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Making Entrepreneurship Policy or Entrepreneurial Policymaking

Europe faces what some have dubbed an innovation emergency. Following the global financial crisis, the Union's challenge has been to return to a path of inclusive, sustainable, and innovative growth. This challenge, we believe, can only be overcome by a strategy acknowledging the importance of entrepreneurship, especially the type of Schumpeterian entrepreneurship that introduces new products and technologies and serves as a conduit of new knowledge to generate innovation and progress. To understand how to promote an entrepreneurial society, policymakers must recognize the crucial importance of collaborative innovation blocs, their agents, the roles these agents play, and how the blocs interact with the institutional framework that surrounds them. Indeed, tracing these components of the entrepreneurial ecosystem helped us identify the institutional areas in need of reform if Europe is to transform into a more entrepreneurial society.

We argued that an entrepreneurship-friendly reform strategy, to be coherent, must be informed by a set of common principles, which we identified for each area under discussion. In total, the result was a list of six principles: *neutrality*, *transparency*, *moderation*, *contestability*, *legality*, and *justifiability*. When tailored to local, regional, and national conditions, a reform strategy inspired by these principles is Europe's best chance to maintain its position in the global world order given the challenges we face in a globalized world increasingly steeped in digitalization.

To illustrate how these principles might be enshrined in Europe's diverse institutional landscape, we have proposed institutional reforms pertaining to six broad areas:

1. *The rule of law and the protection of property rights*: The rule of law and secure property rights are fundamental to any market economy. To understand how they can be strengthened in an entrepreneurship-friendly manner across the EU, we first emphasize the principle of *legality*, i.e., considering de facto rather than de jure institutions. In regard to the protection of property rights, however, these cannot be absolute; property rights applying to intangibles and intellectual property in particular require a careful balancing of public and private interests to ensure *justifiability*. A clear and actionable reform agenda presents itself here given the European Commission's competencies in international negotiations on these issues.
2. *Taxation*: Taxation shapes and biases the incentives for corporations, individuals, and organizations in a multitude of ways, which are often detrimental to entrepreneurial venturing. Sometimes, reforms that explicitly favor entrepreneurship yield strong positive external effects, in line with the principle of *justifiability*. More often, we argue for a level playing field to ensure *neutrality* and *moderate* taxation to restore or maintain market incentives. The EU's limited competencies in this area mean that tax reforms in support of a more entrepreneurial society are chiefly the domain of member states.
3. *Savings, finance, and capital*: Europe's history has left most EU member states with a largely bank-based, highly regulated system of financial markets that predominantly "locks up" savings in professionally managed funds and assets. In such a system, entrepreneurial investees without collateral, strong balance sheets or long track records are fighting an uphill battle for credit and financial resources. We propose to aim for *neutrality* and *transparency* and level the financial playing field to restore *contestability*. Of course, there is a fundamental public interest in financial stability, especially in the payment and store-of-value functions of money. In line with the principle of *justifiability*, these valid considerations must be acknowledged but not allowed to prevent well-designed public interventions that enable the financial sector to mobilize more of Europe's ample financial resources for entrepreneurial ventures. Proposals are mostly addressed at the EU level, as competencies for reform are increasingly delegated to the European level.
4. *Labor markets and social security systems*: These institutions largely determine the allocation of human resources, notably skilled labor, to entrepreneurial ventures. Systems are typically tilted in favor of large, stable incumbent firms, which implies that experimental, innovative ventures are at a disadvantage. Our proposed reforms aim to improve the situation for entrepreneurs in Europe by making rights more *transparent* and portable

and security more universal and unconditional. Such portability and unconditionality ensure *neutrality* and *contestability* for human resources, whereas flexibility for entrepreneurs must be balanced against security for employees, according to the principle of *justifiability*. We primarily address proposals to the member states, as they retain most legal competencies in this area.

5. *Contestable markets for entry and exit*: An area of strong and extensive EU competencies is the single market. Under that heading, Europe can do more to ensure that a vibrant entrepreneurial society can bloom across the Union. Lowered entry barriers are key to this reform area, and this is particularly true for services: especially in the semi-public and public domains of health, education, and similar services, there is room for productive venturing under appropriate constraints. Finally, to facilitate entry in many sectors, exit must also be well arranged, which motivates our proposals in the area of bankruptcy law and the smooth liquidation of outdated and failed ventures. The proposals in this chapter are addressed at national and European policymakers alike, as the EU has extensive competencies in regulating markets and competition, whereas health and education are the domain of member states.
6. *Mobilizing human capital for entrepreneurship*: Since the Treaty of Lisbon, knowledge policy is firmly part of the Commission's competencies, but we are yet to see institutional reforms aimed at building a truly European knowledge space. If realized, such a knowledge space would permit useful knowledge to flow freely to the benefit of incumbents and challengers alike. The large positive externalities *justify* public policy at the local, national, and European levels, whereas *neutrality* and *contestability* inevitably lead to an endogenous clustering of knowledge and innovation across the Union.

Throughout the six chapters, we make no fewer than 50 reform proposals, the lion's share of which are highly concrete. We hope that they will inspire policymakers, practitioners, and other readers of this book and provide a firm and principled idea of how a European reform agenda could look. Of course, policymakers will need to tailor most proposals to specific national and regional contexts; others may need to be reformulated or reconsidered. We see this as demonstrating the robustness of our approach and not as a weakness. There are already enough books where unquestionably talented economists present statistical inference and econometrics to support proposals that, ultimately, amount to an if-it-works-on-average-it-will-work-everywhere approach to reforms (see, e.g., Colander and Freedman 2018). As Rodrik

(2015) argues, no one model can be applied everywhere. All judicious policy advice is context dependent.

Benchmarking is useful, of course, as is learning from success elsewhere. However, one must always dig deep and uncover the full causal chain that explains success before naïvely starting to implement partial reforms. As no two institutions are built upon the same bedrock, it is better to identify the functions that a healthy entrepreneurial ecosystem needs and then build institutions that perform those functions, perhaps differently in different places, but fitting in the local context.

That is not the same as saying “it all depends” and giving up on offering guidance. As long as reforms are informed by the core principles that enabled us to derive our proposals in the first place, reform adjustments and reformulations are, in our view, a feature rather than a bug of our approach. The devil is in the details, and policymaking itself must therefore be an entrepreneurial process. Institutional reforms should go through rapid cycles of experimentation, learning, and pivoting until policymakers find suitable and satisfactory solutions. Ultimately, these solutions may end up looking different from what we have proposed above, but the general principles should still shine through. Below, we identify several points to which followers of our strategy should adhere.

First, a European reform agenda striving to create an entrepreneurial society needs sophistication. It falls to reformers and other practitioners to package the proposed principles into institutional designs sensitive to local constraints and opportunities. The identification of best-practice institutions is a *sine qua non* for any reform agenda to be successful, but so is the recognition that a first-order economic principle such as market competition does not map onto one single policy package. No unique correspondence exists between functionally good institutions and the form that such institutions take; in fact, policymakers must choose between several institutional bundles, each with the potential to achieve the desired economic and social ends. The bundle that is the most appropriate will depend upon the context. At best, misguided reforms that ignore this fact do not work, plain and simple. At worst, a thoughtless introduction of supposedly first-class institutions can backfire, undermining existing domestic institutions instead of taking hold (Rodrik 2008).

Second, a reform agenda must be appropriately concrete. Most historical and econometric studies of institutions and growth tend to remain at a high level of generality and do not provide much policy guidance (Besley and

Burgess 2003; Rodrik 2008).¹ Here, we have attempted to go beyond abstract reasoning, drilling down to the specific effects of particular measures. Much more work is required in this respect before an entrepreneurial reform agenda is realized, but we hope to have proceeded further down the ladder of concreteness than most other books and articles with similar aims.

Third, a reform agenda must prioritize. The EOE and VoC perspectives are valuable for understanding how. The EOE perspective identifies which institutions matter the most for the key actors in collaborative innovation blocs, whereas the VoC perspective groups countries with respect to their institutional frameworks, hinting at the institutional complementarities within a particular cluster of countries (Dilli et al. 2018). Here, an essential part of future work is to identify and suggest the removal of the so-called institutional bottlenecks (Acs et al. 2014). Doing so will make it possible for researchers and policymakers to assess the problems that should be the top priority within a cluster. Furthermore, countries in a cluster can be more or less successful, and their relative rank within the cluster has important informational and practical value for any reform process. Rather than trying to leapfrog directly to a point of institutional bliss, a laggard country should try to become more like the leader in its cluster in the short and medium term. This goal is likely to be attainable by virtue of its relative modesty and because the reforming country then aspires to something that has been tried before in a similar institutional context.

Fourth, the reform process should be incremental and leave room for experimentation rather than imitation without reflection. From a Schumpeterian (and, arguably, Popperian) perspective, the quest to develop an optimal set of legal rules ignores a central feature of successful economic development, namely, the fact that institutions and organizations in a competitive environment continuously contest, innovate, and adapt. Reforms that are tailor-made to a country's specific constraints and opportunities through experimentation during a discovery process will likely be more beneficial than reforms based on mere imitation (Hausmann and Rodrik 2003; Sabel and Reddy 2007). Nevertheless, given the complexities involved, it is important to keep in mind that simple legal principles are often preferable to a detail-oriented case-by-case approach. Indeed, one possibility is to strive for the sort of "simple rules for a complex world" advocated by Epstein (2009).

¹ For instance, although it is very useful to know that inclusive institutions introduced in colonies in the sixteenth century persist to this day and can be instrumented with settler mortality in that era (Acemoglu et al. 2001), that leaves us with precisely little actionable policy advice.

Finally, a reform agenda should dig into the local context. An offshoot of the FIRES project is presently conducting urgent work in this direction that will culminate in the book *The Entrepreneurial Society: Tailoring a Reform Strategy to Local Institutions*, edited by Axel Marx, Mark Sanders, and Mikael Stenkula. If the reform proposals in this book form a menu of options, this second book will show how to assess an entrepreneurial ecosystem and how that assessment should be used to select those proposals that are most relevant to a particular local, regional, and national context. Together, the two volumes help reformers address the most urgent and pressing problems and choose specific designs that achieve the goal and fit the context. Our explicit formulation of our reform agenda's underlying principles gives direction to that exercise, while our proposals may inspire policymakers to look beyond the limits of traditional entrepreneurship policy.

The EU needs a new and appealing narrative. By offering real opportunities for all, the entrepreneurial society provides an urgently needed optimistic answer to the stifling populist conservatism that has swept across Europe and put the European project in jeopardy. The recipes of neoliberal reformers have failed to deliver for significant parts of Europe's constituency, and the current debate simply cannot support another round of "structural reforms" naïvely liberalizing product, service, labor, and capital markets. Instead, the EU needs to start building an institutional environment that brings appealing opportunities to all of its citizens. By directing its citizens' abundant creativity, talent, and resources towards new venturing, Europe can return to socially inclusive, ecologically sustainable, and innovation-driven growth. This will not turn the *gilets jaunes* into a happy and docile electorate. But it will provide the defenders of an open European society with more ammunition to turn the populist, nationalist tide and goes a long way towards protecting the European project that has brought peace and prosperity to most of the Continent for the past 70 years.

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