

Enter the prince of Denmark

Citation for published version (APA):

Sanders, M. (2021). *Enter the prince of Denmark: Entrepreneurship for a resilient and sustainable economy*. Maastricht University. <https://doi.org/10.26481/spe.20211025ms>

Document status and date:

Published: 25/10/2021

DOI:

[10.26481/spe.20211025ms](https://doi.org/10.26481/spe.20211025ms)

Document Version:

Publisher's PDF, also known as Version of record

Please check the document version of this publication:

- A submitted manuscript is the version of the article upon submission and before peer-review. There can be important differences between the submitted version and the official published version of record. People interested in the research are advised to contact the author for the final version of the publication, or visit the DOI to the publisher's website.
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- The final published version features the final layout of the paper including the volume, issue and page numbers.

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Enter the Prince of Denmark :
**Entrepreneurship for a Resilient and
Sustainable Economy**

Enter the Prince of Denmark.

Entrepreneurship for a Resilient and Sustainable Economy¹

Mark Sanders

¹ This is a summary of the inaugural lecture delivered by the author on 25-10-2021 accepting the position of Professor of International Economics at Maastricht University School of Economics and Business

I will speak to you today about international economics, although, I will take a less traditional approach to it. Modern science in general and modern economics in particular, should be less concerned with traditional disciplines and more with the real world. I see three major real-world challenges in international economics that put our existing paradigms in crisis and that scholars should focus on.

First there is “sustainability”. Ever since the infamous Club of Rome raised the alarm nearly 50 years ago, we have come to realise that our international economic system extracts and emits too much and that is simply not sustainable. A famous quote, attributed to Kenneth Boulding, has it that anyone who thinks that exponential growth on a finite planet is sustainable is either a madman or an economist. [...] We now see all around us that indeed planetary boundaries have been overstepped. And this has serious consequences. An economics that assumes we can always substitute for finite resources or can ignore the impacts of our waste on the natural system, will not do. Instead, we need to think about a model in which we might continue to create value without destroying our shared and only habitat.

The second challenge is “inequality”. Inequality of well-being, both within and between countries, has been in focus of international economics since its inception. Smith’s (1776) *Inquiry was into the causes and nature of wealth of nations*. And recent work by Piketty and many others has put the issue back on the international economists’ agenda. They show that the gap between the haves and have-nots is once again widening. And importantly, our capitalist liberal market system has no automatic mechanism in place to correct this. This discussion forces economists to also look at creating a more level playing field and ensuring access and equal opportunity for all.

The third challenge, and I think the most important one, is ... I do not know. And that is because nobody does. It is the “unknown unknowns” that our future has in store for us. It is the next Berlin wall, the next 9-11, the next Fukushima, the next Lehman Brothers, and the next COVID-pandemic. The next “crisis” that we did not anticipate, that will disrupt our lives and force us to adjust to a new reality. To prepare for the unknown is to build an adaptive, resilient economy in which people and firms can rapidly adjust to new circumstances. But when competition in international markets rewards only efficiency and (short run) profitability, how do we create the incentives to build and maintain this resilience?

So, our future holds enormous challenges. At the same time, as a society, we have never been more equipped to face them. We are more, more educated, healthier, and wealthier than ever before. And we have faced different but similar challenges in the past with great success. This success was typically not due to grand designs based on visionary economic theories. It was not a UN list of 18th century “centennial development goals” or a Roman “Green Deal” that all but eliminated hunger and built up educational-, healthcare- and welfare-systems across the world that improved the fate of millions. It was people that were unwilling to accept a status quo and used their talents and mobilized resources to challenge and change it. People that I would define as “entrepreneurs”.

[Enter the prince of Denmark.

It is here that I would introduce you to the Prince of Denmark. Of course, a reference to Shakespeare's *Hamlet*, but in this context more importantly, to William Baumol's (1968) lament that in mainstream economics the entrepreneur had been ignored. As if: "the Prince of Denmark has been expunged from the discussion of *Hamlet*".

Baumol's reference to Hamlet might even be more accurate than he himself anticipated. All can recite the famous: "To be or not to be, that is the question". It will be less known, that this quote is about "to be or not to be" an entrepreneur according to the above definition. For if we read on a little more, Hamlet continues:

"Whether 'tis nobler in the mind to suffer
The slings and arrows of outrageous fortune,
Or to take arms against a sea of troubles,
And by opposing end them?"

In other words: "Do I accept the world as it is, or do I mobilize my talents and resources to do something about it?" Hamlet then decides "to be" an entrepreneur. Against "a sea of troubles", at great costs to himself and despite all arguments against it. He confronts his uncle, who killed his father, usurped the throne of Denmark, and married his widowed mother. In the end, Hamlet pays for this with his life but avenges his father and thereby takes the rot out of the state of Denmark.

Entrepreneurship scholars have been less successful in challenging the status quo in economics that Baumol lamented. A good half century and many brave attempts to change it later, entrepreneurship is still not at the heart, or even in the periphery of mainstream macro- and international economics. But if we want to contribute to our understanding of the challenges for the future, I believe this needs to change.

Schumpeter (1911), in his seminal work in the 1910s, described the process of creative destruction as the fundamental driver of economic dynamics. That process involves an entrepreneur with a new idea, challenging an incumbent and, if successful, driving him out of business, taking his place. In this view, growth and development, the traditional "big" questions in international economics, are the result of an evolutionary process that requires on the one hand a flow of new ideas and on the other a group of talented entrepreneurs willing to take on the incumbents. Schumpeter stressed the importance of the latter, but traditional and later modern growth theory since the 1950s emphasized the former. Not because the scholars leading the field denied the existence of entrepreneurs, but because, in the grand scheme of things, it is the flow of new ideas that drives the long-run process of economic growth and the act of introducing them commercially was considered to be trivial.

The entrepreneurs were thus "expunged from the discussion of *Hamlet*" because they were assumed to do what anybody would have done in their stead. Much like the assumptions that there is always a worker to be hired or a capitalist willing to invest if the price is right, in our models there is always an entrepreneur that will take the pigs to market.

This abstraction may be innocent enough if we study long-run equilibrium economic growth. Indeed, ultimately, without new ideas, entrepreneurship, innovation and therefore growth would inevitably end. So, a focus on the long run process of creating new knowledge and ideas was perhaps justified.

But this abstraction becomes harmful when we start making policy. When, for example, we promote new knowledge creation at the expense of incentives and resources for commercialization through stronger intellectual property protection, the standard model predicts higher growth. But in the real world such policies may produce stagnation (Acs and Sanders 2012; 2013).

More importantly, if we want to model the transition to a more sustainable, more equitable and more resilient economy, I believe entrepreneurship is far from trivial.

With the Glasgow Climate Conference starting in a week or so, the newspapers are once more filled with alarming scenarios. Where in Paris policy makers agreed to keep global average temperature rise below 1.5 degrees, the most optimistic scenarios now put the inevitable temperature rise at 1.6 degrees by 2050. More likely is 2.7 or even 3 degrees, and that is with current plans fully and successfully implemented. If we do not drastically bring emissions down to zero in the next decades, by 2300 sea levels may rise to 15 metres in the worst-case scenarios. At the same time the UN revealed that the extraction plans for fossil fuels add up to twice as much as would be consistent with "Paris". And climate change is only the most urgent of all sustainability issues currently on the table.

To deal with this challenge, there fortunately seems to be no shortage of knowledge or ideas. We know what the problem is: The emission of fossil carbon into the atmosphere. And we have biobased and renewable alternatives. What we lack is people "taking arms against a sea of troubles and by opposing, end them". We need more challengers to pick up these ideas and in a "gale of creative destruction" destroy our old ways. For that we need entrepreneurs. And we need them not only to start up new firms, but to change the existing ones, pushing for change from outside and within. Hamlets everywhere need to stand up, take responsibility and challenge the status quo. And we better support them when they do.

A society in which challenging the status quo is encouraged and supported, we might call the Entrepreneurial Society. The term was coined by Peter Drucker (1985) and taken up by Audretsch and Thurik (2000). Their "Entrepreneurial Society" refers to a society that empowers the entrepreneurial talent that is present, wherever it is present. Audretsch work argued that the US was forced to move towards such a society under pressure of strong competition from Germany and Japan in the 1960s. In Audretsch et al. (2017), that I might add comes very close to traditional international economics, we showed that indeed industrialized countries faced a similar push when East-Asian tigers and dragons challenged their positions in the global marketplace in the early 2000s. But trade and competition alone will not bring us to the entrepreneurial Walhalla. As late as 2016 an impressive list of industry leaders, scholars and policy makers, meeting in the 8th Peter Drucker Forum on the theme lamented that the Entrepreneurial Society had far from fully established itself.

Perhaps it is time we take a more pro-active role bringing about a society that consistently supports the challengers of the status quo. It would help in the transition to more sustainable practices. And it would also go a long way in solving the problems of inequality and resilience. I do not claim to be an expert on the issue of inequality, but I would think that inequality is much more bearable and justified when we know that positions of power and prestige are earned and can effectively be contested. When it comes to resilience, the recent COVID-pandemic and corresponding lock-down measures confronted all of us with a rapidly changing situation. And I have witnessed a lot of entrepreneurial behaviour in dealing with this shock. The same talent and resources one would need to challenge the status quo in normal times, proved most useful in adapting to a rapidly changing situation. Things only started to go wrong when our bureaucratic managers recovered from the shock and started to “manage” these entrepreneurs’ access to resources again.

So how can we “get to Denmark”? (Fukuyama, 2011). How do we build an Entrepreneurial Society where our Hamlets can take centre stage and play their role? Fortunately, there is a lot we know about entrepreneurship and there is a large literature that I can draw on.

The same Baumol (1996) that lamented the Prince’s absence, argued that it was institutions, the “manmade rules of the game” (North, 1991), that determine what entrepreneurial talent in society ends up doing. He hypothesised that entrepreneurially talented people would engage in those activities that would bring the highest return in terms of power, prestige, and wealth. In the US that would be starting up a company in Silicon Valley, in communist Russia it would be a career in the military or the party, in post-communist Russia they would end up as a Putin retainer and an oligarch.

Baumol’s hypothesis explains the sorting of entrepreneurially talented people into productive, unproductive, and destructive activities according to where institutions would guide them. The implication was that we should set the institutions “right” and the rest would follow. But what institutions ensure that entrepreneurs can effectively engage in productive activities?

This was the main question in a European Horizon2020 project: Financial and Institutional Reforms for the Entrepreneurial Society (FIREs), that I was honoured to coordinate between 2015-2018. In this project we set out to formulate an institutional reform agenda for an Entrepreneurial Society in Europe. It would take me too long and too far afield here to cite all the interesting and important work my colleagues in that consortium have done. I could never do it all justice in the time I have. But I can try to summarize what we found (Elert et al., 2019; Sanders et al., 2020).

First, we identified finance, labour, and knowledge as the key resources an entrepreneurial society would have to channel (more) to the challengers of the status quo. We therefore shifted our focus from the institutions that would drive the allocation of talent into productive ventures and zoomed in on the institutions that would prevent or promote that talent’s access to resources when challenging the status quo. More specifically, the financial sector, the labour markets, and the knowledge infrastructure.

We then quickly realized that all institutions evolved in complex interaction with society at large in a historical process that one cannot safely ignore. Banking in Italy goes back to the renaissance and social security in Germany is closely tied to its process of unification as a state. The institutions governing the allocation of financial resources in Spain are very different from those in Sweden or the UK and therefore it makes no sense to propose the Netherlands copy an institution that works well in Greece or the other way around.

So, step one in the proposed approach to build an entrepreneurial society is to research the historical roots of the institutions that channel finance, labour, and knowledge towards or away from challengers in the system. Being keenly aware of how the existing institutions function and interact, one may start to consider change.

In step two we developed tools and methods for scanning the ecosystem for its weaknesses, strengths, and bottlenecks. The approaches developed here built on earlier work, also with colleagues present here today, that tried to identify the institutions that interact with entrepreneurial activity to produce innovation and growth.

In step three we complemented the data driven, quantitative approach in step two with an essential qualitative check by asking entrepreneurs about the barriers to entrepreneurial venturing in different European regions and circumstances. This work confirmed that indeed in different parts of Europe the barriers to entrepreneurial venturing are different. In the UK and especially London, there are plenty of ideas and entrepreneurs trying to develop them into new products and services. But they lack access to a well-trained, and loyal labour force that can help them build their firms into global champions. In Germany, in contrast, it is much harder to start something new, but those that do, are much more likely to succeed.

Step four would then have us triangulate and integrate the information obtained in steps one to three and take our diagnosis to a catalogue of evidence-based treatments that we put together based on the vast literature linking policy and institutions to entrepreneurial success. Here an interesting bias in the literature revealed itself. As most empirical studies use US data, most evidence-based interventions are based on evidence from the US. And of course, that is a severe weakness. Treatments that work well for one patient will not necessarily work in the same way in another.

With that caveat in mind, step five is most important of all. Interventions that are selected in step four must carefully be fitted to the local institutional context. If German politicians lament the fact that venture capital is lacking in their ecosystem, they forget that relationship banking may well have played that role in the German context with different, but not necessarily less access to finance for challengers. Institutional reforms should thus take the form that best fits the local context and establishes or strengthens a function that improves access to resources for challengers.

Step six is then more procedural, but no less important. The FIRES project had an entire work package devoted to linking the proposed reforms to the appropriate policy actors at the local, regional, national, and European level and considering if the required scale for reforming institutions also matched the competencies of the political institutions at that level.

And step seven, to complete a seven jump, well known to all Maastricht alumni, is then to carefully evaluate the effects and if necessary, return to step one to reiterate.

To give you a bit of a flavour of the width and breath of our project I would like to highlight three reforms that we developed in the areas of knowledge, labour, and finance. Recall that the aim of our proposals was not to promote new firm creation, start-ups or support small- and medium sized enterprise, per se, but to improve access to resources for potential challengers of the status quo, wherever they may be.

The first is a set of reforms would limit intellectual property rights and patent protection. This may sound counter-intuitive and goes against what our mainstream models would suggest, as intellectual property is commonly believed to protect the interests of innovators. But the system of intellectual property rights was not designed to serve that purpose. In fact, it has co-evolved, like any other institutions, historically and in close interaction with other institutions in our modern societies. And arguably, it currently serves the interests of large incumbent firms more than those of challengers either from within or outside. For example, patents currently allow the holder to sue infringers and claim a share of their profits if courts uphold the case. This implies that large firms, with strong legal representation and deep pockets, can go after challengers that threaten their business and start patenting defensively. Anticipating this, challengers discount the risk of litigation into their decision to even try as effectively their access to knowledge is blocked. So we proposed reforms, such as the right to “squat” an unused patent and force patent holders to offer their patents at a pre-determined price to limit this defensive use of patents.

The second reform is to reduce conditionality in social security. For simplicity let us call this a basic income. Only last week the Dutch daily Volkskrant (Ten Eerste, 20-10-2021) ran a one-page article in which a social security beneficiary, Annemarie van Krimpen, explained how she did not dare start a new relationship in fear of losing entitlements and being fined. This is wrong in so many ways, but it illustrates how people just give up taking any initiative to improve their lives. Making social security entitlements unconditional would solve this. Again, the purpose of this proposal is not to promote new firm formation, although I suspect it does not hurt in that department. It is to give challengers of the status quo a stronger position in attracting and retaining labour. It will mobilize people and reduce the relative attraction of a secure job in a large incumbent form. An unconditional basic income would support challengers as employer, competing for labour in a market where people value their income security, and as entrepreneurs whose own incomes can be volatile and uncertain, especially in the early stages of their ventures.

The idea of a basic income is old and goes back at least to Roman times, but actual experiments and empirical data on the impacts of such a reform are rare. The political struggle that preceded the field experiments with unconditional welfare benefits that we only recently concluded in Utrecht, have taught me that building a coalition for a more entrepreneurial society is far from easy. I sincerely hope that the 2019 Nobel prize for Duflo, Bannerjee and Cramer and this year’s for Guido Imbens, may convince our policy makers that more extensive and carefully designed experiments are called for. Especially since Imbens et al. (2001), but also our own experiments in Utrecht show that the expected and

feared negative impact on people's willingness to look for work and be productive, are simply not supported by the facts.

The final proposal out of the FIRES catalogue, also strongly advocated by my colleagues in Sustainable Finance Lab (SFL) as a measure to make the financial sector itself more sustainable, is to limit the fiscal advantages for debt finance. Again, this may strike one as counterintuitive. Would cheaper loans not also benefit the challengers of the status quo, who are, as we know from research, typically starved of capital? But the reason they are starved, is not that there is an insufficient supply of loans and debt. In the current low interest environment, that supply is abundant. But it does not flow to entrepreneurs. As with patents, the subsidization of debt finance benefits primarily large, incumbent firms. Investors and intermediaries channel their funds into loans to parties with long track records, strong balance sheets, and solid collateral. Large corporations, governments and existing real estate can be financed at a discount, while small, young, and unestablished organisations need to finance their activities with their own equity and personal loans from family, friends, and fools. Unproductive lending is perhaps privately profitable, but socially no longer very valuable (Bezemer, 2018). There is no sound economic reason to continue subsidizing debt if debt is financing primarily the status quo.

The FIRES project was quite fundamental in shaping my thinking about doing action oriented, problem-based research. On the one hand, more applied research forces us in a natural way to work across and between disciplinary boundaries. In FIRES historians, geographers, economists, finance, entrepreneurship, and legal scholars came together and this diversity of perspectives made the whole more than the sum of its parts. On the other hand, it forced me to challenge the status quo in my own discipline. Bringing entrepreneurship into mainstream international macroeconomics remains an ambition I share with my FIRES colleagues, but making the case that entrepreneurship is not trivial, is going to be much easier when we can show its relevance in tackling the real-world challenges international economics faces today.

The same problem-based research is what I hope to pursue with over 70 colleagues here at Maastricht University in the new Maastricht Observatory on Responsible, Resilient, and Sustainable Societies, Economies and Enterprises, MORSE. There I will try to convince the sustainability scholars, that the Entrepreneurial Society is an important part of the answer to sustainability problems. And advocates of responsible business that responsibility involves corporate leaders to nurture and promote entrepreneurship from within.

In my own pillar, Resilience, we now work on how financial systems, industrial structures and entrepreneurship affect local economies' resilience to extreme weather shocks. There are projects on institutional quality and natural hazard shocks about to be finished, and we are setting up new collaborations on how policy makers and decision makers can develop more effective responses to shocks. With old friends and new colleagues, we have started a project to introduce planetary boundaries and physical feedback effects but also a more accurate empirical description of consumer behaviour in an agent-based model and out of the EU INNOPATHS-project we are now bringing the distinction between debt and equity finance into the macro-energy models that we use to model the energy transition.

I truly believe that “Resilience” can be the new “competitiveness”. Like “sustainability” must become the new “efficiency” and “Responsibility” the new “profitability”. The energy transition, climate adaptation, financial instability and a host of unanticipated shocks will make sustainability, resilience, and responsibility valuable assets that our current economic models and theories have a hard time accounting for. This puts our current economic models in crisis. Being efficient, competitive, and profitable, in highly fragmented global value chains, financing operations with cheap debt, employing only just enough cheap labour on temporary contracts and cautiously guarding intellectual property, will no longer do. Such practices make people, firms, and society conservative, reactive and more vulnerable to shocks in the long run. An Entrepreneurial Society is more innovative in normal times, more resilient in a crisis and more inclusive under all circumstances. With Peter Drucker, William Baumol and David Audretsch I therefore say:

Let Hamlet take the stage.

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