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A Schumpeterian Entrepreneur: A model of economic transition

Abstract

Introduction

The ability to create a new organization is 'characterized by the subjective difficulty of taking new paths, and secondly by the resistance of the social environment' (Schumpeter 2003). Taking new paths and gaining social acceptance varies according to government policies, regulations and whether the culture embraces an entrepreneurial culture (GEM 2009). Furthermore, macro-environmental policies have an affect. The EU and the USA, the worlds largest economies, are using different approaches to help solve their respective countries financial problems. Whilst the USA is spending it's way out of trouble the EU is trying to save its way out of trouble. The USA is focused on boosting the economy through expenditure, the EU is focused on reducing it's debt. For the USA protecting and encouraging entrepreneurship is a must, whereas in the EU, the opposite is true, driving entrepreneurs underground into the shadow economy is the affect of ignoring the importance and value that the entrepreneur can bring.

Legal entrepreneurship creates wealth and provides employment; it improves living standards and provides tax revenues that contribute to a nation's treasury (Dana 2001). Some governments have been spending considerable sums of money trying to ignite entrepreneurship. Whilst implementing national policies that contradict their support for small business and undermine entrepreneurial behavior.

The Problem

A number of Southern European countries are in financial strife. In 2010 Spain's public debt rose to 78.0 percent of GDP, Portugal's public debt was 99 percent of GDP, up 10% from last year (Bloomberg 2010). Italy's public debt rose to 135% of GDP. Sixteen countries that use the European currency have approved a 140 billion euro loan to Greece to prevent its financial crisis from spreading to other EU Countries (BBC 2010). Whilst Greece's public debt hovered around 139% of GDP.

Debt is not the only problem that these countries have in common. Southern Europe has other problems that contribute to its poor economic situation. Greece, Italy, Spain and Portugal, all have a significant shadow economy; Italy's shadow economy is equivalent to 22% of GDP, Greece is 25% of GDP, Spain and Portugal's shadow economy is 19.5% (Schneider 2009). To further exacerbate the problem, Transparency international, rates Greece and Italy in the top 5 most corrupt countries in the OECD, with Portugal and Spain being placed 12th and 13th respectively (CPI 2009).

Illegal entrepreneurship as defined here is a legal business, whose owner, doesn't pay taxes or any other associated government or regulatory authority fees, taxes and charges associated with running his business. According to the literature on illegal entrepreneurship (IE) illegal entrepreneurs demonstrate the same skills as legal entrepreneurs (Aidis & Praag 2003). And research has shown that illegal entrepreneurs can and do transition to legal entrepreneurship and in doing so are most likely to succeed because of their previous experience (Sinclair 2008). Illegal entrepreneurs pursue their economic benefits through the shadow economy for many different reasons.

This work proposes that the size of the shadow economy has grown in conjunction with the difficulty of starting and maintaining a business, and the level of illegal immigration. The World Bank Group maintains an indicator on the difficulty of starting and doing business, with 1 being easy and 182 being extremely difficult. Any ranking above 40 suggests it is difficult start or operate a business. According to the World Bank indicator Spain is rated 145 for starting a business, and 49 for the ease of doing business, Greece is 68 for starting and 80 for ease of doing business, Italy is 68 to start a business and 80 for ease of doing business, Portugal is rated 31 in the ease of doing business and 59 in the difficulty of starting a business.

Aside from the difficulty of creating and maintaining a business in these countries the other significant factor that perpetuates the shadow economy is the level of illegal immigration. Illegal immigrants are attracted by shadow economies because it provides some assurance of employment for the “paperless”. In turn this provides the shadow firms with an attractive low cost labor force. Greece and Italy are the most affected because of their proximity to northern Africa and Eastern Europe and because of their respective governments level of corruption and weak immigration controls (Baldin-Edwards 1999). Another factor that is rarely considered is that immigrants who migrate to a foreign country under these circumstances perpetuate the problem by creating their own shadow firms attracting other paperless immigrants to migrate. In this way they perpetuate the culture of corruption that provides breath to the shadow economy.

The solution

If shadow firms were legalized they could make a significant contribution to the struggling economies of Southern Europe. But they have to be supported instead of being driven underground by the continuing increase in taxes, social security contributions and the increasing intensity of regulations (Katsios 2006). Furthermore, countries need to make it easier for immigrants to migrate to their country and to remove systems, which encourage immigrants to enter countries illegally. It's in the interest of the immigrants and the government. As legal aliens they gain access to benefits such as healthcare, retirement support, and they are less likely to be exploited by shadow firms. For the government they have an increase in revenue from taxes of legal employees and it has a negative impact on the shadow firms because it reduces the amount of paperless workers Baldwin-Edwards (1999).