

Free to Enterprise : Economic Freedom and Entrepreneurship In Romania

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In this article we analyze the relation between the economic freedom and the level of entrepreneurship in Romania. The widely used hypothesis that a free economic environment tend to generate high levels of entrepreneurship is discussed for the case of Romania. The evolution of a few fundamental features of the institutional environment for doing business in recent years is investigated, along with some measures of the level of entrepreneurship.

A strong direct relation between economic freedom and entrepreneurship level was found for a large number of countries and geographic areas around the world. The available data does not allow us to make a quantitative analysis for Romania, but some suspected reasons for a direct relation between economic freedom and entrepreneurship level are presented. Future research directions are also suggested.

Keywords: economic freedom, entrepreneurship, business regulation, liberalization

JEL Classifications: H11, L26, F13

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Introduction

The importance of entrepreneurship in promoting economic growth and prosperity has been widely emphasized in the last few decades (Baumol, 1996; Bjørnskov and Foss, 2012; de Soto, 1989; Sobel, Clark and Lee, 2007). The conclusion suggested by the numerous studies on this subject is that entrepreneurship promotes economic growth and prosperity. In order to survive in highly competitive markets specific to present-day economies, private businesses must offer products required by consumers at ever-lower prices.

On the other hand, a large number of studies and reports investigate the economic freedom of countries at macroeconomic level (Gwartney, Lawson and Hall, 2014; Miller, Holmes and Kim, 2014). These analyses scrutinize the specific conditions that make the institutional environment in which individuals (as consumers, producers, physical resources or working capacity owners, entrepreneurs, etc.) interact to be characterized as free. Individualism, lack of discrimination based on irrelevant criteria and open competition are the distinctive marks of economic freedom. The state's activities are often considered a deterrence of full realization of favourable consequences of human interaction through markets. Examining the relation between economic freedom and economic growth and prosperity, this literature identifies economic freedom as a key factor in promoting growth (Berggren, 2003).

It has also been suggested that one of the most important channels through which an economic free environment promotes economic growth is entrepreneurship (Bjørnskov and Foss 2012; Kreft and Sobel, 2005; Minniti, 1999). Entrepreneurs seek new profit opportunities, thus creating a competitive environment open to new ideas and markets. The elements of a free institutional environment generate not only a direct increase in total factor productivity, but also a foundation for entrepreneurship that in turn leads to greater factor productivity (Bjørnskov and Foss, 2012).

Literature review

Entrepreneurship is not a phenomenon specific to capitalist states or developed economies. Despite an inhospitable environment and the official opposition, there were a small number of entrepreneurs in centralized economies of the Soviet Union and Central and Eastern Europe. The rise of entrepreneurial activities in the transition economies caught the attention of western researchers that looked into the role of entrepreneurs in creating wealth, their strategies and the evolution of the institutional environment features – formal and informal rules, micro and macroeconomic aspects, individual tendencies and values (Aidis, 2003, 2005; Estrin, Meyer and Bytchkova, 2006; Estrin and Mickiewicz, 2011; Peng and Shekshnia, 2001).

Among the features of the institutional environment in transition economies the following have been identified: dramatic changes to socio-economic and political conditions, lack of recent entrepreneurial tradition, absence of business infrastructure and support services, lack of external financing, no previous experience with business tax system or legislation, corruption, bureaucracy, large underground economy, state interventionism (Aidis, 2003). Studying the attributes of entrepreneurs at the beginning of the transition, Peng and Shekshnia (2001) identify four types of entrepreneurs: small agricultural producers (farmers), those acting in the unofficial and semi-official economy, former communist party leaders and officials and the professionals (such as lawyers, managers, engineers, and professors).

There are significant differences among countries in the level of entrepreneurship. For instance, in the European Union there has been a constant and sizeable disparity between Italy (ranking first) and Denmark (ranking last) in the business ownership rates. Although initially demographic and cultural factors – such as different values assigned to individualist traits like personal independence and

autonomy – were primarily employed in explaining these differences, institutional factors – such as legislation, property rights enforcement, regulation, money – have gained in importance (Harper, 2003, ch.6; Powell and Rodet, 2012).

Garrett and Wall (2006) study the influence of economic policy – as an essential feature of the institutional environment of business making – over the rates of entrepreneurship across the US states during the 1990s. Among economic policy variables that have statistically and economically significant effects on rates of entrepreneurship, the authors find state bankruptcy laws characteristics, corporate income tax marginal rates, and minimum wage legislation.

Economic freedom is expected to generate strong entrepreneurial alertness (Harper, 2003, p.63). It is suggested that the likelihood of people using their entrepreneurial predispositions and skills is greater in a macroeconomic free environment. Investment in gaining those skills that raise total factor productivity through entrepreneurship is encouraged. Conversely, the tendency toward entrepreneurship is stifled if people are subject to the arbitrary will and aggression of other individuals. In addition, the investment in gaining entrepreneurial skills tends to be lower, with increasing actions to protect from the aggression of other and no growing effects on total factor productivity.

Starting with this sort of a priori reasoning, an entire body of literature has developed that engages in empirical assessment of the consequences of economic freedom over entrepreneurship in given time and space. In so doing, Campbell and Heriot (2008) investigate the relation between economic freedom and firm formation and firm deaths in the U.S. states from 1990 to 2001. The authors conclude that the economic policy of the states significantly influences the state's scope of entrepreneurial activity. As economic freedom increase, entrepreneurs start new businesses; also, the increased competition adds to the number of firm failures.

Also studying the case of the American states, Hall, Pulito and VanMetre (2012) reach similar conclusions. Defining a new indicator of freedom to include both economic and personal freedoms, the authors identify a positive and statistically significant relationship between overall freedom and entrepreneurship. Moreover, between the two types of freedoms, they show that the economic freedom is driving the relationship.

Aiming to identify the source for the large difference in entrepreneurship levels among countries, Bjørnskov and Foss (2008) consider the traits of economic policy and institutions in 29 countries. They find that the size of government, the quality of the monetary policy and overall financial environment are strong determinants of entrepreneurship across the sample of 29 countries. Other measures of economic freedom – like legal environment, international trade and regulatory quality – are not significantly correlated with entrepreneurship.

Research Methodology

The most renowned effort to design a gauge of economic freedom is due to the Heritage Foundation. The proposed Index of Economic Freedom (IEF) scores nations on ten broadly defined factors: business freedom, trade freedom, monetary freedom, government size, fiscal freedom, property rights, investment freedom, financial freedom, freedom from corruption, labour freedom (Miller, Holmes and Kim, 2014). Although it is not the only such indicator (see also Gwartney, Lawson and Hall, (2014)), the IEF presents a series of advantages over the alternative indicators when used for the study of the relation between economic freedom and entrepreneurship, such as: it is computed from annual data; the methodology has not been changed since the beginning of publication; its components are more policy oriented (Madan, 2002, p.15).

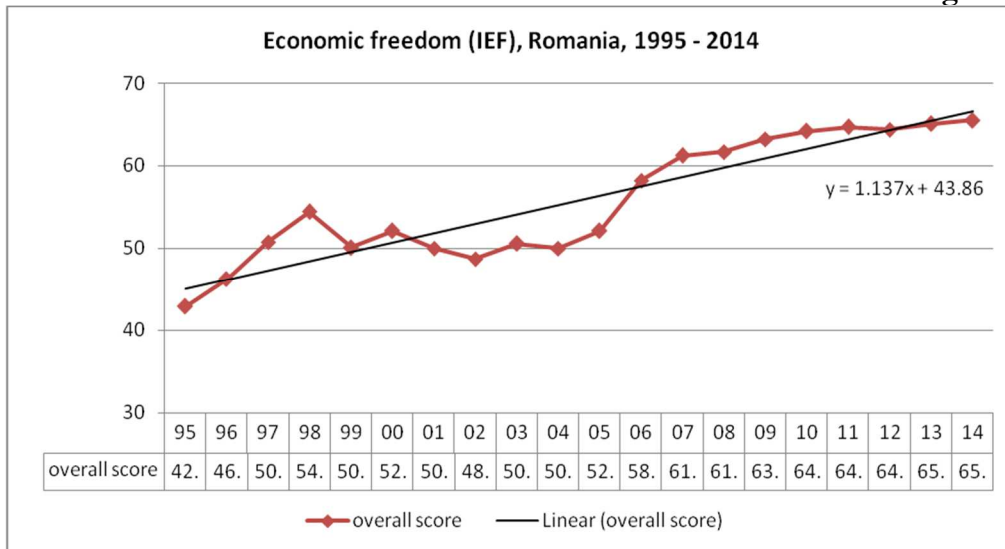
To determine the degree of economic freedom that countries enjoy, we used the Index of Economic Freedom. To determine the level of entrepreneurship, we used the yearly report Global Entrepreneurship Monitor (GEM) (Amorós and Bosma, 2014). To analyze firm births and firm deaths in Romania we used data published by the Commerce Register Office for firm births, suspension of activity, voluntary dissolutions and removals.

We have also used the results of a number of surveys that investigate the attitude of Romanian entrepreneurs towards some aspects of the institutional environment relevant from an economic freedom perspective.

Results and discussion

Romania's transition to a sound, market-oriented economy was facilitated by focusing on international trade and openness to entrepreneurial enthusiasm. Figure 1 shows the evolution of the index of economic freedom in Romania. The rising trend of economic freedom in the last years is noticeable, as Romania entered the path of a market-oriented economy, privatized its state-owned enterprises and opened its borders to foreign flow of goods and investment.

Figure 1

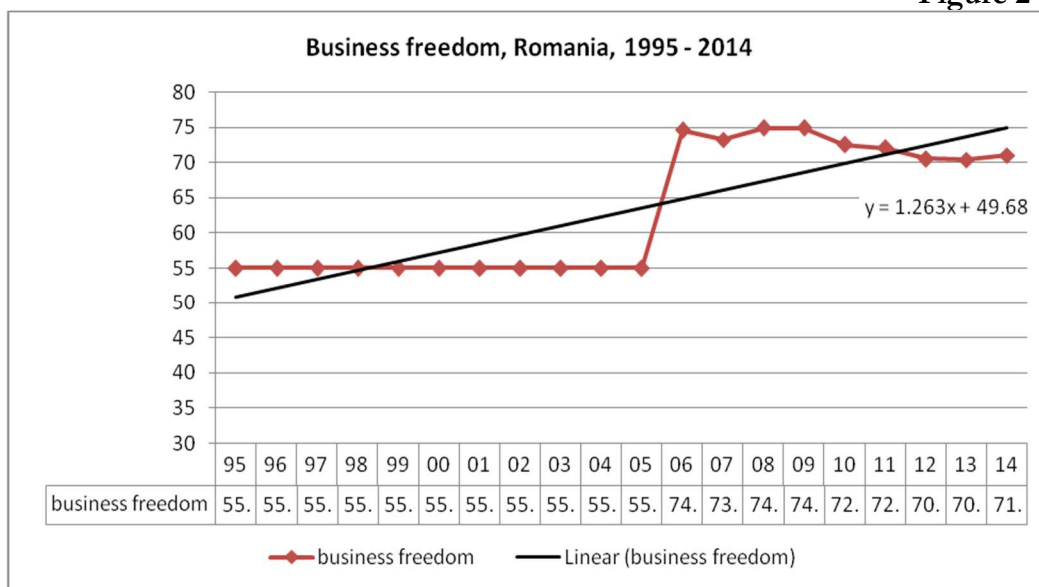


Source of data: author's calculation using data from Miller, Holmes and Kim, 2014

Other indicators published by the Heritage Foundation susceptible to be important for the study of the relation between economic freedom and entrepreneurship are fiscal liberty index and business freedom index.

Business freedom assesses the costs imposed for opening, operating and closing a private business. Figure 2 shows the evolution of the business freedom index in Romania. The highly rising trend of business freedom over the entire period and the declining tendency after 2006 are noticeable.

Figure 2

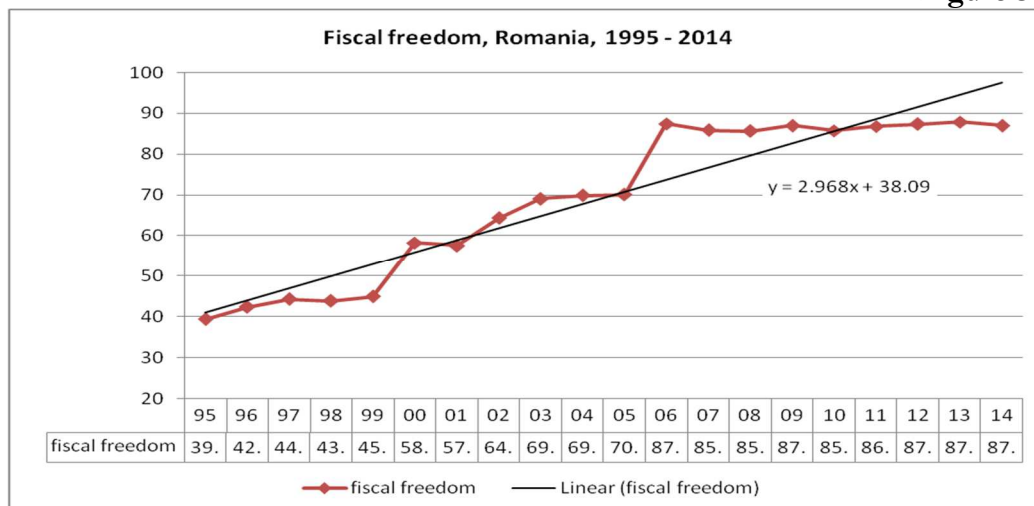


Source of data: author's calculation using data from Miller, Holmes and Kim, 2014

Fiscal freedom assesses the tax burden on individuals and businesses. It is a direct measure of the degree to which individuals are permitted by the state to retain and use their income and wealth. The state can impose a burden on productive activities through taxation, but government debt can have the same result since it must be paid out from future tax collection. The marginal taxing rate of an individual is the unit of profit generated by the last unit of work or entrepreneurial effort that the state collects; the residue is the individual's reward for her effort.

Figure 3 shows the evolution of the fiscal freedom index in Romania. The rising trend of fiscal freedom over the entire period and the slightly declining tendency after 2006 are noticeable.

Figure 3



Source: author's calculation using data from Miller, Holmes and Kim, 2014

Table 1 shows the evolution of the economic freedom index and of the some entrepreneurship measures in Romania.

Table 1
Economic freedom, entrepreneurship, firm births and firm deaths,
Romania.

Indicators	2007	2008	2009	2010	2011	2012	2013
IEF	61,2	61,7	63,2	64,2	64,7	64,4	65,1
GEM	29	24	27	38	42	38	46
Firm births	-	144239	111832	119048	132069	125603	124816
Suspension of activity	-	12019	134441	66420	21086	24078	22079
Dissolutions	-	3762	30105	7508	11660	22500	23208
Removals	-	17676	43713	186144	73244	71746	80786
Insolvency cases	-	-	-	21692	19651	26807	29587

Source of data: Amorós and Bosma, 2014; Miller, Holmes and Kim, 2014; Commerce Register Office.

Survey data may reveal the difficulties encountered by prospective and actual entrepreneurs. In a survey conducted by AKCEES, Romanian entrepreneurs were asked to evaluate on a 1-to-5 scale the kinds of fiscal and administrative barriers they face (AKCEES, 2013). The large amount of time that must be spent resolving administrative requirements was evaluated at 3.305 (StDev 1.084), the public officials' corruption was evaluated at 3.448 (StDev 1.344), while the high level of taxation was evaluated at 3.924 (StDev 1.007).

In a recent survey, JCI Bucharest asked young entrepreneurs to assess the factors that could consolidate the Romanian entrepreneurship environment in the future (JCI Bucharest, 2014). Reducing bureaucracy for operating a business received the highest score.

World Economic Forum in its yearly Global Competitiveness Reports presents the results of a survey conducted for a large number of countries around the world. Romanian entrepreneurs ranked such factors as Corruption (first place in 2011 with 17,4% of respondents), Tax rates (first place in 2012 with 17,8% of respondents), Inefficient government bureaucracy (second place in 2010 with 13,0% of respondents) and Tax regulations on top of the list of most problematic factors for doing business.

The European Commission conducts periodically a general survey of the adult population of the European Union (EU) - the Flash Eurobarometer on Entrepreneurship (European Commission, 2013). Among the difficulties encountered when starting up a business, 85% of Romanian entrepreneurs agree that it is difficult to start one's own business due to the complexities of the administrative process, which is the highest score in the EU, equal only to Greece and Italy. Moreover, the score has increased over time.

The conclusion that may be derived from survey responses is that Romanian entrepreneurs are deterred by such factors that make the institutional environment for doing business to be less economically free. In addition, they are under the direct influence of the

government. Such results suggest that a more free economic environment may lead to a greater level of entrepreneurial activity.

Conclusions

Romania's economic freedom has increased sharply after 1995, but stagnation in the evolution of economic freedom indicators after 2006 is noticeable. Entrepreneurship also grew rapidly. This fact suggests a possible correlation between the two phenomena.

Investigating the attitude of Romanian entrepreneurs towards some aspects of the institutional environment relevant from an economic freedom perspective show that Romanian entrepreneurs are discouraged by factors that make the Romanian economy less economically free and that are under a direct influence of the state, like bureaucracy, corruption, tax rates and tax regulations.

At this time, the available data is insufficient to allow a quantitative analysis for the Romanian case. If more data were available, a more clearly defined relationship between economic freedom and entrepreneurship could emerge. There is evidently scope for future research in this area. A valuable resource for assessing the level of entrepreneurship is the yearly report Global Entrepreneurship Monitor. Economic freedom of countries around the world are compiled in the Index of Economic Freedom and Economic Freedom of the World reports. A number of periodical surveys assess the attitude of entrepreneurs towards difficulties encountered in opening and operating a business. The most important are: the Global Competitiveness Reports, the Flash Eurobarometer on Entrepreneurship.

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