



Development Institute

LESSON PLAN

Entrepreneurship and Innovation as Engines of Growth

Prerequisite: CIPE Development Institute video presentation by Ruslan Stefanov

I. Message

Entrepreneurship is the capacity of individuals and companies to undertake risk in pursuit of innovative ventures. Throughout history, individual efforts of entrepreneurs have been the driving force of modern market economy. But entrepreneurial drive in and of itself is not enough to deliver sustained economic growth and development in a modern economy. Institutions that support entrepreneurship, such as those that guarantee freedom of information or freedom and ease of establishing and growing a business, are necessary to translate innovative ideas into larger economic and social benefits. Free markets, protection of property rights, and the rule of law are at the core of the framework needed to make entrepreneurship work.

II. Objectives

1. Understand the importance of entrepreneurship for growth and development.
2. Discuss the conditions necessary for entrepreneurship.
3. Discuss the consequences of excessive barriers to doing business (including the existence of the informal economy).
4. Explore the sources of innovation.
5. Analyze the opportunities and challenges to building the entrepreneurial culture, using the example of post-communist countries in Eastern Europe.

III. Discussion questions

1. How do you define entrepreneurship? How do you define innovation?
2. What is the relationship between economic freedom and entrepreneurship?
3. How does entrepreneurship contribute to innovation?
4. Why do some entrepreneurs operate in the informal sector?
5. How widespread is the informal sector in your country? Why?

IV. Reading list

Required readings:

- Baumol, William J. "The Free Market Innovation Machine: Analyzing the Growth Miracle of Capitalism." *Princeton University Press*, 2002.
- Baumol, William J. "Entrepreneurship: Productive, Unproductive, and Destructive," *Journal of Political Economy*, Vol. 98, No. 5, Part 1, October 1990, pp. 893-921.
- CIPE, Economic Reform Issue Paper, "Entrepreneurship," No 0401, 1 Oct 2004, <http://www.cipe.org/publications/papers/pdf/IP0401.pdf>.

Optional readings:

- Boettke, Peter J. and Christopher J. Coyne, "Entrepreneurship and Development: Cause or Consequence?" Mercatus Center, George Mason University, Global Prosperity Initiative, Working Paper No 6, http://www.mercatus.org/repository/docLib/MC_GPI_WP6_030921.pdf.
- The Boston Consulting Group Innovation Institute, <http://innovation.bcg.com>.
- Djankov, S., Lieberman, I., Mukherjee, J., and Nenova, T., "Going Informal: Benefits and Costs." World Bank, 2002.
- Kirzner, Israel M. and Frederic Sautet, "The Nature and Role of Entrepreneurship in Markets: Implications for Policy." Mercatus Policy Series, Policy Primer No 4, George Mason University, June 2006, <http://www.mercatus.org/uploadedFiles/Mercatus/Publications/Entrepreneurship%20in%20Markets.pdf>.
- Palmade, Vincent and Andrea Anayiotas, "Rising Informality, Reversing the Tide," World Bank Public Policy Journal, August 2005, <http://rru.worldbank.org/PublicPolicyJournal/Summary.aspx?id=298>.
- Sautet, Frederic, "Entrepreneurship, Institutions, and Economic Growth." In: *Ways of Thinking About Economic Growth*. Ministry of Economic Development Occasional Paper 08/07. Wellington, New Zealand, 2008, 41-55, <http://www.med.govt.nz/upload/63891/0807.pdf>.
- Schumpeter, Joseph, *Capitalism, Socialism and Democracy*, 1942.

V. Lesson plan

Definition of entrepreneurship

- Entrepreneurship is the capacity of individuals and companies to undertake risk in starting a new venture; it is the driving force of the market system
- Entrepreneurship requires supporting institutions and freedoms

The importance of entrepreneurship

- Entrepreneurs bring new ideas, answer the needs of the market, and create wealth
 - It is a way to harness a nation's creative power
- Entrepreneurship requires free markets, property rights, and the rule of law

- The state should play a crucial role in fostering entrepreneurship through: pro-market policies, protecting property rights, upholding the rule of law
- Barriers to doing business should be low so that entrepreneurs are not pushed into the informal economy
- The same elements that are necessary for entrepreneurship also make democracies work

The issue of tax burden

- Appropriate tax burden is a delicate balance that influences entrepreneurship
- Other things being equal, the higher the tax burden for an entrepreneur, the less incentive that entrepreneur has to start a business
 - BUT this is only true for excessively high taxes; e.g., Nordic countries have high taxes and also flourishing entrepreneurship because the level of taxation translates into the high level of public goods
- Tax burden is more than just tax rates: it is the way taxes are collected, the way inspections are done, etc.
 - Other administrative burdens can also hamper entrepreneurship

Creative business

- If business rules are not well defined, companies may look for ways to gain special privileges from the government or monopolize the market
- Only truly creative businesses bring new ideas and value to the market
 - Business innovations are not limited to technological advances; they can also involve organizational innovations to better satisfy customer's needs
- Competition is the key driver of innovation and business creativity
 - If the rules of competition are structured fairly, all businesses flourish

Challenges to entrepreneurship in Eastern Europe

- Establishing formal rules of market economy is easier than changing informal institutions and entrenched mindsets
- Having formal rules does not automatically mean that they are enforced and apply equally to everybody (level playing field)
- The more a country is free and the easier it is to start a business in that country, the higher economic growth is realized
 - Some countries have advanced more than others in implementing reforms
 - Building the vibrant entrepreneurial culture in Eastern Europe means more growth for each country

VI. Sample test questions

- 1. Entrepreneurship involves...**
 - a. Taking risks to pursue innovative ventures
 - b. Willingness to fail and start over again
 - c. Adding value and responding to the needs of the market
 - d. All of the above

- 2. What is the role of the state in fostering entrepreneurship?**
 - a. None. Entrepreneurship spring up naturally among creative individuals.
 - b. Some. The state can only help a limited number of entrepreneurs by providing them with capital for creative ventures.
 - c. Significant. The state, through policymaking and regulation, creates conditions that either foster or hinder entrepreneurship.

- 3. Institutions needed for entrepreneurship to flourish include these except...**
 - a. Freedom of exchange
 - b. Enforcement of contracts
 - c. Two-party political system
 - d. Protection of property rights

- 4. What is the most important aspect of the rule of law from the point of view of entrepreneurial development?**
 - a. Preventing crime
 - b. Arresting the most dangerous criminals
 - c. Ensuring the same rules apply to everybody

- 5. Why is entrepreneurship sometimes perceived negatively in post-communist countries of Eastern Europe?**
 - a. Eastern Europeans do not have enough entrepreneurial skills.
 - b. Many Eastern Europeans associate entrepreneurship and business with breaking the law and abuses of improperly conducted privatizations.
 - c. Because of the communist legacy, they do not believe that private entrepreneurship is the best way to develop their economies.

- 6. If a country has large informal economy, it means that (*choose two true statements*):**
 - a. Businesses perceive the tax and administrative barriers as excessively high
 - b. The level of public service delivery does not match the tax burden
 - c. The profit margin from avoiding taxes is lower than from conducting business legally

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