Introduction to Institutions, Entrepreneurship and Firm Growth: The Case of Sweden

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In 1970 Sweden was ranked as the third richest OECD-country in terms of GDP/capita (adjusted for purchasing power parity), almost 10 per cent above the OECD average. In the late 1990s about 15 OECD-countries was ranked higher than Sweden and the Swedish GDP/capita was then some 15 per cent below the OECD/average. Attempts by Swedish economists to explain the unsatisfactory behaviour of the Swedish economy since 1970 often claim that the institutional framework in Sweden has had a strong negative growth impact during the actual period. The main arguments put forward could be summarised as follows:

"The Swedish tax system – in particular in its pre-1990 form – has strongly disfavoured younger, smaller and less capital-intensive firms and sectors as well as entrepreneurship and family ownership of business while giving advantages to institutional ownership. The national pension system, the employment security laws, the centralised wage-setting system and the earlier credit market regulations have reinforced the distortionary impact of the tax system. The distortions created by the Swedish policies and institutional framework are likely to have hampered the efficient allocation of resources, reduced productivity and retarded economic growth and recovery. It is also likely that these distortions have had consequences for the size structure of firms and industrial distribution of employment. It looks as if Sweden's employment distribution is sharply tilted away from lower wage industries, less capital-intensive industries and industries characterised by greater employment shares for smaller firms and establishments. Compared to other OECD economies, Sweden has the lowest rate of self-employment, a dominant role for larger firms, and a highly concentrated ownership and control of private sector economic activity."

One might, of course, argue that the institutional structure only has played a very minor role for Sweden's insufficient growth performance and that other factors have been more important. However, given that the institutional explanation holds, Sweden faces a most fundamental problem, since many politicians and many ordinary citizens see current institutions as essential elements of the Swedish welfare state. How to preserve the welfare state or at least most of it while creating institutions that stimulate economic growth?

Of course these are very broad and complex questions which may relate to even more interesting underlying questions. Unfortunately, very little is known about (i) how the institutional framework influence entrepreneurship, the formation of new firms and firm growth, (ii) what impacts changes of the institutional framework have on these issues and (iii) the time it takes for changes of the institutional framework in a more growth enhancing direction to have any substantial effect on entrepreneurship and firm growth.

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For this reason, Jönköping International Business School, Jönköping University, Sweden invited internationally well renowned scholars to a workshop with the theme "Institutions, Entrepreneurship and Firm Growth". The workshop was held in January 2000 in Jönköping, Sweden. The workshop was organised by Zoltan J. Acs, Charlie Karlsson and Bo Södersten and sponsored by the PEG-programme at Jönköping International Business School (PEG = Programme on Entrepreneurship and Growth).

The purpose of the workshop was to provide a state-of-art overview of the role of institutions[1] for entrepreneurship and firm growth in developed market economies in general and in Sweden in particular from both a theoretical and an empirical point of view. The participants in the workshop presented papers dealing with various aspects of the role of institutions for entrepreneurship and firm growth. The discussion at the workshop was focused at stimulating revisions and refinements of each contribution. The papers appearing in this special issue of *Small Business Economics* are a selection of revised versions of the papers presented at the workshop. Another selection of papers from the workshop will appear in the form of a second special issue of *Small Business Economics*.

Our purpose with this editorial is to provide (i) an overview of the papers themselves, (ii) some comments as regards what can be learnt from these papers and (iii) an overview of issues that ought to be dealt with in future research in the field.

The first paper by *Olsson and Frey* with the title "Entrepreneurship as Recombinant Growth" is a purely theoretical paper. It presents a way to think about the way that new ideas are created. Closing gaps in the technology space creates new ideas. Social institutions also play an important role. Some technological innovations are, for example, socially unacceptable, and won't be used even if they are created. The framework also allows for – indeed requires – "paradigm shifts", i.e. large-scale, exogenous shifts in the technology space that create new non-convexities that can be the basis for the creation of new ideas. Entrepreneurs play the key role of combining ideas.

The identification of the role of social institutions is, of course, not novel. It has been investigated significantly both theoretically and empirically (see, for example Hall and Jones, 1999). Also, the crucial paradigm shift is not new, and is here as it usually is left completely exogenous and unexplained. The authors realise this, and also realise that, in spite of the bulk of their theoretical analysis, true growth must be due to these effects. However, what the authors here attempt to explain are the mechanisms of growth and the central role of entrepreneurs in this process.

The paper by *Davidsson and Henreksson* entitled "Determinants of the Prevalence of Start-ups and High-Growth Firms" is a purely empirical paper. It is a well-based study of some important institutional determinants of entrepreneurial activity in Sweden. The institutional aspects discussed include: missing arenas for entrepreneurship in the household-related service sector and in the care sector, taxation of entrepreneurial income, incentives for wealth accumulation, wage setting institutions and labour market regulations. The authors claim without being able to provide indisputable evidence that these institutional arrangements can explain the low level of entrepreneurial activity in Sweden. Based upon their empirical results the authors also make recommendations for substantial changes of the institutional arrangements in Sweden.

The results of the paper of course open up for a very interesting hypothesis: can the low level of entrepreneurial activity explain Sweden's substandard economic performance after 1970? The paper contains no test of this hypothesis, which is outside the scope of the paper. Neither do the authors test whether institutional changes encouraging entrepreneurship and firm growth would make it possible for Sweden to shift to a long-run growth path that could bring the country back to its previous top position in terms of GDP per capita. However, their contribution certainly motivates further and broader studies not least focusing the above hypotheses.

Carlsson in his paper "Institutions, Entrepreneurship, and Growth: Biomedicine and Polymers in Sweden and Ohio" aims at examining the institutional differences which determine differences in economic performance of the biomedicine and polymer clusters in Sweden and Ohio. It can be seen as a creative methodological step to avoid comparing the conditions in two coun-

tries that are very different in size and instead comparing the smaller country with a region in the larger country that are almost of the same size. Even though the industrial history and the composition of industrial output in general are quite similar in the two regions and even though the Ohio economy is only about 25 per cent larger than that of Sweden, both the two actual clusters are about twice as large in Ohio as in Sweden. Four categories of institutions are dealt with in the paper to answer the question why these particular clusters have grown faster and become larger in Ohio: (i) the science base and the mechanisms for technology transfer, (ii) the density of networks and the role of business support services, (iii) the entrepreneurial climate, and (iv) the policy and infrastructure environment. According to the author's results the entrepreneurial climate and, in particular, the greater availability of risk finance, appears to be the area where the most significant differences between Ohio and Sweden is to be found.

The paper "A Transaction Cost Rationale for Transition of the Firm within the Family" by *Bjuggren and Sund* takes more of a prescriptive than descriptive stance: That governments in the EU should revise their inheritance laws and other economic policies to promote family succession. In supporting this, on the one hand, the paper argues that due to knowledge idiosyncrasy, more wealth is produced for the family and the overall economy if succession is set up to family members during a CEO-founder's lifetime. On the other hand, people behave irrationally (by inference) in most cases, failing to make proper arrangements until the CEO-founder has passed away. Therefore in its enlightened self-interest, Sweden and other EU countries should revise the laws to remove such a penalty. Certainly, there underlies a research question here that could be more fully explored, namely: Do the laws and institutional norms of a country foster or hamper family succession?

"Do Lower Taxes Stimulate Self-Employment?" *Fölster* asks in his paper. In the paper the author investigates the relationship between taxation and the share of self-employed in two data sets. The first data set is a panel of OECD countries and the second a panel of Swedish counties. In both cases the author finds a strong correlation between the tax burden and the share of self-employment. The results survive both simultaneous equation estimates and tests of Granger causality. Both samples indicate that a reduction of the tax burden with 10 percentage points (of GDP) increases the share of self-employed by about 3 percent of total employment. However, it is not totally clear how this result should be interpreted since the focus in the paper is on the general tax-level. It does not reflect the possible discriminatory effects of the tax system against self-employment as opposed to normal wage employment. Obviously there is a strong need to continue this line of research.

The paper by *Ekholm and Södersten* studies the effects of a very basic institutional framework, namely the free trade regime. In the traditional literature on international trade one can distinguish two research traditions broadly defined as growth and trade and trade and growth. While the first research tradition goes at least 50 years back the second is of more recent origin. Within the second tradition trade has often been viewed as an engine of growth. Important show-cases are the "East Asian Tigers" and Japan that are considered to have benefited in particular from outward looking policies. The authors stress that these outward looking policies has been especially important for small and medium-sized enterprises (SMEs) in the newly industrialised countries, which have learned to work according to new, more exacting standards, and which have been forced to apply advanced quality controls. In their empirical analysis they analyse the relationship between economic growth and growth in income terms of trade. Their results suggest that fast-growing countries have either specialised in sectors that have had a relatively favourable development with regard to world market prices, or they have managed to improve quality successively within sectors, thereby avoiding falling terms of trade in spite of large increases in export volumes. The full implications for SMEs of a free trade regime is not explored in the paper but should certainly be further explored in future research.

The last paper in this special issue by *Karlsson and Karlsson* deals with state intervention in the economic process in capitalist economies and in particular the role of the state in facilitating structural change. The framework for the discus-

sion in the paper is the Swedish version of the so-called Scandinavian model and the role of the state in terms of providing a vision for the future, i.e. "state entrepreneurship" and management of conflicts, which arise during the process of structural change. A comparison is made between the functioning of the model in the early post-war period between 1950 and 1980 and during the period after 1970. In particular the authors examine the possibility that because of radical changes in its economic environment, the Swedish model has been less successful during the second period. They stress the role of the entrepreneurial function for structural adjustments within the economy. And as entrepreneurs all the time enter into new fields of activity it is of importance that the institutional framework of the economy, for example, allows the transfer of profits and other resources from one field of activity to another without too heavy losses in terms of taxes. At the same time the institutional framework must discourage unproductive types of entrepreneurship. The discussion in the paper clearly shows the importance of doing more research on the influence of the institutional framework of an economy on entrepreneurship.

Taken together the papers in this special issue give many evidences and indications of the role of institutions for entrepreneurship and firm growth. Overall the results in the papers are very much in line with research results reported elsewhere, e.g. in Reynolds et al. (2000). It appears as if there is a negative correlation between entrepreneurship and the total taxes as a share of GDP, the public spending as a share of GDP, the average corporate tax level, the marginal personal income tax rate, the degree of equality in the income distribution, labour costs, the degree of rigidity in the labour market, the degree of non-participation in higher education, and so on.

However, even if these results are intriguing it is still important not to overestimate their significance. The results should be treated as circumstantial evidence only. Much of the research on the influence of institutions on entrepreneurship has been conducted within a partial framework, often with a simple cross section approach. What is needed is a new and extended research agenda that optimally takes its starting point in a general equilibrium framework. Given that the purpose of economic activities is to maximise national welfare – not to maximise the entrepreneurial activities in an economy – it is natural to start asking questions about the optimal level of entrepreneurship in an economy. By such an approach the possible goal conflicts between stimulating entrepreneurial activity and firm growth and achieving other goals within an economy are elucidated.

Turning then to the influence of institutions on entrepreneurship and firm growth it is first of all clear that there is a need to more clearly define what is really meant by institutions. Institutions, as defined by Douglas North, is a very general concept. For this concept to be really useful in empirical analyses substantial efforts are needed to operationalise the concept. But this is not enough. It is important to realise that institutions are only a limited part of the overall economic milieu within which entrepreneurship may develop. The economic milieu contain not only the institutional framework but also the overall conditions for entrepreneurial activities such as the demand conditions, the supply conditions, the degree of competition in various markets, the infrastructure conditions, the supply of labour and the skill level of the labour force, the entrepreneurial climate, knowledge production and access to knowledge, and so on. Of course, all research on the influence of institutions on entrepreneurship and firm growth must fully acknowledge the influence also of the other parts of the economic milieu. Since entrepreneurship is not only an economic activity but also a social activity it is very important also to study the relationship between formal and informal institutions to better understand how formal institutions might be used to make informal institutions more conducive to entrepreneurial activities (Acs and Audretsch, 2001).

Furthermore, since entrepreneurship and firm growth are dynamic phenomena it is critical that the empirical research is conducted within a time-series framework where proper account is taken to possible casual relationships. This, of course, implies that more work is needed to develop model frameworks with a capacity to highlight casual relationships.

As a general conclusion we can say that a large number of important questions regarding the rela-

tionship between institutions and entrepreneurship and firm growth remain unanswered and in the cases where the research give answers these answers need to be confirmed by further studies. There is also a need for a broader research framework, for new models and for new empirical research in this area. It is the hope of the organisers of the workshop and of the editors that the research results presented here should encourage further research in the field.

Notes

[1] Some authors use the concept of "social capital" to describe institutional arrangements in an economy.

References

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