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ENTREPRENEURSHIP: THE KEY TO GLOBAL COMPETITIVENESS

ABSTRACT

For more than a decade, the United States has lost manufacturing employment to low wage nations such as China and others on the Pacific Rim. While the Western industrialized nations can no longer compete in many of the lower skilled manufacturing sectors, they have maintained their status as incubators of new ideas and products. While a lack of access to financing has often been viewed as a key reason for a reduced level of new business starts in the West, public policy, and how it is perceived by the entrepreneurial community, can be an even larger obstacle to growth in this important sector. This paper examined policies that affect entrepreneurial vibrancy. The research identified policy consistency (a.k.a. “visibility”), financial stability, and global trade issues including insufficient protections for intellectual property, and household income as factors that influence entrepreneurial activity. Further study is needed to quantify the impact of policy uncertainty on entrepreneurial expansion, the number of jobs related to those decisions, the correlation between household income, entrepreneurial activity, and the universality of their impact across national borders.

Key words: *entrepreneurship, global competitiveness, intellectual property, policy*

JEL classification: *L26*

1. INTRODUCTION

The key to a nation’s economic growth is the nurturing and unleashing of its entrepreneurial talents. Whether in developed nations such as the United States or in emerging democracies, the development and stimulation of a culture of entrepreneurship can create jobs, opportunity, and a burgeoning middle class. The challenge cannot solely be met from top-down strategic planning from a central government, but through the development of a more entrepreneurship-friendly environment in such areas policy visibility, financial stability, global trade and associated intellectual property issues, and household income.

The fostering of entrepreneurship is important to every nation, emerging or enduring, because of its symbiotic link to liberty. As Blassingame (2012) noted, “over time ...as the ideals and values of entrepreneurship acquire critical mass, it will be discovered

that liberty has flourished on the foundation of entrepreneurship.” Entrepreneurship is not a modern phenomenon, and is present in all cultures, albeit to varying degrees of intensity. As Crowley noted by his description of entrepreneurs in *Liberty and Entrepreneurship*, humans in all states reap the ubiquitous benefits of entrepreneurship on a daily basis. “Just as the ubiquity of the air we breathe masks its indispensability to life, so too the workaday character of the entrepreneur’s contribution passes unremarked” (Crowley, 1994).

While this paper is focused on the policies and economic climate in the U.S., the significant drivers of entrepreneurship - necessity, independence, and wealth creation - can be generally found across national boundaries (Hessels, van Gelderen, and Thurik, (2008). Entrepreneurs have faced, and surmounted, challenges throughout history. Today, in the United States and around the globe, entrepreneurs face a complex set of obstacles to their creativity that can be ameliorated by enlightened public policy that celebrates private sector initiative and unleashes the job- and wealth-creating dynamism of entrepreneurship. The short-term policies of debt, deficit, and government intervention following the 2008 global financial crisis will not make the solution to those challenges easy. In fact, at a time when entrepreneurship should be blossoming, the U.S. experienced a 5.9% decline in new business creation (Kaufman Foundation, 2011), indicative of the headwinds faced by the entrepreneurial community.

There are many factors that influence entrepreneurship, including “economic and political to socio-cultural. Therefore, when discussing entrepreneurs as the agents of change, it is at least as important to discuss the environment in which they want to, or have to, create these changes” (The Entrepreneurs’ Ship, 2012), as is the focus of this paper.

2. THE IMPACT OF GOVERNMENT POLICY ON ENTREPRENEURIAL GROWTH

From early Mesopotamians to the present world of globalized opportunity, entrepreneurs have stimulated commerce and prosperity for society. In today’s environment of record levels of financial stimulus, accommodative monetary policies, and myriad free trade agreements, a first impression would be of friendlier environment for entrepreneurship. That, however, is not what many entrepreneurs are facing in the post-2008 financial crisis environment.

Governments, especially in the U.S. and Europe, are struggling to reignite their economies while faced with immense economic imbalances. As fiscal policy makers struggle with measures to address these imbalances, as well as high unemployment and a disgruntled electorate, fiscal policy from the U.S. Federal Reserve (Fed) and European Central Bank (ECB) is being employed to keep struggling economies afloat. The cost to the financial credibility of the nations involved is significant, and credit downgrades of pillars of strength, such as the U.S. Treasury, are taking their toll on the clarity of the economic landscape for entrepreneurs and small businesses. Coupled with political gridlock and growing calls for higher taxes that will impact the entrepreneurial

and small business class, the difficulty of future planning, or visibility, is hindering startups (Hatch, 2012).

2.1. Limited Visibility in the Post-2008 Environment

Entrepreneurs and small businesses have a lesser incentive to develop and grow in an environment shrouded in policy uncertainty (Patterson, 2011 and Barnes, 2012), such as the current, highly-contentious climate that remains deeply impacted by the 2008 financial crisis. Governments around the world were faced with extraordinary challenges following the failure of Lehman Brothers and the near-collapse of the global financial system. In the United States, the federal government increased spending from 21.4% of gross domestic product (GDP) in 2007, to a high of 27.3% in 2009, including the historic budgetary legislation in the Troubled Asset Relief Program (TARP), an expenditure of \$860 billion. With TARP and additional measures, U.S. government “stimulus spending over the past five years totaled more than \$4 trillion” (Laffer, 2012).

Those extraordinary expenditures have done little to boost GDP in the U.S., now hovering in the 2% arena and running well-below potential. The impact of attempting to solve a crisis caused in large part by excessive spending and debt by applying even greater levels of spending and debt has not achieved a significant growth in jobs and output. In fact, the recovery from the recession that ended in 2009 has been the weakest since World War II (Wiseman, 2012). As noted in Figure 1, the growth of nonfarm employment in the U.S. is the most muted of any post-recessionary period since 1981, despite the record federal spending and stimulus programs.

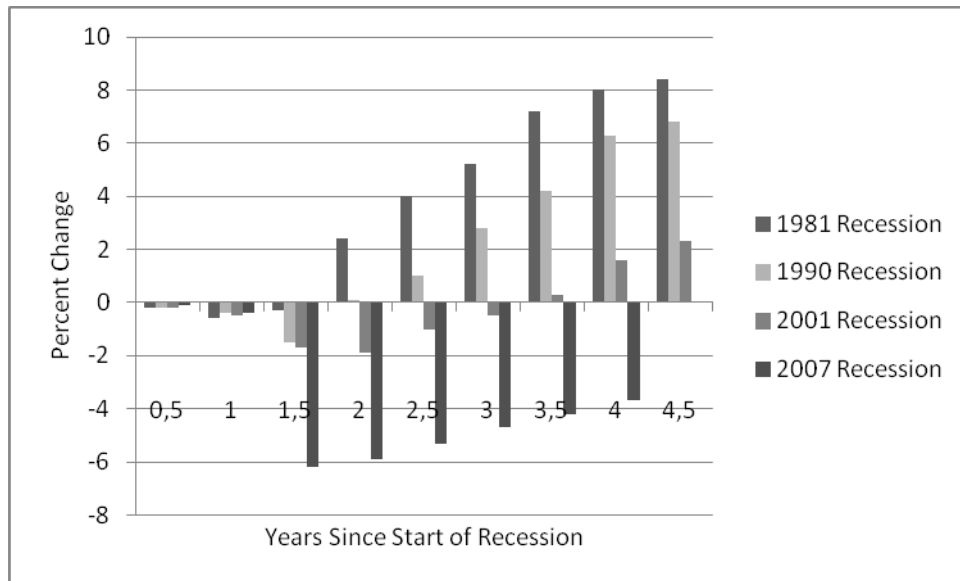
Flooding the market with a consumer-focused, debt-funded stimulus in an economy with high individual debt levels from the pre-recession period had little chance to succeed. Consumers with fragile balance sheets, homes with less value than their mortgage, and fearful of unemployment are loathe to take on additional debt (Mutikani, 2012). Businesses, cognizant of consumer recalcitrance, limit expansion, debt acquisition, and the hiring of new staff. Banks, aware of the fragility of the recovery and cognizant of the fallout from their past willingness to extend credit to questionable risks, are often recalcitrant in their lending to entrepreneurs and small businesses ((Ozanian, 2011).

The policy uncertainty, a polarized electorate, and the potential “Fiscal Cliff,” where myriad taxes are scheduled to rise and budget cuts are implemented in January 2013 are, in juxtaposition, negatively impacting consumption and small business expansion. According U.S. Federal Reserve Board member Jeffrey Lacker, the “significant fiscal adjustment ahead of us...is going to create uncertainty that’s going to impede growth for some time” (2012). The non-partisan U.S. Congressional Budget Office recently added to concern by announcing that, if the Fiscal Cliff occurred, the U.S. would quickly fall into recession, with a negative 2.9% GDP in the first half of 2013 and unemployment would rise to 9.1% by yearend (Murray, S. and Paletta, 2012).

In addition to the issues of policy uncertainty, this has been the first recession in the post-war period that combined U.S. federal, state, and local government employment

has fallen. Most of that employment loss is at the state and local level, where budgets must be in balance and deficits are not allowed. As a result of the myriad headwinds in the current cycle, such as falling housing prices and weak tax revenues, states and local governments have been a significant drag on the U.S. economy. Figure 2 shows the plunge of public sector jobs since the 2009 recovery began in the U.S., compared to the 1990 and 2001 recessions.

Figure 1: Percent Change in Nonfarm Employment since the Start of Recession



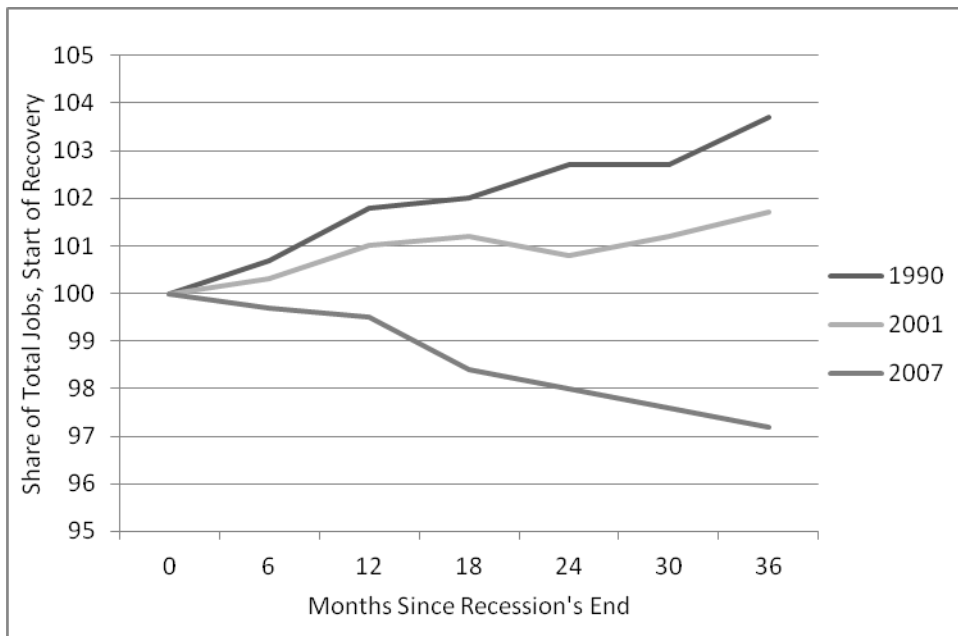
Source: Center for Budget and Policy Priorities, from Bureau of Labor Statistics Data

The rise in bankruptcies of U.S. cities, despite the public sector budget cuts and layoffs, is casting a further pall on consumer confidence, small business investment, and an increase in economic uncertainty. With 706,000 jobs lost by state and local governments from May 2009 through June of 2012 (Dewan and Rich, 2012), those important sectors of the economy are creating another large obstacle to economic recovery and a deterrent to new business creation. According to Nayab (2011), unstable political conditions and uncertain government policies suppress entrepreneurship. The historic financial problems of this important sector in the U.S. economy exemplify that instability. With state and local budgets highly dependent upon the health of the housing market, their problems are expected to continue (“How State,” 2012).

Although the large reduction in employment in state and local government is having a chilling effect on the current economic recovery, lessons can be learned from the retrenchment. According to Mitchell, “from 2000 to 2009, state and local government spending grew nearly twice as fast as the private sector” (2009), commanding a larger proportion of national income. Accommodative Fed policy that fueled the housing boom also spiked state tax revenues, as did rising house prices at the municipal level. Instead of returning those windfalls to the citizens in the form of lower taxes, thence

available for investment and business development, most state and local governments expanded their workforces and programs. Now, as they've had to learn quickly that they must live within their reduced revenue streams, a smaller portion of GDP could be absorbed in the public sector and made available, in part, for private sector entrepreneurship and small business creation.

Figure 2: Total Job Change for Public Sector Workers since Start of Recovery



Source: Center for Budget and Policy Priorities, from Bureau of Labor Statistics Data

2.2. Monetary Policy and Impact on Entrepreneurship

Another element of federal policy that is inhibiting entrepreneurship and small business formation is monetary policy. Four years after the financial crisis, policy makers at the Fed are still unclear about the cause of high unemployment. The Fed opines that it is principally due to a shortage of consumer demand, which they argue can be resolved by ultra-low interest rates and multiple rounds of quantitative easing. Other economists argue that unemployment is caused by structural factors, such as the inability of workers to sell their homes and move to a new geographic area, as well as the mismatch between skills and job openings (Hilsenrath, 2012). As Nayab noted in *Factors Having an Impact in Starting and Operating a Business*, the availability of qualified human assets is a key enterprise success (2011), and these structural factors are having a chilling impact on startups and small businesses.

The structural factors that are impeding job growth in the U.S. are compelling. Housing and worker training can be, in part, attributed to government policy. Failed housing policies fueled by an overly-accommodative Fed policy and geared to support bubble-

era home prices, congealed the housing market while costing taxpayers hundreds of billions of dollars in support of government sponsored enterprises (GSEs) Fannie Mae and Freddie Mac.

According to the U.S. Congressional Budget Office (CBO), the Executive Branch of the U.S. Government has woefully underestimated the true costs of bailing out the two GSEs. The Obama Administration estimated the cost at \$130 billion, while CBO states the real cost as \$317 billion through mid-2011, and is likely to rise further as the backlog of foreclosures enter the marketplace. As stated by Cover, “this merely transfers the risk to the taxpayer” (2011). Such an immense disparity in programmatic costs, on public display, is contributing to the expanding federal deficit. It is also a clear signal to business creators that the future economic landscape could soon be affected by corrective action in the form of higher taxes, having a chilling impact on new business creation (Nayab, 2011).

If policy had allowed housing to resolve by market forces, the temporary pain of lower prices would have been followed by a better-functioning market. It would be an environment in which workers would be free to choose new work opportunities – and fill the skills void for budding new businesses - without the burden of an unmarketable home and attendant geographic limitations.

The failure of federal policy to adequately support worker training programs that target needed skills for new and existing businesses further exacerbates structural unemployment and make it more difficult for small businesses to staff their enterprises. According to U.S. Senator Coburn of Oklahoma, the duplicative and ineffective training programs of the federal government “lack of demonstrable results” and are “outrageous examples of examples waste, fraud, abuse and graft” (2011). According to Coburn:

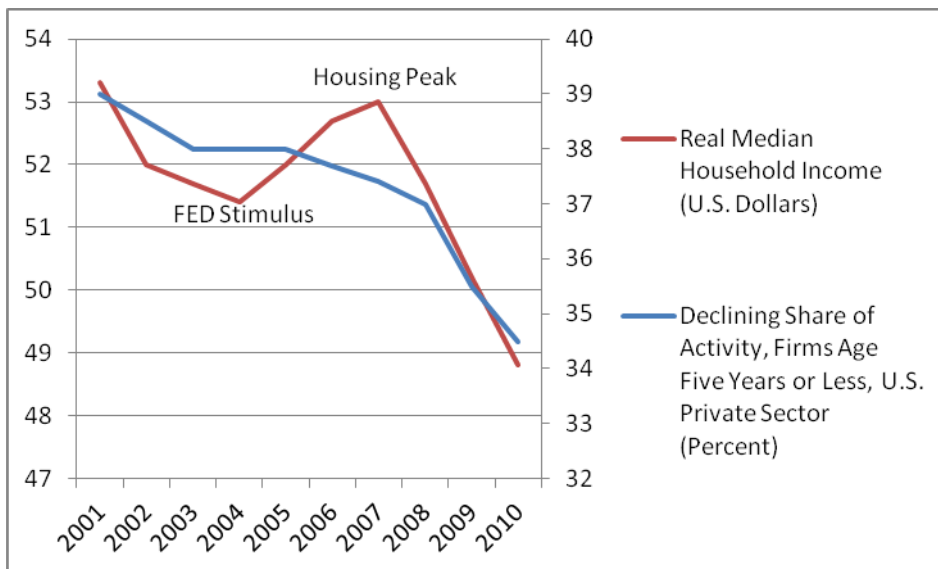
Washington can encourage an economic environment that attracts and retains investment and productivity in the United States. This can be accomplished in part by reducing the national debt, opening foreign markets to U.S. goods and services, reducing unnecessary regulatory burdens on small businesses and employers, and ensuring stable and predictable government policies so employers can make short- and long-term investment and management decisions. (2011)

The most salient element of Fed policy that has severely impacted the entrepreneurial activity and small business growth is their attitude toward the formation of financial “bubbles” in the economy. Their willingness to stimulate economic growth with often less-than-zero real interest rates provided major banks with the ability to market new and creative highly-leveraged financial instruments that spiked earnings and market share. However, the subsequent collapse of many of those instruments has led to the present environment where wounded financial institutions are unable or unwilling to lend to all but the soundest risk, leaving incipient businesses starved of capital. The Organization for Economic Cooperation and Development (OECD) noted in their “*Better Financing for SMEs for Job Creation and Growth*,” (2010), that entrepreneurs and small businesses face many challenging years ahead. They note that the low

interest rates of most central banks have led commercial banks to focus their lending on larger companies where risk is easier to assess than at new business formations.

It is clear that the most accommodative monetary policies in the history of the U.S. have failed to stimulate GDP growth and job creation. As can be seen in Figure 3, they have also failed to stimulate real median household income. In that figure, we find an apparent tight correlation between a declining share of young firm activity and a drop in median income. While the full meaning of that correlation is beyond the scope of this paper and will require additional research, entrepreneurs seem to perceive the impact of failed policy and falling incomes and act accordingly in their business activity.

Figure 3: Declining Share of Activity, Firms Age Five Years or Less & Real Median Household Income (thousands of U.S. dollars)



Source: Author's Analysis of Data from the U.S. Treasury & Kaufman Foundation

2.3. Entrepreneurs Disadvantaged in Global Trade Policy

According to the U.S. House of Representatives Committee on Small Business, entrepreneurs and small businesses face a variety of barriers that significantly inhibit their ability to compete in the export market. Those barriers include higher tariffs, and anti-competitive technical standards. Adding to the global issues, some nations, including the U.S. create complex domestic rules regulating international trade. Entrepreneurs must navigate multiple federal agencies to obtain that license. With their limited resources, entrepreneurs and small businesses rely on free trade agreements to navigate the complexities of international trade (2012).

Despite the agreements in place, their complexity and lack of enforcement have deterred entrepreneurial activity in international markets. Unfair trade practices, especially the theft of intellectual property (IP), deter small business engagement in that arena. According to the U.S. House of Representatives, China is the preeminent offender, including dumping, intellectual property theft, and market access. In total, domestic firms lost an estimated \$48 billion from this theft. As a result, only one percent of the 27 million small businesses are engaged in export (2012).

The U.S. Government has been a failure in ensuring that trade agreements with nations like China have been “fair” as well as “free.” Large enterprises have the scale and clout – for the present – to limit intellectual property theft. The U.S. could impose penalties on certain Chinese manufacturers and products where IP theft was known. The lack of strong action by the U.S., as some allege, may be due to fear of losing the nation’s key source for its debt-fueled economy. To stimulate entrepreneurial development and to restore manufacturing jobs in the U.S., the nation must take a stronger stance against global IP theft.

In a positive signal for entrepreneurs and a possible shift toward a tougher posture on violators, on February 29 of this year the Obama administration signed an executive order to target the unfair trade practices of nations such as China. Commerce Secretary John Bryson, who will appoint the deputy director, said his department “is committed to making it as easy as possible for U.S. businesses to build things here and sell them everywhere.” (Barklay, T. and Favole, J., 2012).

3. CONCLUSION

The role of governments can be quite helpful in the fostering of entrepreneurship and the growth of small businesses. Most efforts to stimulate such business creation have been in the form of tax incentives. While preferential taxation, such targeted capital gains reductions and investment tax credits can be helpful, other, sometimes more subtle policy factors noted in this paper may be more enticing. Chief among them is an environment in which a medium- to long-term assessment of government policy is possible. In the U.S., for example, the lack of policy visibility in a politically divided nation, and fear of new regulations, taxes, and government control is having a chilling effect on new business creation.

Adding to the downbeat dialogue, statements from the U.S. president about who actually should take credit for a successful business (Gardner, 2012). Some Western nations are recognizing the value of providing a more positive viewpoint from government, and one that can diminish policy fears harbored by entrepreneurs. The U.K.’s Department of Business, Innovation, and Skills recently announced the elimination or modification of 3,000 rules that impacted small companies. The U.K.’s Business Secretary noted that “in these tough times, businesses need to focus all their energies on creating jobs and growth not being tied up in unnecessary red tape” (Vina, 2012).

Perhaps the most important element in the need for improved policy visibility is fiscal and monetary policies that are sustainable. The post-Internet bubble recession in early March of 2001, followed by the September 11 attacks, were the spawning grounds for deficit spending and fiscal stimulus of the economy. That was quickly followed by the Fed with massive doses of accommodative monetary policy. While both were well-intended, they sowed the seeds for housing bubble and 2008 global financial crisis.

Notwithstanding the intentions of policy makers, entrepreneurs and small businesses realize that a nation that has incurred more debt in just four years than in its entire 200 year history, as is the case for the U.S., is on an unsustainable trajectory. As a result, their job creating and GDP enhancing efforts are tempered. Many of these same issues are an impediment to business formation elsewhere, such as the European Union. Until a more stable environment, built on policies that engender private sector growth and investment is visible to the entrepreneurial cadre, we can expect sub-par growth in this important sector. Further study is needed to quantify the impact of policy uncertainty on entrepreneurial expansion, the number of jobs related to those decisions, the correlation between household income, entrepreneurial activity, and the universality of their impact across national borders.

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