Fish out of water

Policymakers are turning their minds to the tricky subject of promoting entrepreneurship.

Illustration by Brett Ryder

Unemployment is creeping ever higher. In the United States it will soon exceed 10%. In parts of Europe it is closer to 20%. Around the world young people are finding it all but impossible to get a job.

So far policymakers have focused on rescuing the economy from free fall, boosting demand, however indiscriminately, and rescuing failing companies, however expensively (AIG received $180 billion-worth of government support). But policymakers are beginning to turn their minds to the potentially more rewarding question of creating tomorrow's jobs, rather than trying to save yesterday's. The buzzwords in government circles are entrepreneurship, innovation and venture capital.

This makes perfect sense, in theory. Innovative start-ups are efficient engines of job creation and long-term economic growth. In America start-ups have accounted for almost all the net job creation in the past couple of decades. In the developing world, new technologies are helping to break the cycle of poverty. An extra ten mobile phones per 100 people in a typical developing country boosts GDP growth by 0.8 percentage points, according to the World Bank, by helping small entrepreneurs flourish.

Governments have also played an important role in igniting entrepreneurship. As well as creating some of the vital infrastructure of innovation by investing in higher education, they have also had a direct hand in driving entrepreneurship itself. Governments helped bring into being the venture-capital industry: witness the work of American Research and Development (ARD) after the second world war or the Yozma Fund in Israel in the 1990s. They have also supercharged high-tech clusters: Silicon Valley was created as much by the Pentagon's demand for new kit as by freewheeling entrepreneurs. Most of the world's other great entrepreneurial hubs, from Bangalore to Guangdong, bear the stamp of government intervention.

But replicating these successes is difficult. The road to the entrepreneurial future is littered with failed government schemes. Malaysia's massive BioValley complex, which opened in 2005 at a cost of $150m, is now known as the "Valley of the BioGhosts". Dubai's entrepreneurial hub is awash in a sea of red ink. Australia has little to show for its ambitious BITS (Building on Information Technology Strengths) programme. The European Union's European Investment

Fund, which was started in 2001 with an endowment of more than €2 billion ($1.8 billion at the time), has failed in its mission to burnish the sorry record of the European venture-capital industry.

How can governments do a better job? Two well-timed new books provide some clues: “Boulevard of Broken Dreams: Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed—and What to Do About it”, by Josh Lerner, and “Start-Up Nation: The Story of Israel’s Economic Miracle”, by Dan Senor and Saul Singer.

Mr Lerner, a professor at Harvard Business School, outlines some common failures. Too many countries are seized by ambitions that bear no relation to their particular comparative advantages. Although Malaysia had few skilled biologists, its politicians decided to build BioValley on the ruins of Entertainment Village, an attempt to create a Malaysian Hollywood that failed for lack of media nous.

Too many politicians treat entrepreneurship as yet another gravy train. Norway squandered much of its oil wealth investing in new businesses that were founded by the relatives of politicians and bureaucrats. Policymakers are also lax when it comes to designing venture funds. They try to insulate them from risk or allow public investments to crowd out private ones. The Canadian government’s experiment with venture capital failed because the Canadian Labor Fund Program had so much money that it frightened off private venture capitalists, while earning mediocre returns itself. New Zealand’s government, in contrast, did much better because it invested public money in private funds.

Mr Lerner points out that two foolish tendencies are particularly hard to resist when politicians are struggling with high unemployment. The first is the temptation to spread the wealth around to every region and interest group. France’s attempt to transform Brittany from one of its more backward regions into a hive of high-tech activity failed dismally for an obvious reason: entrepreneurial firms cluster in particular places. The second is a suspicion of foreign investors. The Japanese government lavished money on start-ups in the 1990s but was reluctant to embrace foreign venture capitalists. Japan now has one of the rich world’s weakest venture-capital markets.

Levantine wiles

The country that has led the world in promoting entrepreneurship has also done the most to plug itself into global markets. The Israeli government’s venture-capital fund, which was founded in 1992 with $100m of public money, was designed to attract foreign venture capital and, just as importantly, expertise. The government let foreigners decide what to invest in, and then stumped up a hefty share of the money required. Foreign venture capital poured into the country, high-tech companies boomed, domestic venture capitalists learned from their foreign counterparts and the government felt able to sell off the fund after just five years.

Last year Israel, a country of just over 7m people, attracted as much venture capital as France and Germany combined. Israel has more start-ups per head than any other country (a total of 3,850, or one for every 1,844 Israelis), and more companies listed on the NASDAQ exchange, a hub for fledgling technology firms, than China and India combined. It may not have the same comforting ring as “the Swedish model” or “the polder model”, but when it comes to promoting entrepreneurship, “the Israeli model” is the one to emulate.

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