

Box 3.1

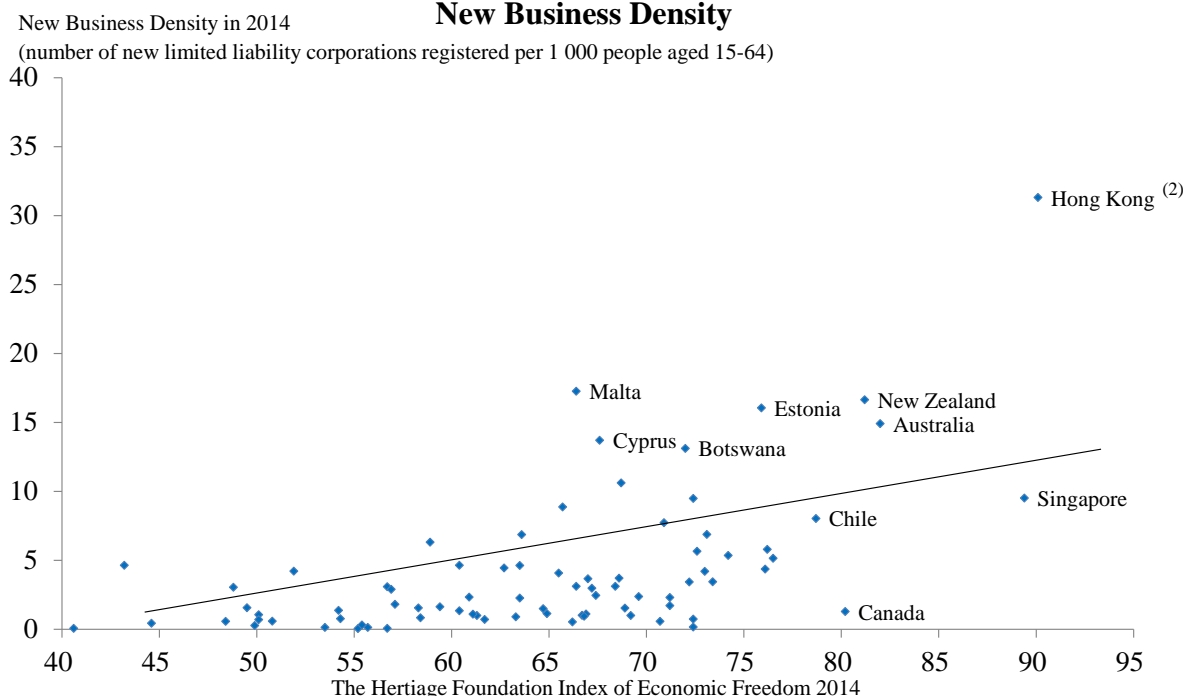
Entrepreneurship and Economic Freedom

Entrepreneurship has always been at the core of Hong Kong’s economic development. Decades gone by, entrepreneurs are behind every turn in the Hong Kong economy, adopting new technologies, establishing new practices, tapping into new geographical markets, venturing into new sectors, thereby propelling productivity growth and providing sustained momentum to Hong Kong’s drive towards higher value-added activities. This article seeks to establish a statistical link between entrepreneurship activities in economies around the world and a certain set of institutional qualities, as summarised in the Index of Economic Freedom by The Heritage Foundation under four main qualities in the Rule of Law, Government Size, Regulatory Efficiency and Open Market.

To measure entrepreneurship, this article adopts the New Business Density from the World Development Indicators provided by the World Bank. It is defined as the number of newly registered corporations with limited liability per 1 000 people aged 15-64.

A casual scatter plot of the New Business Density in 2014 and Index of Economic Freedom 2014 across 80 economies⁽¹⁾ (*Chart 1*) suggests a positive relationship between entrepreneurship and economic freedom.

Chart 1 : The Heritage Foundation Index of Economic Freedom and New Business Density



Sources: World Development Indicators and Terry Miller and Anthony B. Kim, 2014 Index of Economic Freedom (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2014), <http://www.heritage.org/index>.

(1) The number of economies for which both sets of data are available.

(2) According to the Study Report on History of Company Incorporation in Hong Kong released by Companies Registry in 2013, the number of new incorporation surged each year after the CEPA signed in 2003 and the introduction of one-member companies in 2004. Hong Kong’s New Business Density also increased from 13.1 in 2004 to 31.3 in 2014.

Box 3.1 (Cont'd)

To further investigate the relationship, the following regression model is estimated using country-level data from 2005 to 2014:

$$NBD_{it} = \beta_0 + \beta_1 Freedom_{it} + \varepsilon_{it},$$

where NBD_{it} denotes New Business Density for economy i in year t ;
 $Freedom_{it}$ denotes Index of Economic Freedom for economy i in year t .

Column 1 of *Table 1* reports the key results. The coefficient of Index of Economic Freedom is positive and statistically significant. This is fully understandable. A fine tradition of the rule of law that respects property rights and reduces occasions of corruption into rare cases would encourage individuals to start their businesses. A small and disciplined government sector, together with a sound and light regulatory regime, would also create favourable conditions for entrepreneurship, whereas a highly open market that ensure the free flows of people, goods, capital and information would be conducive to new business opportunities.

Table 1 : Regression results with New Business Density as the dependent variable

Independent variables	(1)	(2)
Intercept	-13.209 ***	-1.162 **
Index of Economic Freedom	0.263 ***	0.027 ***
<i>Dummy variables</i>		
D_M		-7.772 ***
$D_M \times$ Index of Economic Freedom		0.162 ***
D_H		-14.285 ***
$D_H \times$ Index of Economic Freedom		0.272 **
Number of economies	126	126
Sample size	933	933
Adjusted R-square	0.284	0.298

Notes: ** denotes statistical significance at 5% significant level; *** denotes statistical significance at 1% significant level.

To examine how the finding above varies with stages of economic development, the base model is further enriched with dummy variables D_M and D_H , together with their interactions with the Index of Economic Freedom. D_M denotes if the economy is classified as either upper-middle-income economy or lower-middle-income economy by the World Bank, and D_H denotes if the economy is classified as high-income economy by the World Bank.

Box 3.1 (Cont'd)

As shown in *Column 2* of *Table 1*, the coefficients of both interaction terms are positive and statistically significant, suggesting that the extent of boosting effect from the same set of institutional qualities on entrepreneurship in economies would vary in different stages of development. In particular, the coefficient of the interaction term of D_H and Index of Economic Freedom is larger than that of D_M and Index of Economic Freedom, indicating a potentially stronger role by economic freedom in entrepreneurship in the more advanced economies. Differences in motivation and nature of entrepreneurship might be the possible reasons behind. Compared to the low-income economies, entrepreneurship in the high-income economies is relatively opportunity-motivated instead of necessity-motivated⁽³⁾. Hence, it is understandable that a better set of institutional qualities is more relevant in enhancing entrepreneurship in the more advanced economies, considering that there are more viable alternatives to entrepreneurship for individuals.

This article points to one of the channels where good institutions lead to economic growth and sustainable development, through fostering entrepreneurship. The Government will continue to upkeep Hong Kong's institutional strength, in the rule of law, a level playing field for fair competition, an efficient public sector, a simple and low tax regime, and an open market for all. At the same time, noting the rising tide of entrepreneurship in the form of start-ups, the Government has also introduced specific measures in recent years to facilitate start-ups that can span across various industry sectors. All these aim at bringing sustainable, diversified and quality economic development in Hong Kong for the years to come.

(3) According to the Global Entrepreneur Monitor (<http://www.gemconsortium.org>), entrepreneurship is opportunity-motivated when individuals perceive a business opportunity and take it. On the other hand, entrepreneurship is necessity-motivated when individuals become entrepreneurs simply because they have no better choices for work.