START-UP COSTS, TAXES AND INNOVATIVE ENTREPRENEURSHIP (SUMMARY)

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SUMMARY

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Principal Topics

Entrepreneurs have to deal with one-off start-up costs, such as notary charges as well as recurring costs in the form of income and corporate taxes. A number of prior studies have linked start-up costs and taxes to the level of entrepreneurial activity within and across economies (Djankov et al., 2002; Braunerhjelm and Eklund, 2014). Start-up costs and taxes may not only influence entrepreneurial entry but also the likelihood of innovative entrepreneurship (Schumpeter, 1934; Baumol, 1990).

Low start-up costs encourage the entry of lower quality entrepreneurs, and hence the pool of entrepreneurs is of higher quality when start-up costs are higher (Kaplan et al., 2011). Taxes, which represent recurring costs that reduce the gains from innovation, have a deterrent effect and discourage, in particular, risk-taking entrepreneurs with innovative ideas. Innovative entrepreneurs are motivated by the expectation of high returns on their innovative activities in the form of "entrepreneurial profit" (Baumol et al., 2007).

Method

To investigate how start-up costs and taxes relate to innovative entrepreneurship, we use the Global Entrepreneurship Monitor (GEM) dataset comprising 632,116 individuals, including 43,223 entrepreneurs from 53 countries for the years 2004 to 2011. Given the binary nature of the dependent variable innovative entrepreneur, we use various probit regressions clustered by countries to avoid underestimation of standard errors.

Results and Implications

Our results support the conclusion that start-up costs and taxes have significant effects on whether nascent entrepreneurs innovate or not. We find significant positive and significant negative required start-up costs and taxes relationships with entrepreneurs’ likelihood to innovate respectively. Our findings suggest that governments can stimulate innovative entrepreneurship by tying costs less directly to the rewards of innovation. In addition, if innovative entrepreneurship is indeed an important source of economic growth (Schumpeter, 1934), then our finding that entrepreneurs have a low propensity to innovate in countries with severe tax systems could partly explain why taxes may have a negative influence on economic growth as suggested in prior studies (Lee and Gordon, 2005).

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