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The Impact of Constitutional Protection of Economic Rights on Entrepreneurship: A Taxonomic Survey

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The Impact of Constitutional Protection of Economic Rights on Entrepreneurship: A Taxonomic Survey

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ABSTRACT

In this monograph we perform an in-depth analysis of 199 constitutional texts to single out the provisions that, by enhancing economic freedom in a country, are likely to create the institutional side of an entrepreneurial ecosystem favorable to new business creation. The relevant information on constitutions is extracted from the Comparative Constitutions Project: A Cross-National Historical Dataset of Written Constitutions (Elkins *et al.*, 2009), a repository of valuable data on the formal characteristics of written constitutions for most independent states since 1789. Data on entrepreneurial activity in the countries taken into account in the empirical analysis are extracted from the World Bank Group Entrepreneurship Database. The study addresses a question of primary importance for the analysis of entrepreneurship: Does constitutional protection of principles

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and values which are commonly referred to as the “economic constitution” and which are usually associated with a country’s entrepreneurial activity, positively influence the rate of new firm formation and the total endowment of entrepreneurship capital in that country? We are able to give a positive answer to this question and this legitimates us to recommend inclusion of provisions prone to entrepreneurship in the constitution of any country.

1

Introduction

In modern economics, the importance of entrepreneurship is usually highlighted in terms of its impact on long-term growth and aggregate productivity (cf., among others, Aghion and Bolton, 1977). But there is more. As suggested by Audretsch and Moog (2022), entrepreneurship is also a cornerstone of democracy. Although one cannot exclude that the relationship between entrepreneurship and democracy might be affected by reverse causation, it is out of question that the latter is the fundamental common value among Western countries, and that entrepreneurship represents the pillar ensuring the “independent, decentralized, and autonomous-decision making” necessary to preserve democracy. It is therefore no surprise that the legal and institutional frameworks that characterize most Western countries have been designed to generate incentive-compatible mechanisms intrinsically favorable to the creation of new firms (Carbonara *et al.*, 2016; Davidsson, 2015). Conversely, the centrally planned economies of the 20th century relied upon institutional arrangements favoring state-controlled transactions and limiting the right to establish and conduct a business.

The institutional setups of Western countries are consistent with the “democratic” view of entrepreneurship described by Audretsch and

Moog (2022). Scholars embracing this view consider the importance of “the many” firms that are created at any time in any industry and portion of territory more than that of “the few” high-growth gazelles, unicorns (valued at \$1 billion), and decacorns (valued at \$10 billion) which are expected to dominate the high-tech field and push forward the frontiers of innovation (cf., among others, Kuratko and Audretsch, 2022; Mogos *et al.*, 2021).

In fact, countries differ in terms of firm demographics and contribution of Small and Medium-Sized Enterprises (SMEs) to Gross Domestic Product (GDP), with some of them characterized by greater proneness to entrepreneurship and higher rates of new firm formation than others. This empirical evidence has been taken by the strain of literature initiated by Acs *et al.* (2009) as a clue that the endowment of entrepreneurship capital varies significantly across countries.

Among the possible explanations of such heterogeneity, the role played by different legal and institutional systems deserves special attention. Legal systems protecting property rights (both real and intellectual), together with the right to establish and conduct a business and market freedom seem to exert a positive effect on entrepreneurship. Therefore, cross-country differences in the enforcement of such norms may explain the observed variation in the endowment of entrepreneurship capital.

Since constitutions delineate the pillars of the legal systems that govern organizations and entities in a country, they can be assumed to represent the institutional framework that governs and addresses the main features of social and economic life in a country. For example, the principles introduced by America’s Founders at the Constitutional Convention sessions in 1787 to protect property rights and free markets clearly contributed to promote the conditions for the entrepreneurial dynamism lately witnessed by de Tocqueville (1838), who wrote “What astonishes me in the United States is not so much the marvelous grandeur of some undertakings as the innumerable multitude of small ones” (*On Democracy in America*, Chapter XIX). The widespread acceptance of such principles is certainly among the underlying factors which on July 30, 1953 lead the US Congress to pass the Small Business Act and

create the Small Business Administration, with the purpose to help small businesses to grow and create jobs.

There is debate on whether the explicit inclusion of a right in the constitution represents an effective protection of that right and a powerful tool for fostering the enactment of consistent lower-level laws. On the one hand, constitutions represent higher-rank legal sources, and the universe of subordinated rules and norms cannot oppose their principles and provisions. Constitutional protection therefore grants a special status to rights (Kelsen, 1967), which is likely to make their impact on economic activity notable. On the other hand, it is often argued that not all constitutional rights are implemented *de facto*, which means that constitutional inclusion might have no impact at all on the behavior of economic agents (Chilton and Versteeg, 2016).

It then becomes interesting to assess whether constitutional provisions directly or indirectly favoring the creation and the success of new firms, and which preserve small businesses exert an effective, positive impact on a country's endowment of entrepreneurship capital.

The purpose of the present study is to highlight how certain characteristics of the legal infrastructure of a country may create conditions that enhance new business creation. Thus, it is an exploration of the institutional determinants of entrepreneurship and the way these can affect the observed cross-country differences in the creation of new firms. Our main aim is then to perform an analysis of 199 constitutions, to single out the provisions that enhance economic freedom and are thus likely to create an institutional and legal setup favorable to new business creation. The relevant information on constitutions will be extracted from the *Comparative Constitutions Project: A Cross-National Historical Dataset of Written Constitutions* (Elkins *et al.*, 2009), a repository of valuable data on the formal characteristics of written constitutions for most independent states since 1789. Country-level data on entrepreneurial activity will be taken from the World Bank Group Entrepreneurship Database. The study will try to answer a question of primary importance for the analysis of entrepreneurship: Does the constitutional protection of principles and values which are usually associated with a country's endowment of entrepreneurship capital and

presence of small firms positively influence the rate of new firm formation and the total endowment of entrepreneurship capital in that country? Should this question get a positive answer, one will be legitimated to recommend inclusion of provisions prone to entrepreneurship in the constitution of any country.

The remainder of this monograph is structured as follows. Section 2 discusses the importance of institutions in shaping the entrepreneurship capital of a country and favoring the emergence of entrepreneurial ecosystems. Section 3 describes how higher-rank formal institutions represented by actual constitutional provisions affect the design of lower rank norms and regulations of primary importance for economic activity. Section 4 outlines the features of “economic constitutions”, i.e., of constitutional provisions playing a key role in the management of a country’s economy. Section 5 gives an overview of alternative measures of entrepreneurship and discusses their implications for empirical analysis. Section 6 focuses on the countries that have adopted the principles of “economic constitutions” in their written constitutions and discusses the impact of the *de jure* and *de facto* implementation of such principles on entrepreneurship. Section 7 shows how the prevailing psychological traits of a country’s population may shape the impact of constitutional provisions on its proneness to entrepreneurship and sheds light on the relationship between constitutional provisions and the observed cross-country and cross-industry differences in labor productivity. Finally, Section 8 concludes and provides some recommendations for entrepreneurship policy.

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