Observers comparing the U.S. economy with the economies of other countries often note that Americans seem to be much more willing to become entrepreneurs. Indeed, a recent survey found that more than 70 percent of adult Americans would prefer being an entrepreneur to working for someone else.[1] In contrast, the same survey showed that only 46 and 41 percent of adults in Western Europe and Japan, respectively, preferred being an entrepreneur. One possible explanation for this difference is that, because the United States is an immigrant nation, its residents have inherited their dynamism from past generations. After all, many of those who came here had the gumption to migrate halfway around the world in search of a better life. Not only were the distances long, but the travel was often dangerous. This cannot be the whole story, however, because even in Canada—another nation of immigrants—only 58 percent of adults would prefer entrepreneurship over working for someone else.

Entrepreneurs in the U.S. Face Less RED TAPE

BY WILLIAM POOLE AND HOWARD J. WALL

Nearly one-half of Europeans who were surveyed said that one should not start a business if there is **any risk at all** that it might fail.

What sets the United States apart? When economists try to explain differences in entrepreneurship across countries or regions, they typically examine the roles of a long list of economic and institutional factors. What they tend to find is that, while these factors are important, they don't tell the whole story.[2] Even if all countries had the same economic conditions and policies, some would still be more entrepreneurial than others, and the United States would be among the leaders. The best explanation for this finding is that there are social factors at work that are difficult or impossible to quantify. These social factors can be referred to collectively as entrepreneurial spirit.

In addition, the United States has been relatively successful in creating a policy environment that takes advantage of this intangible, yet vital, asset. Entrepreneurial spirit and the policy environment are interwoven, and policy-makers should keep in mind that the real key to entrepreneurial success—entrepreneurial spirit—is already in abundance and that we should be careful not to waste it.

The Gap in Entrepreneurial Spirit

Policy-makers in the European Union have been grappling with their perceived gap in entrepreneurial spirit. What they have come to recognize from comparing their countries with the United States is that it is not enough to have appropriate laws and regulations. After all, in many respects, compared with the United States, some European countries have equivalent or superior institutional arrangements for allowing entrepreneurship.

Take, for example, the Scandinavian countries, which, as judged by the World Bank, have among the best institutional arrangements to allow entrepreneurship to thrive. Despite the favorable institutional environment, about 30 percent of Scandinavians say that they would prefer to be an entrepreneur over being an employee of someone else. Recall that in the United States, more than 70 percent of adults say that they would prefer to be entrepreneurs.

A recent survey commissioned by the European Union reveals how Americans and Europeans differ considerably in attitudes toward entrepreneurship.[3] For example, a much higher proportion of Europeans than Americans say that the idea of starting a business has *never entered their minds*. Americans also have a greater tolerance for the risk associated with entrepreneurship, whereas many Europeans appear to be extremely averse to risk: Nearly one-half of Europeans who were surveyed said that one should not start a business if there is *any risk at all* that it might fail.

Policy Environment

Discussion of the role of government in the entrepreneurial process should begin by recognizing the relative abundance of entrepreneurial spirit in the United States. To this end, it is useful to draw a distinction between passive and active policies toward entrepreneurs. Passive policies are those meant to facilitate entrepreneurship by establishing institutions, laws and regulations to reduce the cost of running a business. Active policies, on the other hand, are things such as targeted tax breaks, subsidies and so forth that are meant to direct resources into particular business activities by creating specific incentives.

Given the entrepreneurial energy in the United States, active policies are of relatively limited importance. The focus has been, and should continue to be, on ensuring that the proper passive policies are in place to allow entrepreneurial spirit to thrive. Basic institutions should be in place to facilitate business transactions, and interference into how businesses actually operate should be minimal. In writing regulations, policy-makers should carefully weigh the costs and benefits while keeping in mind that excessive interference can quash or misdirect our greatest advantage.

A particular benefit of the passive approach is that entrepreneurs themselves pick the most promising areas to pursue. In contrast, active policies ordinarily involve efforts of government to pick the winners to subsidize. Experience indicates that governments have a poor track record in identifying promising new technologies. Consequently, subsidies often prove wasteful as they direct resources in directions that turn out to be unpromising. At the same time, taxes that are imposed to support the subsidies create disincentives to entrepreneurs in general.

It is not possible to outline the entire array of policies that affect entrepreneurship, but a few examples can illustrate the ways in which the United States stands out in balancing public policy requirements with the needs and incentives of entrepreneurs and other businesses. First, the structures of our fundamental legal institutions tend to differ from those of other countries. Second, our competitive financial system provides entrepreneurs with a ready source of funds. Third, we do not overregulate our labor markets, and fourth, we have generally lower tax rates. However, improvements in all these areas are certainly possible, especially with regard to labor market and tax policies.

Opening a Business

Generally speaking, policy-makers in the United States have done a good job of creating fundamental institutions. A good illustration of U.S. success is a very basic institutional arrangement: the act of establishing a business as a legal entity. Perhaps surprisingly, countries differ a great deal in terms of what an entrepreneur must do to establish a business as a legal entity. This rather basic step may seem trivial, but there are significant advantages to making it simple. Once a business is established as a legal entity, it gains access to the legal and financial system, thereby affording it the ability to borrow and to enforce contracts through legal means. If establishing a business is too cumbersome or expensive, potential entrepreneurs might decide to forgo their ventures altogether or they will have only limited access to the legal system and to credit markets.

The typical view in the United States is that owning a business is an inherent right and that the operation of the business should be left to the entrepreneur. The simplicity of the process to establish a business reflects this view: In the United States, it typically takes four days and $210 to establish a business as a legal entity. The process amounts to registering the name of the business, applying for tax IDs, and setting up unemployment and workers compensation insurance.

Many other countries seem to view the ownership of a firm as a privilege to be bestowed by bureaucrats. Additionally, some countries impose regulations that take basic business and entrepreneurial decisions out of the hands of entrepreneurs. This approach often leads to government micromanagement of the actual workings of the business, even before the business exists. It is common, for example, that before a company is even allowed to exist as a legal entity, its owner must:

- meet requirements for the level of capital available to the company,
- submit detailed descriptions of corporate rules and organization,
- obtain government pre-approval of financial and business plans, and
- belong to a trade association.

In the course of satisfying these requirements, the entrepreneur often pays exorbitant fees while waiting weeks or months for various forms and applications to make their way through the system.

The World Bank has catalogued the cross-country differences in the process that an entrepreneur must satisfy to establish a business. Table 1 provides these differences for 19 rich countries—including the United States—across four categories: the number of procedures, the amount of time to satisfy the procedures, the costs associated with the procedures and the minimum amount of capital that an entrepreneur must have on hand at the time the business is established.

To establish a business in Japan, for example, a typical entrepreneur spends more than $3,500 and 31 days to follow 11 different procedures. In Belgium, it takes 56 days and more than $2,600.

Table 1

Establishing a Business around the World

	Number of procedures	Time (days)	Cost (US $)	Minimum capital (% per capita income)
Australia	2	2	402	0
Belgium	7	56	2,633	75.1
Canada	2	3	127	0
Denmark	4	4	0	52.3
France	10	53	663	32.1
Germany	9	45	1,341	103.8
Greece	16	45	8,115	145.3
Ireland	3	12	2,473	0
Italy	9	23	4,565	49.6
Japan	11	31	3,518	71.3
Netherlands	7	11	3,276	70.7
New Zealand	3	3	28	0
Norway	4	24	1,460	33.1
Portugal	11	95	1,360	43.4
Spain	11	115	2,366	19.6
Sweden	3	16	190	41.4
Switzerland	6	20	3,228	33.8
United Kingdom	6	18	264	0
United States	5	4	210	0

SOURCE: World Bank (2004)

Greece requires that an entrepreneur satisfy 16 different procedures and pay more than $8,000, including $1,200 for something called "Certification by lawyers' welfare fund" and $3,700 to simply notify tax authorities that business activities are about to commence. Two of the countries listed in the table —Germany and Greece—require that entrepreneurs have an amount of capital on hand that exceeds their country's per capita income.

In many ways, the differences between the United States and other countries with regard to establishing a business reflect more than simple differences in institutional arrangements. They also reveal a great deal about governments' underlying attitudes towards entrepreneurship. Also, given that this procedure is handled primarily at the state level in the United States, the ease of creating a new business provides a good illustration of how our federal system works to our advantage. States must compete with one another to provide suitable business environments or risk losing out to other states.

According to the World Bank, among developed countries, employers in the **United States** have the **most flexibility** in terms of both hiring and firing workers.

Competitive Financial System

Establishing a business as a legal entity allows entrepreneurs greater access to credit markets, access that is denied to informal firms in many other countries. But if credit markets are overregulated, even legally established entrepreneurs may have difficulty financing their ventures. Recent research by Sandra Black and Philip Strahan has argued that the wave of banking deregulation that began in the late 1970s has led to increased rates of entrepreneurship in the United States. In the 1970s, commercial banks faced a variety of restrictions that varied from state to state. The banks often faced restrictions on the interest rates that they could charge to borrowers and pay to depositors. In addition, the banks could not operate across state lines and could deal only in classic financial intermediation activities—deposit-taking and lending. Today, most of these restrictions have been removed.

Other financial innovations have also led to a variety of new entrepreneurial ventures. One that has been in place many years is the venture capital industry, which hunts for promising new firms to finance and help manage. A more recent innovation, dating to the late 1970s and early 1980s, is the junk bond. This is a high-risk/high-yield bond that allows firms with credit ratings below investment grade to have access to investors willing to carry higher levels of risk in exchange for higher rates of return. New firms have been able to raise substantial amounts of capital by issuing junk bonds. Following a handful of scandals in the 1980s, junk bonds have often been disparaged, although, in reality, they fueled a great deal of investment then and continue to do so today.

Labor-Market Regulations

Another area that sets the United States apart is the extent to which the government regulates the relationship between businesses and their employees. There is wide agreement about the necessity of some regulation to protect workers from illegal discrimination or employer fraud. There is less agreement, however, on the extent to which workplace regulations—including minimum wage laws, mandatory severance pay, right-to-work laws and legislated fringe benefits—are necessary. Overregulation of hiring, firing and working conditions can make the labor market too rigid and make businesses reluctant to start up and to hire workers.

One of the reasons that the United States has been able to generate jobs so successfully is that we do not regulate labor markets nearly to the extent that other countries do. Without question, this looser regulation provides entrepreneurs in the United States with much greater flexibility. According to the World Bank, among developed countries, employers in the United States have the most flexibility in terms of both hiring and firing workers. In addition, U.S. firms face by far the least regulation of the conditions of employment. Although hiring a worker in the United States is still a costly proposition, particularly for a small business, for the most part these costs do not derive directly from regulation of the relationship between businesses and their employees.

Table 2

World Tax Burdens

	Total tax revenue as a percentage of GDP (2000)
Australia	31.5
Belgium	45.6
Canada	35.8
Denmark	48.8
France	45.3
Germany	37.9
Greece	37.8
Ireland	31.1
Italy	42.0
Japan	27.1
Netherlands	41.4
New Zealand	35.1
Norway	40.3
Portugal	34.5
Spain	35.2
Sweden	54.2
Switzerland	35.7
United Kingdom	37.4
United States	29.6

SOURCE: Organization for Economic Cooperation and Development (2002).

Examples of labor-market rigidity in Europe are abundant, and one can imagine the effect that they must have on the decisions of existing and potential entrepreneurs. In Belgium, for instance, fixed-term employment contracts are prohibited. In France, the maximum working week is 35 hours, and the minimum paid vacation time is five weeks. In Germany, the mandatory Saturday closing time for retailers has only recently been extended from 4 p.m. to 8 p.m., and stores are still prohibited from operating on Sundays. Many other types of labor-market rigidities are common: Several European governments produce a list of allowable grounds for dismissal, others require third-party approval prior to layoffs and most mandate severance pay equal to several months' salary.

Tax System

Another advantage for entrepreneurs in the United States is that businesses and individuals bear relatively low tax burdens. As Table 2 shows, among the rich countries listed, only Japan imposes a lower tax burden. Taxes, although necessary to finance public services, place a burden on economic activity. High tax rates tend to suppress economic activity of all types, not just entrepreneurship. But for entrepreneurs, high tax rates create an additional incentive that distorts effort. A high tax burden creates an incentive for avoiding taxes, thereby leading some businesses into the informal sector, where their access to credit markets and the legal system is limited.

Again, one of the reasons that the United States has been able to maintain its relatively business-friendly tax policies is its federal system. Many governmental services are provided at the state and local level. For this reason, state and local governments are forced to compete with one another to provide effective services while minimizing the tax burden.

Causes for Concern

Although there are many ways that the policy environment in the United States is in good shape relative to other countries' policy environments, there is still a great deal of room for improvement. Many environmental and other regulations in the United States place too much of a burden on the activities of entrepreneurs, without generating correspondingly large benefits to society as a whole; the tax codes for individuals and businesses are, in many ways, needlessly complicated and introduce countless distortions to day-to-day decision-making; and there are rumblings that we should impose new labor-market restrictions to make it more costly for firms to move some of their operations overseas.

In addition, many business people say that they are reluctant to hire new workers because the rising cost of health care makes it increasingly expensive to do so. Other businesses, including many doctors, refuse to engage in certain activities because, without major tort reform, they find it too risky or too expensive to pay for the necessary insurance.

When addressing these and other important policy issues, it is important to keep in mind that the source of much of U.S. economic dynamism is the entrepreneurial spirit that has been instilled in Americans over generations. We should be careful that we do not needlessly restrict or suppress this spirit. It is a precious resource, not to be wasted or squandered.

William Poole is president and chief executive officer of the Federal Reserve Bank of St. Louis. Howard J. Wall is an assistant vice president and economist there. This paper is based on a speech by Poole titled "Allowing Entrepreneurship," given March 30, 2004. It is available on the web at www.stlouisfed.org/general/speeches/.

ENDNOTES

1. Blanchflower, Oswald and Stutzer (2001).
2. Georgellis and Wall (2000 and 2004) and Blanchflower (2000).
3. European Omnibus Survey Gallup Europe (2004).

REFERENCES

Black, Sandra E. and Strahan, Philip E. "Entrepreneurship and the Availability of Bank Credit." *Journal of Finance*, Vol. 57, No. 6, December 2002, pp. 2807-33.

Blanchflower, David. "Self-Employment in OECD Countries." *Labour Economics*, Vol. 7, No. 5, September 2000, pp. 471-505.

Blanchflower, David; Oswald, Andrew; and Stutzer, Alois. "Latent Entrepreneurship across Nations." *European Economic Review*, Vol. 45, Nos. 4-6, May 2001, pp. 680-91.

EOS Gallup Europe, Flash Eurobarometer 146. *Entrepreneurship*. Brussels: European Commission, 2004.

Georgellis, Yannis and Wall, Howard J. "What Makes a Region Entrepreneurial? Evidence from Britain." *Annals of Regional Science*, Vol. 34, No. 3, September 2000, pp. 385-403.

Georgellis, Yannis and Wall, Howard J. "Entrepreneurship and the Policy Environment." Federal Reserve Bank of St. Louis Working Paper 2002-019B, March 2004.

Organization for Economic Cooperation and Development, *Revenue Statistics 1965-2001*. Paris: OECD, 2002.

World Bank, *Doing Business in 2004: Understanding Regulation*. Washington: World Bank and Oxford University Press, 2004.