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The unintended consequences of easy money: How access to finance impedes entrepreneurship

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Abstract

This paper investigates the manner in which economic policy promotes entrepreneurship, and how this relates to the monetary sources of the business cycle. Whilst access to finance is commonly seen as a crucial means to generate economic growth, efforts to expand the money supply beyond the stock of real savings leads to systemic crises. Therefore the admirable policy goal of promoting more credit for entrepreneurs—whether through access to finance, SME support or regional development—can lead to negative unintended consequences.

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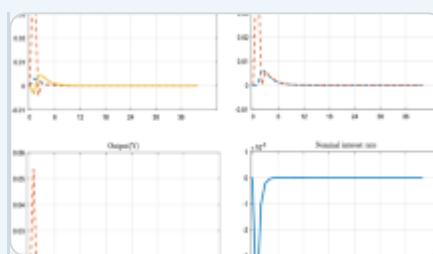
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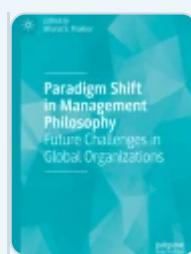
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Notes

1. Notice also that there is a rhetorical difference between these two concerns. Whereas the moral hazard argument implies that *if governments hand out money entrepreneurs may change their plans and behave recklessly*; the adverse selection argument is that *if governments hand out money they'll be enticing the most vulnerable people into market conditions that can not ultimately support them*.
2. “Sound money” is typically used to refer to a monetary system that is tied to the value of a commodity such as gold (i.e., a metallic standard) but more generally refers to a monetary system that is driven by market forces rather than government intervention.
3. By focusing on the functional form rather than practitioners (thereby ignoring leadership) we are not abandoning methodological individualism. On the contrary in this sense “the entrepreneur” is an ideal type, which—in a Weberian sense—is the natural compliment to methodological individualism.
4. Indeed Shane (2008) claims that around a third of business owners “believe that the *best* business ideas come *without searching* for them” (p.69)

It's important to realise that Israel Kirzner wasn't intending to flush out the

5. salient characteristics of an entrepreneur, but to demonstrate the function of entrepreneurship within the broader concept of competitive markets. He sought to raise the profile of entrepreneurship away from being a peripheral concept, to being the central driver of the market process. And this is important, because it shows that entrepreneurship and competition are actually two sides of the same coin. See Kirzner ([1973](#)).
6. Even if the entrepreneur owns capital, it makes sense to view them as lending themselves the money. Indeed in some sense we can only *ever* borrow money from ourselves, albeit our future self.
7. If we define a monopoly as “an enforceable property right in a product or market share” (O’Driscoll and Rizzo [1985](#), p.149) it becomes clear that it is only through regulatory intervention that monopolies *exist*.
8. “Now the chief effect of inflation which makes it at first generally welcome to business is precisely that prices of products turn out to be higher in general than foreseen. It is this which produced the general state of euphoria, a false sense of wellbeing, in which everybody seems to prosper. Those who without inflation would have made high prices make still higher ones. Those who would have made normal profits make unusually high ones. And not only businesses which were near failure but even some which ought to fail are kept above water by the unexpected boom” (Hayek [1996](#), p. 99-100)
9. These are individuals (usually affluent) that supply seed capital for start-ups.
10. A cynic would point out that bureaucrats are incentivised to overestimate the range in which the equity gap appears because this gives them greater funding.
11. See “Finding the cash to go racing”, PriceWaterhouseCoopers, January 2009 [http://www.the-mia.com/assets/PwC_Finding_the_cash_to_go_racing.pdf]

12. This particular survey did not estimate the absolute amount of funding for each threshold. Therefore it is possible that although a certain proportion of investments in the range of £1 m to £2 m are funded by business angels, there are significantly fewer deals for this amount than other thresholds.
13. See “Bridging the finance gap: next steps in improving access to growth capital for small businesses”, HM Treasury and Small Business Service, December 2003
14. See Budget 2005, UK Treasury
[\[http://newsimg.bbc.co.uk/nol/shared/bsp/hi/pdfs/bud05_completereport_1_87.pdf\]](http://newsimg.bbc.co.uk/nol/shared/bsp/hi/pdfs/bud05_completereport_1_87.pdf) Date accessed August 13, 13.
15. There is nothing to say how long such a scheme may last, merely that it cannot exist in the long run. Of course the long run may well be many calendar years in the future. One sign that the scheme is about to run its course is when the rate at which investors withdraw their money exceeds the rate of new money injections. This is the point at which the scheme unravels.
16. In the UK many mortgages are “interest-only”, falling into the “speculative finance” category. Whether the intention of the policy is to help people onto the housing ladder by inducing them to become “speculative” borrowers, which is another matter.
17. This British bank was over exposed to short term borrowing in US markets and in September 2007 required emergency funding from the Bank of England. When news of this broke it prompted a bank run that ultimately led to nationalisation in February 2008.

18. See the website for the Lisbon Agenda
[http://ec.europa.eu/growthandjobs/areas/fiche01_en.htm]
19. A region receives Objective 1 status if it has a GDP per capita of under 75 % of the EU average, or if it has a particularly low population. Hence rich member states qualify (such as Sweden), poor regions within rich member states (such as Merseyside) as well as accession countries (such as Romania).
20. See http://ec.europa.eu/regional_policy/funds/procf/cf_en.htm
21. See "The 2007 EU Funding guide for Private Sector" ISBN:2-914793-60-x and "The 2007 EU funding Comprehensive Guide" ISBN:2-914793-58-8
22. The author of this paper was involved in a consultancy project to advise the EIF on ways to create peer-group analysis of EU regions for the purposes of JEREMIE financing. Evans et al. ([2009](#)) applied this regional perspective to create peer groups based on static factors, dynamic factors, and innovation. This shows that similarities between regions might outweigh the fact that they are in different countries.
23. 2005/601/EC; 12th July 2005
24. Remarks made at 2006 Spring European Council, Brussels, 21st March 2006
[<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/348&format=PDF&aged=1&language=EN&guiLanguage=fr>]
25. See "Putting SME First" - Press package 'SME Policy' 2006" Available at: http://ec.europa.eu/enterprise/entrepreneurship/docs/facts_en.pdf

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