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Labor market institutions and entrepreneurship: the case of European Union countries

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ABSTRACT

Labor market institutions significantly shape entrepreneurial activity by influencing wage structures, labor costs, and employment conditions. This paper examines the impact of labor taxation and labor unions on entrepreneurship across 27 European countries from 2002 to 2021. These countries provide a unique context, characterized by high labor taxes and strong union presence. Using a panel dataset compiled from multiple sources, including the Global Entrepreneurship Monitor, Eurostat, ILOSTAT, and the World Bank, we explore how these institutions affect different stages and types of entrepreneurship. Our study makes three key contributions. First, we use the labor tax wedge (a comprehensive measure of employer labor costs) as a novel proxy for labor taxation. Second, we assess entrepreneurial activity across various lifecycle stages (nascent to established) and motivations (opportunity- vs. necessity-driven). Third, we investigate the interplay between labor taxation and union strength, a dimension largely overlooked in the literature. We find that high labor taxes reduce entrepreneurial activity, especially among opportunity-driven and later-stage entrepreneurs. While strong labor unions generally discourage entrepreneurship, they can moderate the adverse effects of labor taxation for established businesses. These findings offer important insights for policymakers aiming to balance revenue generation with support for entrepreneurship and job creation.

KEYWORDS labor taxation; labor unions' power; entrepreneurial motivation; entrepreneurial lifecycle

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