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ABSTRACT

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The European Commission has adopted an Entrepreneurship 2020 Action Plan as *its answer to challenges brought by the gravest economic crisis in the last 50 years*. Governments of European countries all habour high expectations that entrepreneurship will contribute towards ending the continent's economic malaise. In this article I argue that these expectations may be disappointed because (i) entrepreneurship promotion is a last-resort policy, (ii) entrepreneurs are being overestimated, and (iii) entrepreneurs are too often allowed to capture policy. These reasons are indicative that that in addition to its euro and refugee crises, Europe is suffering from an entrepreneurship crisis. Entrepreneurs are increasingly older and are faring less well in terms of earnings compared to wage earners. Small businesses are not creating sufficient jobs, they are not raising labour productivity, and immigrant-entrepreneurs are not productively assimilated. Big businesses are largely a legacy of the past, and resorting more and more to lobbying. When they innovate it is often to replace labour. Hence, given that Europe faces rising unemployment, growing numbers of unassimilated migrants, and more pensioners - and all in the face of stagnating productivity growth - the conclusion is that entrepreneurs have failed to reduce the dependency burden on those who do work. This puts immense strain on European public finances that are already fragile after the financial crisis. Demographic changes and institutional shortcomings are thus at the core of the entrepreneurship crisis in Europe.

JEL Classification: L53, M13, O52

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1 Introduction

Entrepreneurship is accorded high priority by policymakers in Europe. The European Commission has adopted an Entrepreneurship 2020 Action Plan as its *answer to challenges brought by the gravest economic crisis in the last 50 years.* European governments spend huge amounts of money trying to support new firm start-ups and promote innovation. This enthusiasm may be misplaced because (i) entrepreneurship promotion is a last-resort policy, (ii) entrepreneurs are being overestimated, and (iii) entrepreneurs are too often allowed to capture policy.

There is no doubt that entrepreneurship can and did contribute to economic development in Europe. But as is argued in this article, this will not happen automatically, not straightforwardly, and not unambiguously. Entrepreneurship may even be contributing to many of Europes economic woes. Because this is not generally recognized, current high expectations of entrepreneurs, and recently of migrant entrepreneurs, will likely disappoint. In this article I discuss these concerns. It is time that European governments look afresh at how to galvanize entrepreneurship for development, in particular for job creation and productivity growth, and starting from the realization that a more sober view is required.

2 Entrepreneurship Promotion as Last Resort Policy

Victor Hugo once remarked: You can resist an invading army; you cannot resist an idea whose time has come. Today entrepreneurship is such an idea -The Economist, 2009 [1]

When faced with crisis, policymakers often call on entrepreneurs to rescue the day. The above quote is from *The Economist* magazine, published in 2009 in the midst of the global financial crisis, when it carried a special section on entrepreneurs as *Global Heroes*[2]. The previous time when *The Economist* published such an enthusiastic endorsement of entrepreneurship was during the 1970s recession. Its 25 December 1976 edition carried an article entitled, *The coming entrepreneurial revolution: a survey*[3]. On both occasions entrepreneurship was resorted to because policymakers and academics had run out of other policy options (read money). And in both cases the articles and sections in *The Economist* were actually wrong: the subsequent deregulation and free-marketeering widely adopted in the 1980s and staunchly promoted by Thatcher and Reagan heralded in a period of unbridled growth in the incomes and wealth of the top 0.1 percent of the population in the USA and Europe (Atkinson et al., 2011). The *coming entrepreneurial revolution* stimulated the corporate greed and risk-taking that eventually caused the 2009 financial crisis (Johnson and Kwak, 2011).

Since the 2000s entrepreneurship have stagnated and even declined in the USA and many European countries. For instance in Europe the relative earnings of the self-employed to

[1] See The Economist, 14 March 2009, supplement p.6.
[2] See http://www.economist.com/node/13216025.
[3] See http://normanmacrae.ning.com/forum/topics/entrepreneurial-revolution.

the wage-employed has been declining significantly in the UK for instance by 20 percent since 2006/7 (Hatfield, 2015). And as *The Economist* (Economist, 2012) accurately pointed out this time *The vast majority of Europe's big companies were born around the end of the last century*. Since the 1980s *nearly no international businesses [i.e. Fortune 500 companies] have been developed in Europe* (Lirzin, 2013). A recent Harvard Business School report found that Europe is in a digital recession, with only three European economies making it onto the top of Harvards Digital Evolution Index. Nine European countries can make it only to the bottom slots of the indexs top 50. In one of the key areas of new technology, namely unmanned robotics, Europe has failed to develop its own drones, instead it has to import its spy-drones from the USA and Israel, following the failure of its Euro-Hawk programme (Matlack, 2013). Furthermore in terms of venture capital funding in excess of US Dollar 100 million for high-tech start-ups, Europe ranked *a distant third behind North America and Asia* (Chakravorti and Chaturvedi, 2015).

Scholars studying entrepreneurship in poor countries will spot more and more similarities with Europe. In the poorest countries small businesses and self-employment remain largely a means for survival. It does not drive economic growth, productivity growth nor development or political transformation (Nagler and Naudé, 2014). Despite this, billions of dollars particularly of aid money continue to be spent on promoting small business start-ups, and the more formal economies contract and dysfunctional governance and policy-making make headlines, the louder the UN, development agencies and governments proclaim the importance of entrepreneurship. This continues to happen even in the face of impact assessments that question the effectiveness of most of these initiatives (Karlan and Valdivia, 2011).

3 Overestimating Entrepreneurs

This is one of those cases in which the imagination is baffled by the facts - Adam Smith

Adam Smith, the *father* of modern economics, was apparently not too fond of entrepreneurs or businessmen [4]. He may have been baffled why many scholars and policy makers so enthusiastically cling to the belief that entrepreneurship is a panacea for development, because the empirical evidence is far from conclusive.

As I argued in more detail elsewhere (Naudé, 2011) statistical results do not seem to be robust with regard to definitions, time-periods, quality of data, or estimation methods; reverse causality always crops up indeed from this seems more reasonable to conclude that economic growth drive entrepreneurship and small business start-up rather than *vice versa.*

Some economists even report a negative relationship between entrepreneurial activity and economic growth. For example Wong et al. (2005) finds evidence for *the existence of entrepreneurial activities that do not contribute to economic growth.* Parker (2006) reports

[4] As he pointed out in The Wealth of Nations : '*The interest of [businessmen] is always in some respects different from, and even opposite to, that of the public*'.

that there is no unambiguous empirical relationship between the rate of self-employment and unemployment.

Praag and Versloot (2007) find from a broad survey of published empirical studies, most focusing on entrepreneurship in Europe, that (i) entrepreneurs do not spend more on R and D; that (ii) entrepreneurs create lower quality and less secure jobs, and that (iii) *the relative contribution of entrepreneurs to the value of productivity levels is low* (p.377).

Oosterbeek et al. (2010) used a difference-in-differences approach to evaluate the impact of Europes Junior Achievement Young Enterprise student mini-company (SMC) programme. They found that the programme had no positive impact: it did not enhance students self-assessed entrepreneurial skills, and the effect on the intention to become an entrepreneur is even significantly negative (p.443). Most recently Daunfeldt et al. (2015) found that even focusing on so-called high-growth entrepreneurship (as the European Commissions calls for) is problematic since most high-growth firms in a Swedish sample were not very profitable but financially weak, casting doubt on whether they could sustain growth.

In European countries there is no significant statistical relationship between economic growth and entrepreneurship measures, whether self-employment, business ownership, innovation rates or start-ups and early stage entrepreneurship. There is also no evidence that entrepreneurship helped to reduce unemployment in the largest European economy: in Germany unemployment was declining in the midst of declining rates of start-ups and self-employment for most of the period [5]. Growth rates have tended to slow down when start-up rates increased [6]. For other European countries for which similar data is available one cannot conclude that entrepreneurship is driving economic growth and employment - it is rather that in Europe, as in developing countries, lack of formal economy wage jobs and declining social benefits force people into self-employment [7].

When faced with disappointing empirical findings, entrepreneurship aficionados often claim that these results are due to measurement problems [8]. When traditional indicators such as self-employment and business ownership rates were found not strongly and causally related to economic development they were quickly dismissed as not really reflecting entrepreneurship. In fact most vocal academic proponents of the thesis that entrepreneurship is the key to development considers an indicator as reflecting entrepreneurship only when it appears to be significantly and positively related to economic development as measured by per capita income.

The most sophisticated exercise in this tradition to date is the recent construction of what is misnamed the *Global Entrepreneurship Development Index* (GEDI) (Acs et al.,

[5] For instance between 2001 and 2014 the unemployment rate in Germany declined from 7.8 percent to around 5 percent. This was not due to a higher start-up rate, in fact the rate of start-ups declined from 7 to 5 percent as well over this period.

[6] For instance in Hungary GDP growth per capita declined from 5 percent in 2004 to -6 percent in 2009, with start-up rates increasing over the same time from 4 to 9 percent.

[7] In The Netherlands unemployment increased from 2 percent in 2001 to 7 percent by 2014; this was accompanied by an significsnt increase in the start-up rate, from 6 to 10 percent.

[8] Just as many economist wrongly argue that the US's dismal productivity growth of the past decade is due to mis-measurement, see e.g. Syverson (2016)

2016). The GEDI is disingenuous in that it that succeeds to show, unsurprisingly, that the richest countries are also the *most entrepreneurial*. In its most recent GEDI, the top country- the most entrepreneurial country in the world is the United States with a historical high value, claiming the US is getting even more entrepreneurial, despite the finding of Decker et al. (2014) that the share of US employment from new enterprises has declined by 30 percent over the past 30 years and the start-up rates have declined across all sectors.

The US may indeed for the moment have the highest per capital income in the world but if one considers further measures of development it is seriously lacking. Most noticeably, as Case and Deaton (2015) reports, the US has seen an increase in the mortality of middle-aged white non-Hispanic men and women since 1999, a reversal after decades of development, and the first advanced country ever to experience such a situation. According to Stiglitz (2015) the *US could soon be the World's First Former Middle Class Society*. The US Census Bureau reports that 15 per cent of Americans live in poverty; and as noted by Quiggin (2015) the numbers of households in poverty in the US is currently higher than in 1959. At the same time inequality has soared. Not exactly encouragement for other countries to want emulate the world's *most entrepreneurial* society.

4 Allowing Entrepreneurs to Capture Policy-Making

Throughout history there has been a tussle between those who make their way by honest but unimaginative toil and the gamblers, pirates, hucksters -Silberman (1956) [p.42].

Iceland was once hailed a *miracle economy* and an example of an entrepreneurial economy par excellence, compared in the latter aspect favorably with the bastion of entrepreneurship, the US: *Iceland is a European country with an American labour market* reported Keiser (2008) in the Huffington Post. But by 2008 Iceland's entrepreneurs had created a financial sector that was by 2008 ten times the size of its GDP. As the sub-prime mortgage crisis started to unfold, the country's bloated financial sector collapsed in October 2008. It was rapidly followed by the collapse of the country's government, in January 2009. What happened to the miracle entrepreneurial economy?

What happened was that entrepreneurs had captured the financial system and the policy-making process. Three entrepreneurial families, who made their fortunes in the shipping, brewing and frozen food industries, took complete control of the countrys banks, the Glitnir, Landsbanki and Kaupthing (Mason, 2008). Emboldened by the ideology of free markets, financial deregulation and financial engineering, they seemed to have convinced and lobbied policymakers of the soundness of their business model and that there was no conflicts of interest between them owning Iceland's banks and running many large businesses in other sectors of the Icelandic economy. As the Special Investigative Committee (SIC, 2010) [p. 10] report into the Icelandic crisis reported *The SIC is of the opinion that the operations of the Icelandic banks were, in many ways, characterized by their maximizing the benefit of the bigger shareholders, who held the reins in the banks, rather than by running reliable banks with the interests of all shareholders in mind and* *showing due responsibility towards creditors. It appears that worries about conflict of interest between the operation of the banks and the operation of other companies owned by the same parties had vanished*. The pirates and hucksters got their way.

Much has now been written on the government and policy capture that caused the financial crisis in Europe and the USA (for a good account, see (Johnson and Kwak, 2011)). With the Greek economic meltdown jeopardising the entire Eurozone, it is worthwhile to recall that Der Spiegel (8 Feb 2010) reported *How Goldman Sachs Helped Greece to Mask its True Debt* to explain how the lingering euro-crisis can at least be raced back to the ideological support and free hand of unscrupulous entrepreneurship, of the financial *pirates and hucksters* in Europe.

Despite the lack of political and other regulatory oversight in Europe that twisted the incentives of entrepreneurs and businesses that contributed to the financial crisis, little has been done to resist run-away entrepreneurialism, as the 2015 scandals of Volkswagen and of the Swiss-based FIFA reflected. In both cases the free hand that these organisations had lead to their entrepreneurs/managers acting opportunistically, corruptly, and against the public interest- as *pirates and hucksters*. And in both cases it was due to USA-instigated investigations, and not European, that the culprits were exposed.

In 2015 Europe continued to face a migration (refugee) crisis, the result of millions of refugees fleeing conflict and economic destitution in the Middle East and North Africa and ending up in Europe, often after dangerously crossing the Mediterranean. Although there has been debate about the EU and European governments' handling of the migration crisis, a discussion falls outside the scope of this article. For present purposes though, with an EU governance system gathering increasing scepticism among others due to the scale and scope of the at least 30,000 lobbyist lobbying in Brussels (Guardian, 2014) the EU's responses to this crisis have not been free of entrepreneurial policy capture. Andersson (2012) [p.7] has disconcertingly described the new business of *illegality* as containing elements in common with the financial crisis:

European states are taking yet another leap with Eurosur and the investments this system entails: surveillance machinery, coordination centres, patrol vehicles and manpower. For the border guards, defence contractors, international organizations and aid agencies involved, clandestine migration has become big business. In this growing industry, careers are made, networks created, knowledge and imagery circulated, and money channeled in increasing amounts.Here Frontex, pushing the securitization analogy, works much like the offshore special purpose vehicles used in derivatives banking before the crisis spreading risks off-balance-sheet, diffusing accountability away from sovereign states and their elected governments.

The above are some examples (there are many more in contemporary Europe) of the truth that Baumol (1990) [p.894] recognized 25 years ago namely that *at times the entrepreneur may even lead a parasitical existence that is actually damaging to the economy. How the entrepreneur acts at a given time and place depends heavily on the rules of the game the reward structure of the economy that happen to prevail*.

In contemporary Europe the reward structure of society is increasingly making it difficult for small businesses to grow and innovate, and increasingly motivating a privileged economic and business elite resorting to engage in unproductive and even destructive actions, including patronage, corruption and rent-seeking. Policies all too often end up prolonging of the life of inefficient and low-productivity firms. Even well-intentioned policies may be fundamentally flawed, because an EU over-eager to raise the number of entrepreneurs may push too many people without entrepreneurial ability into the market causing negative spillover effects on entrepreneurship with good abilities to start and run a business. Such a situation would call on entrepreneurship to be taxed, rather than subsidized (see also DeMeza and Webb (1987)).

5 The (Slow) Reversal of Fortune

Although prosperous, Europe is in relative and absolute decline. It is in relative decline as the income and wealth gaps between Europe and many emerging and developing countries are shrinking. It is in absolute decline as many European countries seem to reverse many gains made after the Second World War, for instance in access to health and education, in rising and stubbornly high unemployment rates, and loss of global political influence (see e.g. Applebaum (2015)). Ferguson (2015) describes what he calls an institutional degeneration in Europe.

In 1494 European powers were so powerful that Portugal and Spain divided the non-European world at the Treaty of Tordesillas. By 1900 the sun never set on the British Empire. But by 2010 Portugal and Spain had become *submerging economies* (Collier, 2013) with unemployment rates around between 11 and 25 per cent (and youth unemployment around 50 per cent). And by 2015 there was not a single British firm among the Top 100 Innovating Firms worldwide according to the Thomson Reuters Top 100 Global Innovators Report [9].

The rise and fall of its city of Glasgow is in many ways a metaphor for Europe's fortunes and that of its entrepreneurs. As Frisby (2014) chronicles, Glasgow rose during the 18th and 19th centuries through entrepreneurs sizing on its favorable location as a harbor and seafaring hub (exploiting the trade winds) and the inventions of the industrial revolution, to become by 1900 the second city of the British Empire. It was considered the best-governed city in Europe. It adapted innovatively to many changes in external circumstances: when it lost its position in the tobacco trade after American Independence it moved on to cotton; when steam ships made its position on the trade winds irrelevant, it became a major producer of ships, producing one fifth of the world's ships between the 1890 and 1914. But after 1914 its long and slow relative decline set in. Today is has, as reported by Frisby (2014) a 30 per cent unemployment rate, the UK's highest homicide rate, and moreover, the lowest life expectancy in the UK. It is no longer a manufacturing hub. Its entrepreneurship, which helped it to buffer many changes and shocks in the 18th and 19th centuries, was powerless to prevent its decline.

[9] And from Europe only France, Germany, Belgium, The Netherlands, Sweden and Switzerland had firms in this list.

Demographic change has always fundamentally shaped Europe. At present Europe's population is in decline and moreover aging (see e.g. Falkingham et al. (2011). This will continue notwithstanding current immigration, and even in the face of a (unlikely) baby boom. Europe's working age population had stopped growing in 2014. According to estimates of Pritchett (2015) with no immigration Europe will face a labour force gap of 212 million people by 2050. In the Euro-area labour productivity growth between 2000 and 2012 was a mere 1 percent per annum (compared to 3.9 percent in Korea, 3.3 in Turkey, 3.9 in Russia and 2.9 in Chile, among other OECD countries, see OECD Stat). In contrast labour productivity growth in major emerging economies were 4.9 percent per annum between 1999 and 2006, and 5.8 percent per annum between 2007 and 2012 (According to the Total Economy Database of the Conference Board). The low productivity growth seen against the declining working age population, an increase in unemployment, and an increase in the retirement population, implies that the dependency burden on the working force is putting unbearable strain on public finances. The implications for productivity, social security, inequality and growth are ominous. This is not a crisis similar to the Euro crisis or migration crisis that happens suddenly and acutely. Because it is a creeping crisis it gathers far less debate and concern even though its impact will be more severe and long-lasting. It has at its core an entrepreneurship crisis: Europe's entrepreneurs are failing to create enough jobs or to raise labour productivity significantly enough to reduce the dependency burden.

One of the first reactions to an aging workforce will be to get people to retire later and making more occupational changes later in life. Europe's *active ageing* policies are aiming to support such labour market adjustment. Hence, continent's continued relative decline over the next half-century will result in more older entrepreneurs and also more people who enter entrepreneurship for the first time at an older age. The growth in self-employment amongst 50 to 65 years old is already significant in many European countries, particularly The Netherlands and the UK. In the latter one our of five persons in the 50 to 65 age category is self-employed compared to only one in seven in younger age categories (Hatfield, 2015). The age-structure of business firms in Europe will also age along with its population, with the accompanying effect of older business firms being less innovative and less dynamic, less productive, and less likely to employ new labour, than younger firms (see Decker et al. (2014) for similar trends already taking place in the US). Europe's entrepreneurship crisis can hence potentially become a self-reinforcing poverty trap.

6 Concluding Remarks

Crises-hit Europe will require substantial institutional reform to face its many current challenges. In addition to its euro and refugee crises, it is facing an unappreciated entrepreneurship crisis. As described in this article, small businesses are not driving productivity or jobs growth, are faring increasingly less well in terms of earnings compared to wage earners, and will increasingly become run by older entrepreneurs. These small businesses do not create enough jobs for the working age population and they do not stimulate labour productivity gains. This is not helped by the fact that policies to productively assimilate immigrants and stimulate immigrant entrepreneurship and small business have largely failed (Naudé et al., 2015).

As far as the *big* businesses are concerned, they are by and large a legacy of Europe's past. Many are engaging more and more in lobbying and attempting benefit from the gravy train in Brussels. When they innovate it is increasingly to reduce dependency on labour. Some leave Europe or outsource their jobs, so as to take better advantage of emerging markets, and escape altogether from Brussels' bureaucracy. Other firms are being swallowed up by more efficient competitors from outside [10] (in 2015 the value of acquisitions of EU-based firms from outside the EU was the highest since 1970). And a number of large, centuries-old European business icons have fallen in recent years, some as a result of weaknesses in the institutional framework.[11].

Demographic changes and institutional shortcomings are thus at the core of the entrepreneurship crisis in Europe. Increasingly, as in many poorer regions, *survivalist* entrepreneurship is becoming more prominent in Europe than *transformative* entrepreneurship, and political influence is beginning to matter more for business profits and survival than technical abilities. This changes the relationship between entrepreneurship and development: entrepreneurship becomes less of a driver of development. Without taking into account these factors, and without a better understanding of the relationship between economic development and entrepreneurship, the Europe's answer to challenges brought by the gravest economic crisis in the last 50 years is likely to remain only half an answer.

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[10] Including China's state-owned firm Cosco buying up the Greek harbour or Piraeus and its Sinochem aquiring 26 percent stake in the Italian Pirelli group, among others.

[11] For example in February 2016 the Dutch retailing group of Vroom and Dressman declared bankruptcy. This 128-year old firm, employing 10,000 workers across 67 stores was according to Lassing (2016) and Reudink (2016) due to the unscrupulous behaviour of private equity funds who exploited legal loopholes, which amounted to *legalised theft*.

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