Industrial and Corporate Change Advance Access published May 23, 2006

Industrial and Corporate Change, page 1 of 15
doi:10.1093/icc/dtl010

Entrepreneurship and the welfare state: a reply

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It is widely recognized that the supply of entrepreneurial talent is likely to be important for economic growth, innovation, and job creation. In Henrekson (2005, *Industrial and Corporate Change*, **14**(3), 437–467), it was shown that the supply of productive entrepreneurship is likely to be reduced by the kind of tax and welfare arrangements that prevail in a mature welfare state. Welfare state institutions developed mostly during a period when it was common among politicians and economists to assume that individual entrepreneurship and new firms were of minor importance. However, in an environment where entry, exit, and turnover of firms are important for growth, and where scale economies are less important, this kind of model may be more problematic. There are a number of measures that can be implemented to strengthen entrepreneurial incentives within extensive welfare states, but their implementation is unlikely because there are strong vested interests, including the incumbent business elite, defending the current model.

A number of objections against this analysis have been raised by James K. Galbraith and Ronald Dore in the previous issue of *Industrial and Corporate Change*. In this reply, it is shown that these objections are either largely unfounded or just misunderstandings.

1. Background: the political economy of entrepreneurship

During the first three decades of the postwar period, many leading policymakers and economists harbored a strong belief in the desirability of direct government regulation and intervention in the national economy. A growing role for the public sector was, with few exceptions, seen as an inexorable trend. Scholars such as the Nobel Laureate Jan Tinbergen (1967) even predicted that there would be a convergence between the economies in the West and in the centrally planned countries in Eastern Europe. Among Western democracies, Sweden was often seen as a precursor in this development.

In the latter half of the 1970s, there was instead a renaissance of ideas advocating deregulation of markets and smaller governments in the leading industrialized countries. These ideas were fuelled by the disappointing effects of public interventions and

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planning in Europe and the United States, and by the increasingly manifest failure of the socialist bloc. This renaissance coincided with a break in the previous trend of a growing predominance of giant corporations and the waning importance of small entrepreneurial firms (Piore and Sabel, 1984; Loveman and Sengenberger, 1991).

The literature attempting to explain this break is by now enormous.[1] For our purposes, it is sufficient to note that the proposed explanations often point toward the importance of technological development, shifts in consumer demand, and deeply rooted structural changes in the economy. In this new economic and social environment, central planning and large size seem to have proved a less effective recipe for economic success. There is now also broad consensus that an economic system, which evolves successfully for an extended period of time, cannot do so without having or introducing "appropriate" institutions (Gerschenkron, 1962).[2] Institutions refer to the rules of the game that govern the conduct of economic activity and that shape "the social structure of payoffs."[3] A particular bundle of institutions, what may be called an institutional setup, characterizes an economic system. Appropriateness may be construed broadly and be judged with respect to a number of aspects of the economy such as distribution of firms across industries, the size of these firms, etc.

Economic institutions are social decisions, chosen for their consequences. Different groups and individuals typically benefit from different economic institutions, which makes conflicts over institutional choices a ubiquitous trait of all (democratic) societies. The distribution of political power in society is in turn a function of political institutions and the distribution of economic resources. But because prevailing economic institutions affect the distribution of resources, and because groups with political power today may strive to change institutions in their favor, policies that were initially "appropriate" may persist due to vested interests even after exogenous changes have made these policies "inappropriate."

2. The Swedish Model and the entrepreneur: incompatible entities?

In Henrekson (2005), I provided an in-depth examination of how the supply of productive entrepreneurship is likely to be affected by the kind of tax and welfare arrangements that may prevail in a mature welfare state. Sweden, allegedly the most extensive of all welfare states, was chosen as the object of the empirical analysis. I argued that the Swedish welfare state early on chose a specific "Swedish Model" of trying to combine ambitious welfare programs and a high tax burden with favorable

[1]See, e.g., Acs (1999) and Wennekers and Thurik (1999) for an overview.

[2]Institutions have moved to the fore of mainstream explanations for economic performance, especially over the longer term. See, e.g., North and Weingast (1989), Rodrik *et al.* (2004), and Acemoglu *et al.* (2005).

[3]The term is borrowed from Baumol (1990).

opportunities for economic growth.[4] But this particular view rested heavily on the assumption that innovative activity was best performed in large established firms and that entry of new firms was unimportant.

Policy and institutions were therefore geared to promoting certain types of activities that could deliver growth in situations where scale economies are important and intrapreneurship can substitute for entrepreneurship. The examination showed how key welfare state arrangements had reduced the economic return to entrepreneurial behavior both in relative and in absolute terms. A number of channels contributing to this effect were examined: taxation of entrepreneurial income, muted savings incentives and rules encouraging savings to take forms that withdrew funds from entrepreneurial ventures, comprehensive government service provision and very high tax rates on labor that barred large parts of the economy from entrepreneurial exploitation, schemes for redistribution across individuals and regions and a high level of minimum standard of living guaranteed by the government that rendered necessity entrepreneurship largely pointless, and strict labor security legislation that discouraged mobility of individuals across firms and industries.

The institutional setup thus created an incentive structure where long-term economic progress depended heavily on the success of incumbent large companies and on the feasibility of large-scale government production of highly income-elastic and tax-financed services.

However, if the underlying technological and structural conditions change so that an environment where entry, exit, and turnover of firms becomes important for growth and job creation, and where scale economies are less important, this kind of model is likely to be less appropriate. It turned out that both aggregate economic performance and data on firm growth and direct measures of entrepreneurial activity were broadly consistent with the identified structure of payoffs.

Naturally, the extended period of success for the Swedish Model created groups with strong vested interests in this model, notably the labor movement with its two inseparable branches (the Social Democratic Party and the trade unions) and the incumbent business elite. An institutional setup characterized by high redistributive aspirations, a high general tax rate, but relatively favorable conditions for large incumbent firms could in fact be an endogenous outcome of a political process.[5] As

[4]As stressed by many observers (e.g., Freeman, 1995), the Swedish welfare state can be seen as an economic model, or system, defined by a particular mix of institutions. The mix of institutions and the interactions among them are key determinants of economic performance. For instance, the combination of high marginal tax rates and a narrow pre-tax wage dispersion is likely to discourage labor supply under the Swedish model, but this effect was mitigated by mechanisms that restricted access to highly subsidized services to non-employed persons (Lindbeck, 1982).

[5]Roe (2003) provides a highly suggestive analysis of cross-country differences in corporate governance structures. His main conclusion was that social democracies (with Sweden as one of the most prominent examples) fray the ties between shareholders and management. To make up for this fact, social democracies require a concentrated ownership structure to function well.

shown in Roine (2006), it is possible to have political equilibria characterized by a coalition where those with the very highest initial resources can agree with those with the smallest initial resources to tax the middle group heavily as long as members of the top group do not pay (full) taxes themselves.[6] Applying a similar logic to the buildup of the Swedish welfare state, the (owners of the) initially large firms could agree with (the representatives of) the workers (i.e., the unions) to have generally high taxes, as long as there were some concessions for them. In fact, such an agreement can even be seen as more beneficial to the large firms than a generally lower tax rate, because high taxes act as a barrier to entry for initially small firms with growth ambitions, but which are too small to be part of the initial coalition.

Although I point to several measures that may provide strengthened incentives for entrepreneurship while retaining the core of the welfare state, including very high tax and government spending levels, such measures are unlikely to be implemented. This can be understood when policy determination is analyzed as an outcome of an endogenous process. The long-term reliance on large incumbent firms and the public sector as the creators of employment opportunities and economic progress (Söderström and Viotti, 1979) has made them seem indispensable. Their dominance has also turned these groups into powerful lobbyists for a continuation of traditional policies. As pointed out by Lindbeck (1995), it may be a difficult collective problem to unwind a welfare system in which most individuals have stakes. Similarly, it may be difficult to change industrial policy in a situation where many people have become dependent on the success of the incumbent large firms, and where vested interests have substantial political influence (Henrekson and Roine, forthcoming).

Apparently (and not surprisingly; after all, scientific discourse thrives on dissent), not everybody agrees with the above analysis. I am really happy to note that the editors of *Industrial and Corporate Change* have decided to publish two comments by James K. Galbraith (2006) and Ronald Dore (2006), respectively. I now turn to a discussion of their objections.

3. A reply to James K. Galbraith's objections

Professor Galbraith begins his criticism of my paper by claiming that I have drawn general conclusions from a single case. This is a complete misunderstanding. I explicitly state on the outset that the analysis is for Sweden only and that "similar studies are needed for other national settings in order to find out the degree to which the findings in this paper have general validity."

As a case study, it offers a base for discussing many aspects of the particular incentive structures that the welfare state gives rise to. Hence, it is not an argument about how we

[6]For empirical evidence on the favorable treatment of the very top of the income and wealth distribution, see Roine and Waldenström (2005).

are best to organize society, which is obviously a much broader question. It is simply an examination of what certain kinds of welfare state arrangements do to some incentives likely to be important for certain types of entrepreneurial activities. As stated, I warmly welcome careful studies of other countries and evidence-based assessments of whether, how, and to what extent welfare states retard or promote entrepreneurship and innovation. Preferably, this task should for each country be conducted by scholars with deep insight into the specific economic, institutional, and historic background of that country.

The evidence that entrepreneurship in Sweden is weak does *not* rest heavily on the low share of production of care and educational services. Instead, the evidence is drawn from an array of observations traditionally used in comparative studies, notably the incidence of fast-growing firms, the rate of start-up activity, and self-employment rates. Meanwhile, in the most recent period, the problem of underprovision of government-funded and -produced services has led to large problems. Newspapers are filled with stories of people dying while queuing for cancer treatment. A new political party that solely focused on the problems in the health-care sector won many seats in the 2002 regional elections[7] and is planning to run in the next national election. School performance as measured by numeracy and literacy among adolescents is falling rapidly.[8] There is plenty of evidence that the quality of university programs is down; the number of students has increased by roughly 100% in 20 years, while the number of lecturers has increased far less.

The morale and efficiency of Swedish police is low (Holgersson, 2004), and the relative crime rate has skyrocketed in recent years. Violent crime per capita has increased by a staggering 212% in Sweden in 30 years, rising for 24 of the last 30 years. Reported rapes per 100,000 people have increased by 308% during the period, serious robberies by 254%, and reported store robberies are up by 321%. The latter finding suggests that it is not just the tendency to report crime that has gone up, because robberies are unlikely to have been left unreported in the past. While international comparisons of crime are always difficult, Sweden recently seems to have surpassed the Unites States in the number of rapes per capita, while the US still has twice as many murders per capita (compared to seven times as many 25 years ago).[9]

The very idea of an all-inclusive tax-financed provision of key social services is now so compromised that the upper middle class is beginning to opt out: Thai and Indian clinics have begun to market their services directly to Swedes who go there and pay cash for treatment that they are in theory entitled to get free of charge from the Swedish public sector, and private health insurance is now growing very rapidly and it is

[7]The regional government is in charge of the public health-care system. In some cases, this party got roughly 20% of the votes.

[8]For instance, the percentage of students finishing mandatory schooling with incomplete grades has increased from 20.4% in 1998 to 24.5% in 2005 (source: SIRIS, the National Agency for Education's online information system on results and quality).

[9]All crime statistics are from http://statistik.bra.se.

currently estimated that some 4% of all employees have private health insurance as part of their employment package.[10] Hence, we are clearly beginning to observe exactly the development Professor Galbraith requested as a criterion for the accuracy of my analysis.

Professor Galbraith believes that there is no reason why for-profit hospitals in the US should be preferred to non-profit ones. It is a unique attribute of a market economy that such assertions are not only left to the subjective judgment of researchers, but can be tested by consumers themselves. We are restricted to one form of service provision, as in the centrally planned model. In fact, in the US, only a small fraction of the health market is served by for-profit firms, non-profit stand for some 70% of hospital beds, the remaining being shared by public and for-profit hospitals. The defining characteristic of a free market is in fact choice, not for-profit motives.

In contrast, the Swedish system does not allow any organizational choice and limits the amount citizens can spend on health care if they are not satisfied with the public system. Already there are considerable legal restrictions, and the government is seriously considering a total ban on all for-profit hospital care (the so-called "stop-law"). Despite what Professor Galbraith seems to believe, the Swedish public is severely restricted in their ability to opt for non-public hospital care. Hence, the "choice" of accepting the system is not particularly informative of preferences and efficiency. Moreover, individual entrepreneurs in the health-care sector face huge political risks, because their revenue comes from government contracts and not from clients directly. It has turned out that although politicians may be in favor of private provision of welfare services in theory, they are less encouraging when there is a clear risk that the private provider achieves a higher quality than the government provider (Dareblom, 2005).

However, the rate of personal taxation in Sweden is so high that an average worker pays 62–65% of his/her labor compensation in taxes, so the option of just saying no to the highly subsidized publicly provided education or treatment and pay out of your own pocket is simply not open to the average person. To make the point even more clear, assume that the US government subsidized GM cars so that Americans would get them free of charge and it turns out that people stop buying unsubsidized Toyotas, would that prove that GM cars are better than Toyotas?

Some would say that the most fundamental of all insights that economics provides is gains from specialization, in particular when combined with the comparative advantage principle. Modern societies are getting increasingly complex, while the cognitive capacity of humans basically remains unchanged (Martens, 2004). Hence, in order for individuals to be able to cope and become successful in an advanced society,

[10]The fact that there are major problems of underprovision and inefficiency in the Swedish health sector, of course, does not imply that the British, French, or American health-care sectors work perfectly. It is clear that each system suffers from problems, in the American case, those of cost containment, inefficient delivery modes, and most importantly uneven access.

they must be able to benefit from an increasing number of specialists, the efforts of whom need to be coordinated largely through markets.

High personal taxation is equivalent to the introduction of a tariff creating a wedge between what is economically rational for an individual and what would be rational for society. One often-used example in Sweden is that of the brain surgeon who, for economic reasons, takes time off to renovate his house rather than saving lives, while at the same time there is high unemployment among construction workers. Davis and Henrekson (2005) provide details on the level of taxation and make a systematic examination on how this affects the choice between production in the regular market and in the black market or the untaxed "do-it-yourself" sector. One salient observation from that study is that total work (paid plus unpaid) is no less in Sweden than in the US.[11] Moreover, it is no surprise that successful Swedish firms in recent decades are often firms—such as IKEA and H&M—that specialize in providing products to consumers with low after-tax income but with a low opportunity cost of their own time because of high personal taxation. Hence, the argument proposed by James Galbraith is just wrong. In the absence of tax wedges, the household would be free to specialize in market work or become homework "generalists," as they saw fit. Taxes distort that choice.

Just as in the case with the public provision of services free of charge, I have not made any normative statements regarding what is preferable. I merely pointed out that these mechanisms gave rise to steep distortions in individuals' choices, which has important implications for both the supply of entrepreneurial talent and the demand for entrepreneurial provision of new professional services. That there is such an effect is logically hard to deny, regardless of what one may think of the moral validity of private enterprise or whether a profit motive "degrades" services.

In many instances, Professor Galbraith is less interested in discussing the validity of economic mechanisms presented in my paper and more in providing a moral defense of the welfare state. Professor Galbraith, for example, asks why one should care about the low financial wealth in Sweden, when one does not need financial wealth to make up for all those things the welfare state provides. But that is beside the point in this context, which concerned entrepreneurial start-ups, not whether or not Swedes are rational not to accumulate savings. Rational analysis suggests that because of lower personal savings an individual who realizes that he/she would like to pursue a perceived business opportunity is less likely to have the requisite equity to start a company. This is part of the explanation why there appears to be relatively little entrepreneurship in Sweden.

On a similar note, Professor Galbraith questions the aggregate importance of weak entrepreneurship. The lack of growth to reach a minimum efficient scale (Audretsch, 2002) may be compensated by rapid growth in new product divisions of large firms.

[11]Similar results in a comparison of time use in Germany and the US are reported by Freeman and Schettkat (2005).

Admitting the methodological difficulties of proving causality, it is still true that there is a great deal of evidence from business research (e.g., Cressy and Olofsson, 1996; Wiklund *et al*., 2003) showing that when growth is expected to lead to loss of control for the founder, this has a strong growth-deterring effect. This "control culture" is underpinned by institutions that make it inexpensive for owners to abstain from growth, but this is likely to be detrimental to growth and economic dynamism in the corporate sector.

Professor Galbraith's deficient knowledge about Sweden comes through again and again. This is certainly understandable; few of us have detailed knowledge of all nations in the world. But it does weaken many of his arguments. One example is the following remark: "Given that the Swedish technology advantage never lay in information processing hardware or software...." Nothing could be further from the truth. This is the very industry that epitomizes Sweden since the mid-1990s. In 2000, Stockholm was named the Internet capital of Europe by the *Newsweek Magazine*. According to *Newsweek* (2000), the Stockholm phenomenon could be explained by "the looming marriage of the Internet and the third generation mobile telephony in Europe." In the 1994–2004 period, real value added in electrical and optical products grew by a stunning 930%(!), according to official statistics.

Finally, Professor Galbraith cites evidence that the US may not be less redistributive to its poorest citizens than many European countries with larger welfare states. That is a highly relevant point in this context. High-tax states do not redistribute so much from rich to poor as one would expect, instead they redistribute over the life cycle and across different states for each individual. In Sweden, it is estimated that the bulk of the redistribution concerns intra- and not interpersonal redistribution. According to the most recent official estimate, 82% of all redistribution is intrapersonal[12] (see also Bergh, 2005). But an important, and in my view grossly neglected, side effect of these large intrapersonal redistributions is the reduction of incentives to productive entrepreneurship.

In the US, on the other hand, proprietors' income has fallen since the 1950s according to Professor Galbraith, which should prove that US redistribution may be equally inimical to the entrepreneurial drive. This is not an accurate description of US development. Non-farm proprietors' income fell from 1950 to a low point in the early 1980s, but since then it has rebounded again, that is, during the aforementioned revitalization of entrepreneurship (Piketty and Saez, 2003). Moreover, entrepreneurial income for the rich has increased substantially since 1984 (Piketty and Saez, Table III), and for the richest, it is even larger than in the 1950s. This is consistent with the view that small non-entrepreneurial businesses (such as farms and mom-and-pop stores) have waned in importance, while truly entrepreneurial firms have become more important.

[12]See http://www.scb.se/Grupp/allmant/BE0801_2005K03_TI_06_A05ST0503.pdf.

4. A reply to Ronald Dore's objections

Professor Dore starts out by asserting that I and other economists assume "some unidimensional vision of mankind as being motivated solely by material self-interest." This is a false representation of my article, bordering on a straw man. The economic literature about entrepreneurship, including everything I have written, proceeds from the premise that material self-interest is *one* important source of motivation, not the only source of motivation. Other motivations clearly enter the picture, such as preferences for being one's own boss and the desire to innovate and create something new. But how and to what extent does that undermine my analysis of the entrepreneurial climate in Sweden? Ronald Dore does not explain this, nor does he even offer any examples.

The complex web of incentives faced by potential entrepreneurs has both monetary and non-monetary elements, and tends to become codified in society in the form of norms and habits. Norms and habits are not cut in stone but may at least partially be endogenous, that is, the consequence of a certain set of policies, social institutions, and economic incentives (see, e.g., Lindbeck *et al.*, 1999). Institutions feed back on behavior and vice versa, so that both are outcomes of interconnected processes (Schmid, 2004, ch. 4). Institutional changes are likely to be followed by changes in norms and attitudes, because they are in part a culturally codified product of the reward structures in society (Bowles, 1998).

This also helps explaining why Ronald Dore's distinction between "Promethean" and "Glittering Riches" entrepreneurial behavior is largely irrelevant. First, even if money is not an end in itself, it is always and everywhere the most important means for an entrepreneur who would like to materialize his/her vision. For example, that liquidity/equity constraints impede business development is one of the most robust findings in the small business economics literature (e.g., Blanchflower and Oswald, 1998; Parker, 2004). A system that discourages private savings will therefore reduce the opportunity for start-up success and future expansion, even for entrepreneurs who are completely uninterested in any material reward.

Second, the dichotomy between material and non-material goals is in many situations questionable. One can use "Glittering Riches" to make the world a better place (e.g., Bill Gates and his disease eradication efforts), while at the same time receive honor and acclaim through philanthropy (Acs and Phillips, 2002). In other words, financial rewards can be used to purchase and pursue Promethean goals.

Ronald Dore also makes some sweeping comparisons of US and Japanese management practices, allegedly to try to cast doubt on my thesis that certain welfare state institutions are likely to weaken the incentives to supply entrepreneurial effort. First, one major flaw with this comparison is that Japan, in contrast to Sweden does not have an extensive welfare state, in fact, it has one of the smallest governments in the OECD relative to GDP.[13] Second, one may note that in the last 15 years (1990–2004),

[13]Government outlays as a share of GDP was 38% in Japan and 58% in Sweden in 2005 (OECD, *Economic Outlook*).

the US economy grew by 53%, while Japan grew by a mere 19%. In the same period, working-age population grew by 18% in the US, while it decreased by 1% in Japan. Hence, Japan fell behind in both total and per capita GDP. Judging from relative overall performance in the last 15 years, the Japanese model of imitation and incremental improvement as opposed to novel innovations demonstrates inferior performance. If anything, this lends further credence to the thesis in my paper.

More generally, certain types of innovations may best be carried out in corporate environments, whereas other types are best carried out in individualistic environments. If so, then an innovation-friendly society will facilitate both (or many) modes of innovation, not just one. If the welfare state chokes off innovation in individualistic enterprises only, it still has a cost even if it sustains innovation in corporate environments just as well as, say, the American model. Part of the problem with the Swedish Model may therefore be the one-size-fits-all approach promoted by the welfare state.

Professor Dore also questions the value of economic growth and increased material standard of living for "quality of life." One obvious line of defense against this questioning is that my study did not deal with this much harder question, but rather specifically with the effects on entrepreneurship. Still, one may note that "quality of life" has several measurable aspects that are related to economic success and the policy choices and institutions that create prosperity. There is extensive evidence that higher GDP per capita is associated with better life-quality outcomes on many dimensions—see, for example, Maddison and Johnston (2002) and the UNDP databases.

Professor Dore is right when pointing out that by providing insurance for bad outcomes, the welfare state can in principle encourage individuals to pursue entrepreneurial endeavors. This is a valid theoretical point shown formally by Sinn (1995), but it is an open question whether it is important empirically. Unfortunately, Professor Dore neglects to point to evidence that this insurance effect is in fact important in practice. A person with first-hand knowledge about the Swedish welfare system knows that giving up a tenured position for self-employment or a job in a newly established firm with uncertain prospects is associated with a high opportunity cost. In particular, if employment with the current employer has lasted for a long time, and the employer is unlikely to be forced to shut down, the system in reality provides income security for the individual. By contrast, somebody who willingly gives up a tenured position for self-employment may often end up having no more security than what is provided by social welfare, and this presupposes that the individual depletes all his/her own assets. Hence, the construction of the public income insurance systems in combination with the labor security legislation tends to penalize individuals who assume entrepreneurial risk. Here, Sweden differs strongly from Denmark where instead generous welfare systems are combined with weak job security mandates, sometimes called "flexicurity" (Andersen, 2005). As a result, the opportunity cost of giving up a tenured position is lower than in Sweden.

Professor Dore is right about the point that provided that the culture of a society is such that that it approves bold innovation more than bureaucratic conformity, "prestige and power and organizational loyalty can be powerful motivators for innovation." However, he does not address the question whether or not the welfare state in fact cultivates such a system. As it happens, and given Professor Dore's argumentation unfortunately for Sweden, it has *not* been the case that this society has developed a culture of respect for (non-monetary) achievement. Quite the contrary, social rewards are given for average performance and for not standing out, whereas "excessive" success is frowned upon.[14] This attitude toward success is in fact by many observers seen as a fundamental trait of Scandinavian societies, and it even goes under a specific name, namely "the Law of Jante," coined in 1933 by the Danish novelist Aksel Sandemose.[15]

While I enjoyed the exchange, it would perhaps have been even more rewarding to all parties if the critique had been focused on my paper, and not on what Professor Dore is upset about in the world more generally. It is, at least at a first reading, difficult to see the precise connection between "the total cultural insensitivity of the Bush administration's bellicose policies" and my paper about the effect on entrepreneurship of welfare state institutions in Sweden. Neither does there seem to be any direct connection to American "cultural hegemony," some statements by an American business leader that upset Professor Dore, or for that matter the equally subjective opinions expressed by a retired Italian industrialist. I certainly have sympathy for Professor Dore's personal feeling about the Middle East policy of the Bush administration. Yet I cannot help feeling that the discussion would have been even more fruitful if it had been geared toward the topics and arguments put forth in my paper.

5. Concluding remarks

There is no single recipe for achieving prosperity. In fact, there is a whole literature out there maintaining that there are "varieties of capitalism" (Hall and Soskice, 2001; Roe, 2003). However, backed by empirical evidence, it is claimed by many observers that individual entrepreneurship is more important for growth and prosperity today than in the Fordist era, and also that it is likely to be more important, *ceteris paribus*, at high levels of income (see Carree *et al.*, 2002; van Stel *et al.*, 2005). This is not to deny

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[14]A good illustration of the fact that there can be drawbacks to making it generally known that one's company is successful is from the annual contests held, first regionally and then nationally, to find the gazelle company of the year. The first selection of candidates is often made on purely statistical grounds; these entrepreneurs are then asked if they wish to participate in the final round. In recent years, it has been the rule rather than the exception in certain regions that entrepreneurs do not wish to participate; to feature in a context where one is publicly labeled successful is judged neither good for business nor good for relations with local political representatives, unions, employees, or suppliers.

[15]See Henningsen (2001) for an introduction to the Law of Jante. Stenius (1997) provides a good background and Henrekson (2003) illuminates some of the pitfalls for high-achieving entrepreneurs caused by the prevailing political culture, putting great weight on conformity and equality in terms of outcome rather than in terms of opportunity.

that there are difficult definitional issues involved and that entrepreneurial activity is more difficult to measure and make analytically tractable than many other economic variables.[16]

To further our understanding of the functioning of society and the economy, I would like to suggest inquiries where entrepreneurship is treated as a factor of production distinct from labor and human capital. The total supply of entrepreneurship and its distribution across (productive, unproductive, or destructive) activities (Baumol, 1990) is likely to be influenced by the institutions defining a particular economic system. More specifically, the Swedish welfare state system is characterized by extensive regulations, by tax wedges of roughly 60–65% for average workers, and by an extensive public sector, all of which give rise to complicated incentive effects for individuals and organizations. That such a large welfare state has far-reaching effects on the structure of payoffs is obvious. While many of the effects are intentional, some negative side effects are unintended. Equally importantly, many welfare state systems were designed for a different and more stable economic environment and may be less appropriate when the economic system is exposed to shocks and deep-seated changes in the underlying structural conditions. Adaptation and improvements in the design of programs and policies would therefore, in my view, make it possible to reduce many negative side effects without having to give up much of the core aspirations of the welfare state model.

Apparently, this observation is hard to accept for some scholars, which the two comments to my original article by James K. Galbraith and Richard Dore make clear. In this reply, I have tried to show that their arguments are overall weak, in many cases unrelated to the topic at hand, and in some cases simply wrong. It is obviously important that we learn more about how entrepreneurship is affected by different institutional setups, something which can be achieved both through in-depth studies of particular systems and through comparative work such as studies based on the rapidly developing GEM database (Reynolds, 2005). It is impossible to entirely avoid ideological biases, or the nostalgia many feel for the world of their ideals. However, moralistic or emotional argumentation can never substitute for systematic, rigorous enquiry based on sound theoretical premises and a variety of empirical observations of the best possible quality.

Acknowledgements

I thank Steve Davis, Jesper Roine and, in particular, Tino Sanandaji for useful comments and suggestions. Financial support from the Jan Wallander and Tom Hedelius Research Foundations is also gratefully acknowledged.

[16]See Bianchi and Henrekson (2005) and Barreto (1989).

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