

# Globalization and Entrepreneurship: The role of Institutions and Culture<sup>1</sup>

**Alina Sorgner**

John Cabot University, Rome, and Kiel Institute for the World Economy, Kiel, [asorgner@johncabot.edu](mailto:asorgner@johncabot.edu)

**Eckhardt Bode**

Kiel Institute for the World Economy, Kiel, [eckhardt.bode@ifw-kiel.de](mailto:eckhardt.bode@ifw-kiel.de)

## Extended Abstract

This paper investigates the association between global trade integration and entrepreneurship on the backdrop of countries' institutional settings and cultural values. Some studies suggest that globalization encourages firm startups. On the one hand, greater trade integration creates additional opportunities to exploit market niches (opportunity entrepreneurship). On the other hand, tougher import competition forces affected employees to exploit alternative sources of income, including (necessity) entrepreneurship. Other studies suggest that globalization discourages firm startups because it disproportionately benefits incumbent and larger firms. Studies on the decline of economic dynamism in the US and other developed countries argue that falling trade and communication costs affect start-up rates by increasing market transparency at the national and global scale, and by reducing the costs of serving foreign markets. In the presence of increasing returns to scale and imperfect competition, this has arguably both intensified import competition in domestic product markets, and offered especially larger, more productive firms that can afford the high upfront costs of exporting and offshoring additional opportunities to become even more productive by expanding into foreign markets.

Entrepreneurship-friendly reforms of institutional settings or entrepreneurship-friendly changes of cultural values are frequently expected to foster entrepreneurship by reducing the monetary or social barriers to market entry for new firms. They thus can be expected to either magnify potential positive or mitigate potential negative effects of globalization on entrepreneurship.

The present paper shows that the joint effects of trade integration and institutional or cultural changes on entrepreneurship are more complex, however. It investigates the determinants of entrepreneurship rates at the national level in OECD countries during the period since the early 2000s. This period is characterized by both an increase of global trade integration up to the early 2010s and a decrease of trade integration thereafter ("peak trade" phenomenon). To identify the interdependencies between globalization and national institutions or cultural values in their effects on entrepreneurship, we regress different indicators of entrepreneurship rates, including those for opportunity and necessity entrepreneurship, on a standard indicator of trade integration (sum of imports and exports divided by GDP), a variety of indicators of national institutions and cultural values, and the interaction terms of the two. Country fixed effects ensure that the parameters are identified from the variations within countries over time but not from the variation across countries. A rich variety of control variables additionally eliminate possible alternative causes for the observed changes of entrepreneurship rates, which include technological progress (digitalization, robots), demographics (population growth, aging), economic prosperity, human-capital formation and unemployment. Data on entrepreneurship rates are from the Global Entrepreneurship Monitor, a

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large-scale, representative and internationally comparable survey of entrepreneurial activity that has been among the most widely used databases for entrepreneurship research. Using established indicators from this database, we distinguish between opportunity and necessity entrepreneurship as well as between nascent entrepreneurs and those that pay wages. Indicators of national institutions are primarily from the World Bank's Doing Business and Worldwide Governance Indicators Databases. The Doing Business Database quantifies the ease of doing business in a variety of different fields, including starting a business, employing workers, getting credit, registering property, paying taxes, enforcing contracts and trading across borders. The Worldwide Governance Indicators provide the most comprehensive, internationally comparable rating of institutional quality and political stability. They summarize governance indicators from more than 30 sources, including research institutes, think tanks, non-governmental organizations, international organizations and private firms in six dimensions, which are voice and accountability, political stability and absence of violence or terrorism, government effectiveness, regulatory quality, rule of law and control of corruption. Indicators of national cultural attitudes and values are drawn from various different sources, including the World Value Survey, Hofstede's Cultural Dimensions and the Global Entrepreneurship Monitor's National Expert Survey. As usual in the literature, we assume that most cultural values are persistent over time and focus on potential changes in their relevance for entrepreneurship in the context of increasing trade integration. Apparent similarities in the societal values covered by the different sources offer additional scope for robustness checks. The World Value Survey is a large-scale, representative and internationally comparable survey that has been used extensively in economic and social research. We use indicators on personal initiative, individualism, egalitarianism, generalized trust and openness to innovations, among others. Hofstede distinguishes between six Cultural Dimensions, which are uncertainty acceptance, indulgence versus restraint, acceptance of power distance, individualism vs. collectivism, masculinity and long-term orientation. The Global Entrepreneurship Monitor's National Expert Survey relies on an only fairly small sample of experts in each country but focuses on those values that are particularly supportive of entrepreneurship. It also provides time-varying ratings. These values include self-sufficiency, autonomy, and personal initiative; entrepreneurial risk-taking; creativity and innovativeness; and individual (vs. collective) responsibility.

Preliminary regression results suggest that trade globalization has little direct effects of on entrepreneurship rates. The estimated association between trade integration and entrepreneurship rates is small and insignificant almost all regressions. However, the regressions identify indirect effects of trade globalization. They indicate that institutional reforms or cultural changes towards more entrepreneurship-friendly societal values become less effective in fostering entrepreneurship at higher levels of trade integration. Among others, deregulation of worker dismissals is estimated to significantly foster entrepreneurship at low degrees of trade integration but to lose part of its effectiveness as trade integration increases. This estimated loss of effectiveness is stronger for opportunity than for necessity entrepreneurship. Likewise, cultural changes towards greater individualism (vs. collectivism) are estimated to significantly foster opportunity and necessity entrepreneurship at low levels of trade integration but not at higher levels.

The declining role of institutions and cultures for entrepreneurial activity in the course of increasing trade integration of the OECD countries identified in this paper has a number of interesting policy implications. First, institutional or cultural differences matter less in highly integrated economies. Poor institutions are easier to overcome for entrepreneurs with better access to the global markets. Second, entrepreneurship-friendly institutional reforms or changes of cultural values tend to be less effective in globally more integrated countries. Governments of these countries may have to develop alternative tools to foster productivity and income growth.