation	Reduce high tax burdens on labor instead of making subsidies, pension rights and social benefits more conditional on employment status.
7	Transparency	Corporate income taxation	Remove discrepancies between statutory and effective corporate income tax rates.
8	Moderation and Transparency	Corporate income taxation	Eventually, corporate income taxation should be abolished. Steps in this direction would start by granting full corporate income tax exemption to start-ups up through their 3 rd year.
9	Moderation and Transparency	Dividend and capital gains taxation	Countries should aim for low dividend and capital gains tax rates with few exceptions and few (opaque) concessionary schemes.
10	Moderation and Neutrality	Wealth taxation	Reduce taxes on private wealth, private wealth transfers and inheritance if productively invested.
11	Neutrality	Debt and equity Taxation	Initiate a balanced program aiming to achieve tax neutrality between debt and equity finance.
12	Moderation	Stock options taxation	Capital gains on stock options and underlying stock in start-ups should be low and only be taxed when exercised and/or sold, i.e., when gains are realized.

III. Savings, capital and finance

Problem: Financial resources are not in short supply, but they are intermediated largely through institutional investors that prefer large, low risk, debt-based assets over small, risky, equity-based investments.

Principles to guide reform:

- 1) *Neutrality*: create a level playing field in the competition for financial resources.
- 2) *Transparency*: reduce asymmetric information problems for investors
- 3) *Balance public and private interests*

III. Savings, capital and finance

Table 4.3 Summary of reform proposals regarding savings, capital and finance.

No.	Principle(s)	Policy Area	Proposal
14	Neutrality and transparency	Private wealth	Allow for more wealth to accumulate and remain in private hands and make it possible, easy and attractive to invest such wealth in entrepreneurial ventures.
15	Neutrality and balancing public and private interests	Pension funds	Allow people to choose how and where to invest part of their pension savings individually.
16	Neutrality and balancing public and private interests	Pension funds	Pension funds and other institutional investors should, on an experimental basis, be allowed to invest more in equity in general and in venture capital specifically.
17	Neutrality and balancing public and private interests	VC	Develop competencies for private equity and venture capital investment in the field and avoid promoting VC capital with public funding directly.
18	Neutrality	VC	Reduce barriers to the sale, acquisition and IPO of VC-funded start-ups to facilitate profitable exits.
19	Neutrality and transparency	Banks	In the system of bank loan guarantees for start-ups, ensure that (appropriately anonymized) credit decision information becomes publicly available.
20	Neutrality and balancing public and private interests	Banks	Increase the mandatory equity ratio in banking gradually to 10-15 percent to allow them to take on more risk responsibly in their lending portfolios.
21	Neutrality and balancing public and private interests	Banks	Introduce central bank digital currency to replace deposits at commercial banks as the dominant medium of exchange.
22	Neutrality	Fintech	Implement a light-touch regulatory regime for equity crowdfunding and peer-to-peer lending.
23	Neutrality and transparency	Fintech	As part of its efforts to allocate the Juncker Fund, the European Investment Bank could experiment with a euro denominated European crowdfunding platform and match successful campaigns with public funds.

IV. Labor markets, social security

Problem: Rigorous employment responsibilities may be particularly hard for new, entrepreneurial ventures to shoulder, limiting the access to key personnel.

Principles to guide reform:

- 1) *Neutrality*: equal access for employers competing for workers and employees competing for jobs.
- 2) *Balance public and private interests*: efficiency vs. security, stability, and equitable distribution
- 3) *Transparency*: social security systems as simple as possible.

IV. Labor markets, social security

Table 5.3 Summary of proposals regarding labor markets and social security

No.	Principle(s)	Policy Area	Proposal
24	Neutrality and transparency	Employment protection	Relax the stringency of employment protection legislation for permanent contracts.
25	Neutrality	Employment protection	Allow for more flexibility in working hours.
26	Neutrality and transparency	Employment protection	Lift the legal enforceability of confidentiality agreements between employers and their employees.
27	Neutrality	Social security	Guarantee equal access to welfare state arrangements for all, regardless of tenure in a specific job or labor market status.
28	Neutrality and transparency	Social security	Carefully consider the impact of flexicurity reforms on young SMEs and do not force them to take on excessive risks and burdens.
29	Transparency and balancing public and private interests	Social security	Introduce mandatory universal insurance for healthcare costs, old age and disability.
30	Neutrality	Social security	Ensure full portability of social security entitlements by making them independent of tenure at a specific employer.
32	Neutrality	Active labor market policy	Establish or strengthen training programs to prepare workers for new occupations.

V. Contestable markets for entry and exit

Problem: Learning from failure. Collaborative innovation bloc is evolutionary process where we wish to avoid Type 1 (rejecting a good idea) and Type 2 (pursuing bad ideas) errors.

Principles to guide reform:

1) *Contestability*: openness to innovation and challengers.

2) *Transparency*: potential challengers must know what to expect, incumbents not be allowed to co-author industry-regulations.

3) Balance public and private interests: challengers vs financiers, employees and other stakeholders.

V. Contestable markets for entry and exit

Table 6.3 Summary of reform proposals for contestable markets for entry and exit.

No.	Principle(s)	Policy Area	Proposal
33	Contestability	Entry barriers	Excessive barriers to new business formation and new entry should be lifted where possible
34	Contestability, Transparency and Balancing interests	Entry barriers	Create transparent and open systems of occupational licensing, such that skilled people can move across occupations and in and out of new ventures easily
35	Contestability and Balancing interests	Entry barriers	Continue to harmonize and liberalize product and services markets in the Union by setting functional and transparent minimum requirements and limiting the influence of lobbyists
36	Contestability	Entry barriers	Undertake responsible deregulation of (public) services to introduce contestability in these growing areas of the economy
37	Balancing interests	Entry barriers	Allow experiments with private actors providing public services in carefully designed markets and learn from these experiments
38	Contestability and transparency	ICT	Invest in an excellent, open access digital infrastructure for European citizens and businesses
39	Transparency	ICT	Develop open, but responsible standards and open regulation for the many digital platforms that emerge to facilitate peer-to-peer and business-to-business trade, services and finance
40	Balancing interests	Insolvency	Insolvency regulation should protect inherently healthy and promising ventures and allow for a quick and ex ante transparent liquidation of those that are not.
41	Transparency	Insolvency	Set up publicly funded “entrepreneurial knowledge observatories” where knowledge accumulated in the entrepreneurial process is collected, curated and freely diffused

VI. Mobilizing human capital

Problem: R&D requires entrepreneurship to translate into economic growth. Policy should pursue the overall objective of promoting the process of production and commercialization of knowledge.

Principles to guide reform:

- 1) *Balancing private and public interest*
- 2) *Neutrality: all talent in society should be allowed to develop to its potential*
- 3) *Contestability: challengers should be able to compete for knowledge and skills on a level playing field with incumbents.*

VI. Knowledge and innovation

10 proposals: three examples

Prin- ciple(s)	Policy Area	Proposal	Policy Level
Neutrality & Contest- ability	Edu- cation system	Reforms in primary and secondary education to provide pupils with a solid and coherent knowledge base and promote initiative, creativity and a willingness to experiment	MS, REG, LOC
Neutrality & Contest- ability	Edu- cation system	Promote STEM education and English early on and then throughout educational career.	EU, MS
Justifi- ability & Contes- tability	Entrepre- neurial clusters	Liberalize spatial planning regulations to allow endogenous clustering of business activity; do not try to plan clusters from the top down.	MS, REG, LOC

Concluding remarks

- Innovation needs entrepreneurship to translate into valuable goods and services. Entrepreneurship depends on institutions.
- We propose a reform strategy involving a broad range of areas pertinent to the agents of the collaborative innovation bloc
 - Enable and facilitate bottom-up value-creating collaborative processes
 - No one-size-fits-all strategy (VoC)
 - Our approach helps prioritize and identify weakest links
 - Reform process should be incremental, leaving room for experimentation rather than unreflected imitation

THANK YOU!

Niklas Elert, Magnus Henrekson & Mark Sanders
25 September 2019