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Evasive Entrepreneurship and Institutional Change

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Abstract: In this paper, we argue that evasive entrepreneurship is an important source of innovation in the economy. Institutions may prevent or raise the cost of exploiting business opportunities, which can trigger evasive behavior because an entrepreneur may earn large rents by circumventing institutional impediments. Paradoxically, institutions may be less of a constraint for entrepreneurs than for other economic agents because entrepreneurs may be better able to evade them. Although evasive entrepreneurship can be both productive and unproductive/destructive, its dynamic character is more important because evasive entrepreneurship may be able to prevent economic development from being stifled by existing institutions during times of rapid economic change. Furthermore, if evasive entrepreneurship becomes sufficiently widespread and economically important, it may trigger a response from lawmakers and regulators, leading to institutional change with potentially important welfare implications. We illustrate this thesis by considering a number of real-word examples of evasive entrepreneurship.

JEL Codes: L5; M13; O31; P14.

Keywords: Entrepreneurship; Innovation; Institutions; Regulation; Self-employment.

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1 Introduction

> The natural effort of every individual to better his own condition … [is] not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operation.
>
> Smith (2004 [1776], p. 316)

Adam Smith saw freedom and security as prerequisites of economic progress, pointing to the importance of institutions such as rule of law, property rights protection, and contract enforcement. Yet, as the citation above suggests, Smith also noted that individuals could circumvent institutional constraints unfavorable to commerce. In recent times, this kind of entrepreneurial activity has come to be known as evasive entrepreneurship.

We argue that evasive entrepreneurship – i.e., entrepreneurship aimed at circumventing the existing institutional framework – constitutes a unique and important source of innovation in the economy. Evasive entrepreneurship is distinct from other types of entrepreneurial activity in terms of its welfare implications (which are more context dependent than other types of innovations) and its interaction with institutional evolution. Compared with other types of entrepreneurship, evasive entrepreneurship interacts more strongly with regulations and institutions, and should therefore be analyzed as endogenously codetermined with institutions.[1] In accordance with Wagner and Runst (2011, p. 135), it is useful to make a ”distinction between selecting rules for a game and playing a game within those rules … [H]owever, the two types of activity occur simultaneously and not sequentially.”

In most theories of institutions and entrepreneurship, causality is understood to run from institutions to entrepreneurship, and some scholars thus conclude that institutions are the main determinant of entrepreneurship (see, e.g., Boettke and Coyne 2003). This conclusion clashes with the Schumpeterian view of the entrepreneur as a rule-breaker (Schumpeter 1934, 1942; Zhang and Arvey 2009). Why would Schumpeterian entrepreneurs merely adjust to prevailing institutions if they can earn rents by circumventing them? Furthermore, why are institutions of particular importance for entrepreneurial activity? Why would institutions not be equally, or even more, important for other types of economic agents?

Paradoxically, our analysis suggests that institutions matter less for entrepreneurs than for other economic agents. The intuition is straightforward; politically determined institutions may prevent or raise the cost of exploiting business opportunities. This triggers evasive behavior, and an entrepreneur may thus earn large rents if he or she can sidestep institutions (Li et al. 2006; Boettke and Leeson 2009). It is frequently unclear whether this type of entrepreneurship is legal or illegal be-

[1] The notion of endogenous rule formation is not new, in and of itself (Aligica 2014). For example, it has been noted that formal law is derived from the accumulation of precedents. In many countries, the role of judges and lawyers has been to articulate and implement habits and customs, which the contesting parties acknowledge as established practices (Hayek 1973; Boettke and Candela 2014).

cause judicial precedence is lacking. Moreover, the lack of resources in the judicial system frequently makes enforcement impracticable.

As with other types of entrepreneurship, the evasive activities may be both productive and unproductive (Boettke and Coyne 2009). When evasive entrepreneurs sidestep regulations and create contracts and patterns of behavior to overcome institutional impediments, these entrepreneurs may cause a positive shift in the production possibility frontier (PPF). However, there may also be negative effects – with respect to public finances, in particular. Tax evasion is a prime example; although illegal and harmful for public finances, it can be productive if the economic activity in question would not occur in the absence of such evasion.

The most important facet of evasive entrepreneurship is its dynamic character. An important feature of political and economic institutions is their relative inertia (Glaeser et al. 2004; Scott 2008). In times of rapid change driven, for example, by a high rate of technological progress or new supplies of resources, economic adaptability may be difficult or impossible when actors abide by existing institutions. In such circumstances, evasive entrepreneurship may be a prerequisite for preventing existing institutions from stifling economic development.

If it becomes sufficiently widespread and economically important, evasive entrepreneurship may trigger a response from lawmakers and regulators. An unfavorable response may ensue when regulators take legal action against the evasive entrepreneur or his clients under current laws, or when lawmakers (if there is currently a legally grey area) undertake an institutional "tightening", i.e., a reform enabling legal actions in the future. A favorable response from the perspective of the entrepreneur may be either inaction (i.e., not enforcing current laws) or an institutional "slackening" whereby the evasive behavior is made (explicitly) legal. These institutional reforms may, in turn, have important welfare implications.

In this study, we follow in the vein of Baumol (1990) and Acemoglu and Robinson (2012), and illustrate the mechanisms and conditions for evasive entrepreneurship by drawing upon a number of real-world examples. First, we consider 20th century China, where evasive entrepreneurship in different periods has resulted in institutional "tightening" and "slackening". Second, we consider the technology-driven evasive behavior by Swedish entrepreneurs in the telecom, television, and finance sectors in the 1980s and 1990s, which, by and large, served to "slacken" institutions as old monopolies were abolished and free-market directed initiatives were undertaken. Finally, we consider evasive entrepreneurial action with respect to the recently emerging sharing economy – particularly American firms that have emerged in the driving and lodging industries – and how this type of action affects institutions at the local, state, and country level.

Our examples have several features in common. First, the actors are entrepreneurial in a Schumpeterian sense, creating and commercializing something new and disruptive. Second, some aspects of the entrepreneurial business models are evasive, i.e., they either engage in evasive behavior or enable others to engage in evasive behavior, such as avoiding regulations and taxes. Third, and as a consequence of the second feature, these entrepreneurs disrupt both market and institutional equilibria. What distinguishes these evasive entrepreneurs from one another is the context in which they operate. Institutional responses to the evasive behavior depend on both the local and national environments, e.g., the strength of incumbent competitors, the existing legal code, the tenacity of lobby groups, political activists, and politicians. The contextual variation makes it possible to better gauge how and why evasive entrepreneurship affects institutions and, in turn, how these institutions shape subsequent entrepreneurial activities.

2 Definitions

2.1 The evasive entrepreneur

There is no consensus in the literature regarding the nature of entrepreneurial talents. Whereas some scholars emphasize cognitive abilities (e.g., Gaglio and Katz 2001; Ward 2004), others point to motivation (preferences) (e.g., Weber 2001 [1905]; McClelland 1961; Rauch and Frese 2000). The properties are consistent with the historical accounts in Schumpeter (1934) and Kirzner (1973, 1992). In our model, entrepreneurial talents make the individual more perceptive to opportunities and more able and prone to act upon these perceived opportunities. While any entrepreneurial action is inherently uncertain (McMullen and Shepherd 2006), the entrepreneurial talents can be understood to increase both the likelihood of entrepreneurial venturing and the probability of success.

The entrepreneur's main function is to introduce and disseminate innovations through profit-driven business activity. Whereas the bulk of entrepreneurial research has addressed the effects of such innovations in the economic sphere, we focus on the effect of innovations on institutions. Hence, the entrepreneur is here driven by profit opportunities, primarily engaged in commercial business activities and engages in institutional entrepreneurship as a means to further those interests (Wennekers and Thurik 1999; Hébert and Link 2006).

Institutions are normally divided into (i) legislative/political institutions, (ii) enforcing institutions, and (iii) regulations, laws and policies. Our analysis is limited to the third category. Furthermore, we confine our analysis to formal institutions imposed through political decisions and to the effect of these institutions that depend on their implementation by government ministries, executive agencies, and the civil service/bureaucracy. Thus, we do not explicitly discuss informal rules such as norms, values, and codes of conduct.

In accordance with Acemoglu et al. (2005a), we distinguish between institutions and the productive economy (defined by resources and technology). Economic institutions particularly important for entrepreneurship include tax codes, social insurance systems, employment protection legislation, competition policy, trade policies, capital market regulation, contract enforcement, and law and order (Hall and Jones 1999; Henrekson and Johansson 2009).

Institutions may entail great costs or altogether block the perceived opportunity. The way in which the entrepreneur can use his talents to respond to institutions falls into three categories: (i) abidance, (ii) evasion, or (iii) act to alter the institutions (*cf.*, Oliver 1991). Webb et al. (2013) point out that scholars who employ institutional theory traditionally examine how institutional pressures lead to activities that conform to prescriptions. Indeed, most entrepreneurship scholars (e.g., Baumol 1990) implicitly assume that entrepreneurs abide by institutions and act within prescribed institutional constraints. However, Li et al. (2006) describe as institutional entrepreneurs those who not only play the role of traditional entrepreneurs in the Schumpeterian sense, but who also help establish market institutions in the process of their business activities (see also Khanna and Palepu 2000; Khanna and Rivkin 2001; Leff 1978).

Evasive entrepreneurs are a type of institutional entrepreneurs who attempt to circumvent the existing institutional framework. This is conceptually different from engaging in rent-seeking, which can be seen as *abiding* by existing institutions. Such evasive behavior is also conceptually different from entrepreneurship directly aimed at *altering* institutions through political activity. Nevertheless, evasive and altering entrepreneurship frequently go hand in hand, and evasive entrepreneurship can have indirect (intended or unintended) effects on institutions (Henrekson and Sanandaji 2011a, p. 53).

As two brief examples of the difference between evasive and altering entrepreneurs, consider first the effect of the opening of Atlantic trade. Acemoglu et al. (2005b, p. 550) posit the following: “From 1500, and especially from 1600, onward, in countries with non-absolutist initial institutions and easy access to the Atlantic, the rise in Atlantic trade enriched and strengthened commercial interests outside the royal circle and enabled them to demand and obtain the institutional changes necessary for economic growth.” Next, consider Silvio Berlusconi, who influenced Italian institutions, both in his role as a businessman and as a politician. In the first role, he established a system of local stations to broadcast the same TV programs simultaneously. This circumvention of the law challenged the public monopoly on national broadcasting, and this evasive entrepreneurial act eventually led to free competition in broadcasting. Berlusconi later made use of his media platform to launch his political career and employed his political power to substantially alter Italian institutions and further his own business interests. (Henrekson and Sanandaji 2011a, p. 66).[2]

According to Boettke and Coyne (2003), proxies for evasive activities include the size of the black market and the extent of tax evasion. The size of the black market sector across countries appears to be negatively related to the institutional quality of a country, as OECD countries have the smallest relative black market size whereas the most ill-functioning developing countries have the largest (Schneider et al. 2010). It has also been suggested that corruption may be a substi-

[2] Nevertheless, it is rare in developed countries that entrepreneurs become involved directly in the political process, in part because of the increased separation between political and economic institutions. By contrast, a despotic ruler or a small clique can only wield significant discretionary power when political institutions, political power, and economic institutions are closely connected. This situation is most common in developing countries in which the ruling elite benefits from inappropriate institutions and thus contributes to preserving the *status quo*, irrespective of welfare costs (North 1981; Lundahl 1997), such as in contemporary Zimbabwe.

tute for poor institutions, serving as grease rather than sand to the economic wheels. As Carden and Verdon (2010) state, “corruption can increase growth by allowing entrepreneurs to circumvent barriers to trade.” Djankov et al. (2002) find that in countries with high entry costs and regulations, the size of the informal economy is higher. According to Naudé (2007), the size of the informal economy indicates the existence of evasive entrepreneurship.

However, not all evasive actions are instances of evasive entrepreneurship. If, for example, corruption is widespread and part of the routine workings of the economy, it is no more entrepreneurial than the activities of small, non-growing firms that abide by institutions (*cf.*, Henrekson and Sanandaji 2014). Evasive activities should have a Schumpeterian element to them to be considered entrepreneurial.

2.2 Institutional consistency

What properties of institutions motivate and enable entrepreneurs to evade them? What we will call institutional consistency is critical to understanding this question. The literature on contract incompleteness has long since recognized that writing a contract to cover all possible situations and all states of the world can only be achieved – if even possible – at sharply increasing costs (Hart and Moore 1988). The same reasoning applies to regulations instituted by governments. To some extent, labor laws, tax codes, and environmental regulations are all open to interpretation and inapplicable to exceptional cases.

Theoretically, we may think of a regulation as a written document that prescribes a sanction to some behavior/activities. Consistency can then be defined as the extent to which a given behavior/activity is unambiguously mapped to a sanction. Moreover, we may define *intra-consistency* as consistency within one type of regulation (e.g., the tax code), and *inter-consistency* as consistency between different types of regulations. The latter notion is motivated by the fact that a certain behavior may be subject to sanctions based on different regulations that do not always provide consistent sanctions. Another dimension of the inconsistency is geographical, and different polities (cities, states, countries) have different rules. An entrepreneur can exploit these inconsistencies by locating where rules are less binding or less enforced, provided that there is free movement. Additionally, one may mention what Webb et al. (2009) define as institutional incongruence, i.e., a difference between what formal and informal institutions define as legitimate. Entire communities or identity-based groups can adhere to norms, values, and beliefs that conflict with laws and regulations (Safran 2003).

For an example of institutional inconsistency, consider the many countries and states where the use of soft drugs such as cannabis has been legalized or decriminalized. Oftentimes, it is still illegal (and penalized) to produce or distribute these drugs for market transactions. Hence, the legal (or non-sanctioned) use of soft drugs could not occur without previous illegal activity. Furthermore, under federal law in the U.S., the use, possession, sale, cultivation, and transportation of cannabis is illegal. However, the federal government has given states the choice to decriminalize cannabis for recreational and medical use if they want to. As a result, a number of states have decriminalized cannabis to varying degrees, or created exemptions for medical use. The emergence of this institutional inconsistency may in part be driven by institutional incongruence, as a majority of Americans now seem to favor legalization of marijuana (Gallup Politics 2013).

Institutional (in)consistency carves out a role for entrepreneurial innovations. If an activity is not mapped consistently to a sanction, there is scope for entrepreneurial innovations that increase the likelihood of the least costly sanction. If questioned by enforcing authorities, a talented entrepreneur may know how to appeal to inconsistencies or loopholes in the rules in a manner that prevents legal bodies from reaching a clear-cut verdict.

This view also puts lobbying in a new light. In the previous literature, lobbying has been the prototypical case of acting to change institutions. Yet the changes may take forms other than an explicit wording that favors the interests of one group or another. Substantial lobbying efforts may be aimed at introducing institutional inconsistencies, allowing the entrepreneurs pushing for these changes to sidestep the regulation at a later stage.

In general, the effect of evasive entrepreneurship on institutions is indirect. Such entrepreneurial activities do not alter the formal institutional setup; instead, they alter the *de facto* effect of institutions previously in place. Inconsistencies in the institutional framework can be used innovatively to appropriate rents from a third party. A business-owning entrepreneur may engage in evasive entrepreneurship to reduce his or her own costs. Other entrepreneurs may found businesses based on the idea of enabling others to circumvent institutional barriers (Henrekson and Sanandaji 2011a, p. 56–57). In fact, entire sectors of the economy can be considered responses to costly institutions, such as ferry traffic on international waters as a response to high alcohol taxes, or hiring labor from staffing service companies to circumvent employment regulations.

Conversely, evasive behavior, if sufficiently widespread, may induce reforms in existing institutions. We argue that this force of institutional change is both common and underrated. Evasive behavior tends to weaken the evaded institutions; a formal institution not regularly enforced is likely to lose its practical relevance. As evasion is replicated and spreads, regulation loses some of its bite, and may, in time, be abolished or modified in response. This race between regulators and innovative evaders is a defining feature of much evasive entrepreneurship.

3 Welfare implications of evasive entrepreneurship

In accordance with basic microeconomic assumptions, we argue that entrepreneurs use their talents to maximize individual utility, not social welfare. Thus, evasive entrepreneurship is not necessarily welfare enhancing; it can be productive or unproductive, depending on the circumstances. Baumol (1990) distinguished different types of entrepreneurship by their normative implications.[3] The most productive forms of entrepreneurship are closely related to Schumpeter's (1934) discussion of new combinations of resources and technology in the market, combinations that create positive social value. Less productive entrepreneurship entails some combination of rent-seeking technologies that enables the entrepreneur to appropriate rents from other agents. Depending on how an activity is classified in terms of productivity, entrepreneurship shifts the production possibility frontier (PPF) outward (more productive) or inward (less productive) (Coyne and Leeson 2004).

If a business activity would not have occurred at all without evasive actions, they may indeed be productive. At other times, the evasion of institutions results in wasted resources (such as costly cross-border smuggling, rather than regular bulk import). Other destructive/unproductive responses to institutional flaws may include outright theft, litigation, and more sophisticated economic crimes.

There may be a fine line between activities that are downright illegal and activities that are simply not regulated because they are new and unknown. One salient example is the emergence of India's IT sector, which was at first ignored by the typically quite interventionist government, which did not understand its economic significance. The industry proved successful and generated economic value, and has since remained relatively unregulated. Rather, this sector "has forced the government to mend and repeal many a petty control: working on national holidays; allowing women to work on night shifts; and allowing offices to function twenty-four hours a day all year" (Shah and Sane 2008, p. 318).

Sidestepping regulation is a common type of evasive activity. The welfare consequences largely depend on the nature of the sidestepped institution, and on the business activity pursued. When sidestepping entails corruption, such as bribing a bureaucrat to look the other way, sidestepping may well serve as grease to the wheels of poor institutions (Klapper et al. 2006; Dreher and Gassebner 2007; Méon and Weill 2008). Similarly, the consequences of creating contracts to overcome institutional impediments largely depend on the nature of the activity such contracts enable. If the activity facilitates lobbying, rent-seeking, and tax avoidance, it may be welfare-reducing – but not if it enables actors to pursue productive business opportunities that they would not have otherwise pursued.

Institutions can be described as efficient or inefficient, depending on their effects on productive activities. If an institution stifles productive entrepreneurial activity, sidestepping the institution may well be welfare-enhancing, notwithstanding the fact that it is mainly driven by an incentive to earn profits. Productive examples include the pursuit of contractual arrangements to escape costly institutions (Douhan and Henrekson 2010). In such a case, the evasive activity is a necessary input

[3] Sobel (2008) finds empirical support for Baumol's theory, whereas Stenholm et al. (2013) find that differences in national institutional arrangements are associated with variance in both the rate and type of entrepreneurial activity across countries. However, the regulative environment matters less than knowledge spillovers and access to capital for the formation of innovative, high-growth new ventures.

in the production process. Hence, evasive entrepreneurship may provide a welfare-enhancing second-best substitute for inefficient institutions, but there is the concurrent risk that it may also reduce welfare.

Table 1 provides a list of evasive activities with respect to economic institutions with great importance for entrepreneurship (Hall and Jones 1999; Henrekson and Johansson 2009). An attempt is also made to identify whether there is a role for entrepreneurs in these evasions, and whether the activity is likely to be productive or unproductive. Below, we briefly comment on the categories listed in the table.

Table 1. Examples of evasive entrepreneurship vis-à-vis certain key institutions.

Economic institution	Example of evasive activity	Entrepreneurs	Productive/ unproductive
Tax code	Tax avoidance, the legal use of the tax regime to one's own advantage, e.g., by purchasing municipal bonds in the US. Tax evasion, illegal evasion of taxes, e.g., by deliberately misrepresenting the true state of affairs to tax authorities.	Tax consultants	p/u
Employment protection legislation	Hiring labor from staffing service companies to circumvent employment regulations.	Staffing service companies	p
Competition policy	Establishing peer-to-peer networks, e.g., in housing and transportation, to avoid hotel and taxi market regulations.	Peer-to-peer firms	p
	Secret agreements to circumvent poor economic policies, e.g., by Chinese farmers.	Chinese farmers	p
Capital market regulation	Creating new financial instruments not covered by the existing legal code to help address risk	Financial innovators	p
	Credit default swaps to help firms avoid capital regulations by technically removing risk from the balance sheet.		u
Trade policy	Cross-border smuggling.	Smugglers	p/u
Enforcement of contracts	Selling contractual arrangements that change the impact of a certain institution.		p/u
	Bribing a government official to obtain a contract.		u
Law and order/ property rights	Protection enhancing the workings of beneficial – but poorly implemented – institutions.	Mafia, security service firms	p
	Extortion, theft.	Mafia, warlords	u
	An informal sector in which firms operate without legal titles due to excessive regulation.	The poor in developing countries	p/u
	Self-governing in the commons, dividing up commons into private ownership.	Property rights entrepreneurs	p

Tax avoidance (legal) and tax evasion (illegal) are two typical examples of evasive entrepreneurship. Taxes that reduce the opportunities for individual wealth can be expected to have a negative effect on entrepreneurship (Hansson 2012; Henrekson and Sanandaji 2011b), as can the administrative burden associated with taxes (Djankov et al. 2008). Evading them or enabling others to evade such taxes may therefore shift the PPF outwards. However, the tax effect is sensitive to the potential for arbitrage between tax bases, suggesting that this may in fact be an unproductive activity (Gentry and Hubbard 2000; Parker and Robson 2004; Cullen and Gordon 2007). Self-employment may in and of itself facilitate tax evasion; Engström and Holmlund (2009) estimate that Swedish households with at least one self-employed member underreport their total incomes by approximately 30 percent.

Many empirical studies meanwhile suggest that rigid labor market regulations have a negative impact on entrepreneurial activity (Klapper et al. 2006; Micco and Pagés 2006; Autor et al. 2007; van Stel et al. 2007; Kugler and Pica 2008; Stephen et al. 2009) and the negative effect appears greatest for opportunity-based entrepreneurship (Ciccone and Papaioannou 2006; Ardagna and Lusardi 2010; Bosma and Levie 2010). Staffing service companies that provide a way to circumvent such regulations may therefore induce an outward shift in the PPF.

As for competition policies, excessive rules and procedures risk discouraging potential entrepreneurs (Dana 1990; Gnyawali and Fogel 1994; Djankov et al. 2002; Begley et al. 2005) and hamper the process of creative destruction (La Porta et al. 1997, 2000; Caballero and Hammour 2000; Desai et al. 2003). Evasive entrepreneurship that offers a way around such competition regulations may lead to an outward shift in the PPF. We will present some evidence of entrepreneurs who broadly fall into this category in sections 4.1 and 4.3.

When capital market regulations are circumvented in order to create new instruments to help address risk, this may result in an outward shift in the PPF (one example of this will be given in section 4.2). On the other hand, much financial innovation may be of a more destructive character. A prime example is the 2008 financial crisis, where actors in the sub-prime security market had exploited implicit government guarantees and used credit default swaps to avoid capital regulations by technically removing risk from their balance sheets (Skeel and Partnoy 2007; Calomiris 2009a, 2009b).

Trade policy, in turn, may be circumvented by cross-border smuggling, which creates economic activity that otherwise would not have occurred. It is, however, unclear whether smuggling enhances social welfare (Bhagwati and Hansen 1973; Lovely and Nelson 1995). Furthermore, if trade regulations are motivated by environmental or health concerns, such evasion may have high societal costs.

In general, contract enforcement regulation affecting the efficiency of the legal system tends to improve the potential for entrepreneurship and innovation (Djankov 2008, La Porta et al. 2008, Aidis et al. 2009). Hence, evasive activities that try to alter the impact of a certain arrangement can be expected to have a negative effect on productivity. If, however, the contract enforcement regulation is flawed, circumventing it may shift the PPF outwards.

The institutions governing the protection of property rights are regarded as fundamental to the promotion of entrepreneurial activities conducive to knowledge and growth (Baumol 1990; Johnson et al. 2000; Boettke and Coyne 2003; Spencer and Gomez 2004; Acemoglu et al. 2005a; Powell 2008). However, Ostrom (1990) has documented the great diversity of institutional forms that a variety of groups have discovered and developed in their efforts to govern people with not state involvement. These institutional forms are often functionally equivalent to private property rights in limiting access, assigning responsibility, and introducing penalties. In the extreme case, even outright illegal evasive activities, for example, activities by the Mafia, may have a welfare-improving element to them. Under unstable institutional circumstances, organized crime can provide a measure of stability and predictability that enables agents to undertake productive economic activities (Bandiera 2003; Milhaupt and West 2000; Sutter et al. 2013). As Milhaupt and West (2000, p. 43) argue, this result is "an entrepreneurial response to inefficiencies in the property rights and enforcement framework supplied by the state" (*cf*., Boettke and Leeson 2009, p. 255). Whether this response outweighs the unproductive activities such syndicates also engage in is another matter.

Furthermore, De Soto (1989, 2000) has written extensively about the informal sector of the economy in which firms operate without legal titles due to excessive regulation, usually in developing countries. While formally illegal, these entrepreneurs may create economic value that would not have been created without circumventing laws. Sinclair-Desgagné (2012, p. 19) argues that both least confident necessity-driven entrepreneurs and "the best or most optimistic entrepreneurs might actually choose the informal sector when the relative benefits of formal ventures are small (a situation more likely in poor countries)". On the other hand, studies finding a positive link between entrepreneurship and economic development and technology advancement are usually based on registered business data, while studies finding a negative link are usually based on data which include both formal and informal entrepreneurship (Thai and Turkina 2014).

In the short run, the effects on the PPF from evasive entrepreneurship depend on the nature of the entrepreneurial activity that the evasion enables. If it enables the reallocation of resources to the pursuit of profitable business activities, it may well be socially productive. However, if it enables lobbying, rent-seeking, or risk-obscuring, it may cause a negative shift in the PPF.

From this perspective, the existence of evasive entrepreneurship may provide an explanation for some of the unexplained variation from studies that examine the link between institutions and economic growth in a regression framework. In other words, this phenomenon may offer insight into why some countries function better than expected. For example, GDP per capita in Greece is approximately 40 percent lower than in Sweden (World Bank 2014), whereas a much greater income difference might be predicted based on the difference in institutional quality between the two countries.[4]

Gennaioli et al. (2013) study the determinants of regional development in 110

[4] For example, Rodrik et al. (2004) find that the quality of institutions is much more important in explaining country incomes than other factors, such as geography or trade/integration. The *R*-square in their main IV regressions is between 0.37 and 0.66. These authors state that (p. 136) "[o]ur estimates indicate that an increase in institutional quality of one standard deviation, corresponding roughly to the difference between measured institutional quality in Bolivia and South Korea, produces a two log-points rise in per capita incomes, or a 6.4-fold difference."

countries and find that institutions cannot explain any of the cross-regional differences *within* countries (p. 107). Instead, these researchers assert that (p. 109) “the evidence points to a large influence of entrepreneurial human capital, and perhaps of human capital externalities, on productivity.” It may be argued that the evasive actions of entrepreneurs provide second-best substitutes when institutions are inefficient, accounting for some of the previously unexplained variation.

In addition, we should also consider the long-term (welfare) effects resulting from institutions responding to evasive entrepreneurship. These effects depend on the direction and magnitude of the institutional change. If reforms result in a move toward more efficient institutions, the long-term welfare gains may be substantial. As with all reforms, there are important considerations, such as whether losers from the institutional change should (and could) be compensated (Sansing and Van Doren 1994). It follows from the Kaldor-Hicks criterion that an institutional reform is efficient if the gain from it – at least theoretically – could fully compensate losers. The prospect that institutional change depends on the productive nature of the evasive entrepreneurial activities is important. In particular, if evasive entrepreneurship is welfare enhancing, it creates additional resources *prior* to undertaking any reform. These resources may be used to compensate the losers from the institutional reform, thereby facilitating the reform. If, however, evasive entrepreneurship reduces welfare, it is more likely to meet opposition and to ultimately result in institutional “tightening”. In the financial sector for example, evasive entrepreneurship in the sub-prime security market caused institutions to “tighten”, i.e., making them more binding and comprehensive.

In this respect, it is important to consider that the gains from institutional reform are often uncertain in advance. To again name the case of the emerging Indian IT-industry, a prime reason why regulators ignored this sector was because they failed to see its future economic significance (Shah and Sane 2008). The actions of evasive entrepreneurs serve as an educational source when there is such uncertainty, as their provision of second-best substitutes for inefficient institutions may demonstrate, on a smaller scale, the economic consequences that might result from institutional change. This is akin to the emphasis by some development economists on bottom-up, market-based strategies for endogenously transforming least developed countries (Collier 2007; Easterly 2008; Powell 2008). In this market-based approach, entrepreneurial projects are seen as experiments that are retained only when positive feedback is received from the poor (McMullen 2011). In the words of Coase (1988, p. 30), “without some knowledge of what would be achieved with alternative institutional arrangements, it is impossible to choose sensibly among them.” As such, the actions of evasive entrepreneurs may alter perceptions of what is desirable and feasible, thereby altering the prospects for reform.

Whether reforms occur and what form they will take are questions that also depend on the nature of the regime. For example, Wintrobe (1990) argues that a “tin-pot” dictatorship – in which the dictator solely desires to minimize the costs of staying in power to collect the fruits of office – is likely to increase repression when there is negative economic change and reduce repression where there is positive economic change. A totalitarian regime, which strives to maximize its power over its population, will respond in the opposite manner. Furthermore, good economics is not necessarily the same as good politics, and regimes must consider subsequent political responses to institutional change to avoid coup d'états, for example (Acemoglu 2010, p. 11).

4 Examples of evasive entrepreneurship

In this section, we follow in the vein of Baumol (1990) and Acemoglu and Robinson (2012) and illustrate evasive entrepreneurship by exploring some real-world examples. The examples are intentionally gathered from vastly different institutional settings, but are all chosen with the purpose of identifying the rules being evaded, the specifics of the evasive action, and the actors or firms that can be labeled Schumpeterian entrepreneurs.

4.1 Evasive entrepreneurship in China[5]

Developments in China after Deng Xiaoping rose to power in 1978 offer an example of how evasive entrepreneurship can erode the relevance of institutions. Deng initiated reforms that extended the scope of private enterprise, but these reforms were largely a reaction to prior entrepreneurial actions. For example, contracts had been previously implemented that allocated land to households on a long-term basis and allowed farmers to retain profits. At the time of its official endorsement, the practice had already been widely adopted.

This transformation was due to the actions of a number of farmers in a poverty-stricken village in the Anhui province. The farmers decided to evade the perverse incentives created by forced collectivization by secretly dividing up the land and allowing each household to work alone. Although they had the implicit support of local reform-minded officials, the farmers nevertheless ran the risk of jail sentences. This framework proved to be a big success, as the subsequent year's grain production equaled the total of the production from the previous five years combined. Faced with the success of the innovation and with lobbying by local governments, the central government validated and propagated the Household Contract Responsibility System (HCRS), which became the foundation of China's agricultural reform (Li et al. 2006). The farmers' evasive entrepreneurship provided a second-best substitute for inefficient institutions. Only after the emergent process of *de facto* privatization did the government implement it *de jure* (Coase and Wang 2012, p. 154). The reforms made in response to the evasive entrepreneurial initiatives had large welfare enhancing effects.

Another part of the Chinese reforms was a policy enforced in 1981 that allowed limited private enterprise, but with severe restrictions on the maximum number of employees. In practice, these limitations did little to restrict the size of private

[5] Our account draws on Lu (1994, Ch. 4).

firms. In 1986, an official survey showed that a great many firms had exceeded the stipulated limits. In response, new institutional reforms in 1987–88 legitimized the status of these firms. Lu (1994, p. 117) concludes that “the Chinese policymakers did not pre-design the boom of the private sector in the 1980s and the relating changes in institutions. In many cases, what happened was the official adaptation to reforms initiated by private entrepreneurs.”

These examples illustrate how politicians can respond to evasive entrepreneurship through an institutional “slackening”, i.e., by initiating reforms that are beneficial to the entrepreneurs. However, this outcome is by no means given. Evasive entrepreneurship can also induce regulators to drastically “tighten” the institutional setup. An earlier period of Chinese history provides an illuminating example. The move to a full-blown socialist regime after the Communist Revolution in 1949 was a gradual process completed in 1957. Entrepreneurs were still allowed to operate in the market and respond to market signals, but the institutional reforms brought about far-reaching changes in the way entrepreneurs operated, as their activities were reduced to contests for processing orders and escaping controls. Concurrently, the system offered ample opportunities for the officials in charge to earn rents through corruption.

The consequences for the economy as a whole were highly detrimental. In 1951, the government began to strike at the “five evils”: bribery of government officials, tax evasion, theft of state property, cheating on government contracts, and theft of economic information for speculative purposes. Blame was laid largely at the feet of the private sector and resulted in accelerated collectivization and nationalization of resources. The evasive activities quite possibly were the second-best option in response to inefficient institutions and enhanced welfare. Nevertheless, they triggered a regulatory response that was detrimental to those activities.

4.2 Evasive entrepreneurship in Sweden[6]

In Europe and North America, the emergence of new and disruptive technological solutions (notably the microprocessor) resulted in an escalating conflict between entrepreneur-driven solutions and existing institutional solutions in the 1980s and 1990s. At that time, many markets were traditionally organized along national lines. In particular, in the early 1980s, the European telecom, television, and finance sectors were still highly regulated, typically with strict limits on entry, pricing, and marketing. Starting companies and introducing new products in these markets was *de facto* infeasible (Jörnmark 2013, p. 15–22).

Therefore, technological knowledge and economic resources were seldom sufficient for an entrepreneurial venture to succeed in these sectors. Instead, entrepreneurial venturing had to be combined with a good understanding of the workings of the relevant political and legal systems. In particular, entrepreneurs stood to gain much by exploiting growing inconsistencies in institutions across countries – a form of institutional arbitrage. Furthermore, because little was known regarding

[6] Our account draws on Jörnmark (2013).

the new technology in this area, there was generally an absence of clear regulations surrounding such technology. Entrepreneurs could exploit such legislative gaps. At the same time, the risk was substantial; institutional reforms in response to the new technologies and the evasive behavior of entrepreneurs were more or less inevitable, but it was far from clear whether they would result in a "tightening", i.e., extensive new regulation in combination with strong barriers to international trade, or "slackening", i.e., liberalization (Jörnmark 2013, p. 24–41). The emergence of pirate radio stations along the European coasts is an early example of a tightening. The pressure against state radio monopolies had become massive, but the result was an expansion of sea borders in the 1960s. According to Jörnmark (2013, p. 62), the challengers did not yet have sufficient technological advantage, and thus the *status quo* could be maintained.

Sweden was at the forefront of the legal struggles of the era, in large part due to the pressure exerted by two technological entrepreneurs, Jan Stenbeck and Olof Stenhammar. The technologies they exploited enabled them to establish companies in previously small or nonexistent niches of the telecom, TV, and finance markets, which were not covered by the existing monopolies until that point. The impetus of institutional change, meanwhile, came from their opponents. When their ventures became successful, the traditional forces attempted to either ban or socialize their activities. Stenbeck and Stenhammar spent a large part of the 1980s defending their ventures. In so doing, they were ultimately successful (Jörnmark 2103, p. 62–64). Three examples from this period serve to illustrate our point.

Example 1. Telecommunications. In one week in 1981, Sweden obtained the world's first two cellular mobile systems: the NTM system of Televerket (Sweden's government agency responsible for telecommunications) and the Comviq system established by Stenbeck. Comviq was approved by the Minister of Communications because, at that time, cellphones fell outside the telecom monopoly. Because it had invested substantially in NTM, Televerket lobbied for more stringent regulation and an expansion of its monopoly to include cellphones. While arguing its case, Televerket used strongly protectionist rhetoric, which made its position unpopular.

In 1985, Comviq applied for permission from Televerket to establish Skyport, a satellite B2B line between Sweden and the U.S. The request was denied by Televerket. This application was essentially a legislative trap set by Stenbeck and his company, Kinnevik. Because Comviq wanted to establish their own independent network, Kinnevik could press charges against Televerket for erroneous application of the radio law and an attempt to create an illegal monopoly. In 1988, the Minister of Communications allowed Skyport's application. A fierce debate regarding the state monopoly resulted in a government bill advocating competition and leading to the dismantling of the telecommunications monopoly. Televerket's defense of its own position ultimately backfired, as regulators moved to abolish the Swedish telecom monopoly, four to five years before any of its Western European counterparts (Jörnmark 2013, p. 89–102).

Example 2. Television. Kinnevik also circumvented the Swedish TV monopoly by using the Astra Satellite, which was launched from Luxembourg, for broadcasts by the new channel TV3.[7] The cable supply was regulated from 1986 onwards by the cable law, a large part of which ensured the prohibition of commercials directed at Sweden. Low frequency satellites such as Astra were not covered by the law; therefore, Kinnevik's new venture operated in a legally grey area. Just before the launch of Astra in 1988, full-page ads in the Swedish press marketed TV3 as a new advertising medium directed at Swedish customers.

The Swedish Cable Board determined that TV3 had not broken the cable law and that it was allowed to operate. A member of the board observed that the commercials could not be banned unless new legislation was enacted. Two months later, a government commission was launched with the purpose of exploring options for the future of this field (Blomberg and Larsson 1990). The commission eventually concluded that, given the new technological landscape, it was no longer beneficial to ban commercials on Swedish television. The stringent measures that would be required to achieve this goal risked jeopardizing other television-related political priorities (Jörnmark 2013, p. 120–125).

Example 3. Finance. In 1984 Olof Stenhammar founded Optionsmäklarna (OM), which became Sweden's first marketplace for stock options and the world's first privately held, profit-driven, electronic stock exchange. Stenhammar had realized that there was no Swedish legislation covering financial derivatives. Stock options and other derivatives were not defined as financial instruments. Therefore, they were not subject to the stock-market monopoly. As a result, there were no formal barriers to creating a marketplace for stock options although, in practice, agents had to heed the views of the Swedish Bank Auditing Agency.

OM's result vastly exceeded expectations. One reason for its success was that options were extremely favored from a tax standpoint because the tax for options was generally calculated on a tenth of the value of the underlying stock. This intra-inconsistency in the tax-code was unintentional but extremely beneficial for options trading. The Securities Market Committee was at first rather skeptical vis-à-vis the new exchange, but their view was altered following successful lobbying by OM, and its final suggestion was that the stock-market monopoly be abolished and replaced by a concession procedure (Jörnmark 127–162).

As these three examples suggest, neither Stenbeck nor Stenhammar made a frontal assault on existing institutions. Instead, they moved into previously unoccupied – and therefore largely unregulated – market niches, in which they could engage in productive ventures. Concurrently, they could challenge the monopolies from the inside. Regarding Comviq, cellphones fell outside Televerket's copper wire monopoly, and the agency's own attempts to expand its monopoly rights backfired. Similarly, the television monopoly only covered ground-distributed television, and the cable law did not address broadcasting via low frequency satellites. Final-

[7] Daniel Johannesson, Kinnevik's CEO, claimed that Stenbeck intentionally used the Astra satellite as a means to demolish the TV monopoly: "By putting up a satellite with such strong transmission power to enable reception by individual dishes, it would be possible to circumvent the TV monopoly. Technological development, that is, would make the TV monopoly impossible to maintain. That was the idea." Quoted from Ewertsson (2001, p. 281).

ly, there was no existing legislation regarding options instruments, except that the Swedish Stock Exchange was not allowed to engage in derivatives trading. It should be noted that neither Stenbeck nor Stenhammar ever actively demanded the abolishment of any of the monopolies in any of these instances; however, that was the ultimate outcome of their evasive entrepreneurship. Although the bulk of their evasive activities were productive, the greatest welfare effects likely resulted from the subsequent moves toward more efficient institutions governing telecom, television, and finance.

4.3 The sharing economy

The sharing economy can be described as a socio-economic system built around the sharing of human and physical assets, whether through creation, production, distribution, trade, or the consumption of goods and services by different people and organizations. This economy includes a wide range of emerging peer-to-peer businesses, such as social lending and crowd-funding (e.g., Prosper, Lending Club, and Kickstarter), peer-to-peer accommodation (e.g., Airbnb, VRBO), peer-to-peer task assignments (e.g., Mechanical Turk, Ushahidi, and TaskRabbit), and peer-to-peer ride sharing/car sharing services (e.g., Uber, Lyft, and Zipcar).

The emergence of such firms is driven by a number of factors. Societal drivers include increasing population densities, which enables sharing with less friction (Kriston et al. 2010), and the effects of growing environmental awareness on consumption patterns (Porter and Kramer 2011). Economic drivers include the desire to monetize excess or idle inventory and resources (Botsman and Rogers, 2012), increased financial flexibility, and an influx of venture capital (Chui et al. 2012), in addition to the realization that access to expensive and luxury goods is more important than ownership. Technological drivers that reduce transaction costs include social networks that match supply and demand (Constantinides and Fountain 2008), mobile platforms and GPS mapping in real time (Black and Lynch 2004), and e-commerce payment systems enabling trust and quick transactions (Black and Lynch 2004; Nakamoto 2008).

The emergence of peer-to-peer businesses may also be driven by regulatory factors as a means of circumventing existing regulations. Jenelle Orsi, director of the Sustainable Economies Law Center, notes that the sharing economy exists in an "economy sandwich", a grey area located somewhere between less regulated private ownership and highly regulated public commerce (Guardian 2013). In other words, the areas of the economy in which these firms operate are characterized by regulatory inter-inconsistency.

Many academic studies identify excessive regulation as an important barrier to new entry (Begley et al. 2005; Dana 1990; Djankov et al. 2002). An article from the *New York Times* (2014) observes that, until recently, startups generally avoided heavily regulated areas – such as industries involving transporting people and renting rooms – because not even well-funded startups had the requisite funds, time or patience to wrestle approval from bureaucrats. Presently, according to the

NYT, this situation appears to be changing, in a manner that is similar to Silicon Valley's collective determination a few years ago that it is "[b]etter to ask forgiveness than permission". In a conference on the sharing economy in 2013, Kevin Laws of the site AngelList (which unites startups and investors) said, "the approach almost all start-ups take is to see if they can be successful fast enough so they can have enough money to work with the regulators" (Santa Clara Law 2013), which applies to many peer-to-peer firms.

The most prominent peer-to-peer businesses are based around accommodations and cars, which is not surprising, given that such items are expensive to buy but are widely owned by people who do not make full use of them (*The Economist* 2013). We consider the activities of a few firms in these industries in more detail.

Example 1. Rides for hire. The business idea of companies such as Uber and Lyft is to summon rides-for-hire via smartphone applications.[8] Neither Uber nor Lyft are exactly taxi companies because, if they were, they would face an array of restrictions and requirements. Uber CEO Travis Kalanick is fond of asserting that Uber is a technology company instead of a transportation company; therefore, the argument goes, it should not be regulated the way taxis are. As such, the firms offer a means for clients and drivers to circumvent existing regulations. Local taxi markets are typically heavily regulated with licensing systems that create high entry barriers. In New York City the cost of a taxi medallion amounts to more than one million, and in Boston it costs $625,000.

In Schumpeterian fashion, the rides-for-hire companies combine new knowledge (the latest information technology combined with a knowledge of local demand) to enable users to circumvent regulations. They prove a second-best substitute for inefficient institutions governing the taxi market. The result is disruptive for the taxi industry in many cities in which the companies operate. Incumbent taxi drivers sometimes respond fiercely. In LA hundreds of taxicabs inched around City Hall in June 2013, protesting against "the app-summoned bandit drivers". In Paris, taxi drivers reportedly attacked and vandalized an Uber car in January 2014.[9]

The disruption by the evasive entrepreneurs has provoked responses from local, state, and country regulators. In September 2013, after a unanimous vote by the California Public Utilities Commission (CPUC), California became the first U.S. state to establish a set of regulations governing the rides-for-hire companies, including licensing, driver-training programs, and mandatory insurance policies

[8] Uber is an American venture-funded startup and transportation network company that makes mobile application software (an "app") that connects passengers with drivers of vehicles for hire and ridesharing services. The mobile app was launched in 2010 in San Francisco, and the company has since gradually expanded its service. With its launch in Beijing in April 2014, Uber is now available in 100 different cities around the world, 46 of which are in the U.S. Lyft is a privately held, San Francisco-based transportation network company. In contrast to Uber, Lyft drivers do not charge fares; instead, they receive "donations" from their passengers.

[9] However, large companies that face disruption from sharing firms have embraced the business model themselves, and acquired shares in sharing rivals (*The Economist* 2013). Furthermore, incumbent taxi companies have responded through (replicative) innovation, such as by establishing their own smartphone dispatch services, which demonstrates how evasive entrepreneurship has considerable disruptive effects both on the market equilibrium and on the institutional equilibrium.

(CPUC 2013). Although these regulations raise the cost for rides-for-hire drivers, they are less rigid than those that apply to taxi-drivers and are unlikely to entirely cripple the new technologies or companies. The Colorado legislature has since created a statewide regulatory category for what they label "Transportation Network Companies" through its legislature. In Washington, D.C., a recent proposal would allow its cab drivers to employ "surge pricing", i.e., pricing that ignores the taxi meter and adjusts prices to contemporaneous demand. In these cases, the regulatory response appears to be a move toward more efficient institutions.

Other regulatory responses move in the opposite direction. Uber and Lyft have been banned entirely in New Orleans, Portland, and Miami. A Frankfurt court ruled in September 2014 that Uber lacked the necessary legal permits to operate under German law, after a lawsuit by Taxi Deutschland. Uber has stated that it will continue to operate in Germany and plans to appeal (BBC 2014). In December 2013, the French government passed a bill forcing urban transportation startups to wait 15 minutes before they can pick up a customer, although the French Competition Authority had stated in a report that "[t]his competitive imbalance is not necessary to protect the taxi monopoly on this market. Moreover, it potentially contradicts the objective to improve free traffic flow" (TechChrunch 2013). In March 2014, the Seattle city council limited access to ride-sharing services by capping the number of vehicles that each service can have to 150 each (Uber claims to have 1,000 drivers in the city).

Example 2. Accommodation. Airbnb is an online service that connects residents who want to make extra money to out-of-towners who are looking for cheaper alternatives to traditional hotels; it is available in 192 countries. This is also a type of evasive entrepreneurship. Hosts on the site use privately held resources – their homes – to generate money. They are competing with hotels, but they typically do not pay the taxes or face the zoning and safety regulations that hotels face. By exploiting this inconsistency, Airbnb hosts gain an economic advantage.

In many cities, the Airbnb service is in violation of local regulations. Many American cities ban rentals shorter than 30 days on properties that have not been licensed and inspected. In Austin, Texas, anyone who wishes to offer a couch or a spare bed is first required to undergo a home inspection, purchase a $285 permit, and pay local hotel taxes. In cities with rent control, such as New York City, incumbent landlords use Airbnb to circumvent rent control, whereas tenants with rent controlled contracts frequently re-rent their apartments to tourists at market rates. Thus, Airbnb also enables and facilitates evasive behavior by providing a second-best substitute to existing institutions. Although the company comprises only a small fraction of the U.S. lodging industry, Airbnb has already made many enemies, ranging from the traditional hotel industry to tenants' rights advocates.

As with ride-sharing, regulators' responses vary across cities and states. Portland bans Airbnb in all residential neighborhoods. In New York City, hosts are only allowed to operate if they are at home while they have a guest, and if they offer open access to the entire apartment. Fines to individual hosts for noncompliance are in the thousands of dollars, but these laws are rarely enforced. By contrast, New York State passed a law in 2011 that strengthened enforcement against landlords using Airbnb, and state senator Liz Krueger stated in 2013 that Airbnb is putting New Yorker's "in the line of fire by recruiting them to feed its business model and participate in what is essentially a black market."

In October 2013, New York State Attorney General Eric Schneiderman issued a subpoena requiring Airbnb to hand over a detailed list of all its hosts statewide, their bookings, and how much money they have earned. However, the Airbnb affiliated group, Peers, gathered more than 200,000 signatures for a petition urging the state to become more lenient on short-term rentals. In response, the AG's chief of staff Micah Lasher said, "being innovative is not a defense to breaking the law". Similarly, San Francisco's former city planning commissioner Doug Engermann, who is one of the architects behind a recent ballot initiative against Airbnb, has said, "I have a real problem with businesses that basically build a revenue model on encouraging their hosts to do illegal activities—that's basically what Airbnb's business model is" (VentureBeat 2014).

To summarize, the institutional outcome from the regulatory struggles related to the peer-to-peer firms remains unclear. The prospect for welfare-enhancing reform is likely greater if losers are compensated – at least to some extent. An obvious example is taxi drivers who see the value of their investments in taxi-medallions dwindle (Van Doren 2014). Nonetheless, the outcomes from the institutional struggles induced by evasive entrepreneurship will likely vary substantially across geographical areas, which may result in institutional changes that either enhance or reduce efficiency.

5. Discussion

In this paper we make a number of contributions to existing theory. First, while evasive entrepreneurship has been discussed in the previous literature, it has generally been seen as a byproduct of poor institutions. By contrast, we stress the significance of evasive entrepreneurship by pointing out that it is oftentimes a quite sensible second-best substitute in the face of poor institutions. Institutions may prevent or increase the costs of exploiting business opportunities. An entrepreneur may therefore earn large rents by sidestepping institutions. Such evasive entrepreneurs seek to avoid regulations and create contracts and patterns of behavior to overcome institutional impediments, causing a positive or negative shift in the PPF. As such, we demonstrate how evasive entrepreneurship is a unique and often important vehicle for innovation in the economy.

Furthermore, we demonstrated that the pressure that evasive entrepreneurship exerts on the existing institutional setup may be large and lead to subsequent institutional change. This dynamic characteristic of evasive entrepreneurship is its most important facet. In times of rapid change, evasive entrepreneurship may be a prerequisite to prevent institutions from stifling economic development. If evasive entrepreneurship becomes sufficiently widespread and economically important, it can trigger a response from lawmakers and regulators. These institutional reforms may, in turn, have important welfare effects.

We have illustrated this situation by exploring a number of real-world examples of evasive entrepreneurship in China and Sweden during the late 20th century, and pertaining to the sharing economy that has emerged in recent years. In all cases, we have emphasized how the actions of evasive entrepreneurs affect institutions. The picture that emerges is that welfare-enhancing evasive entrepreneurship not only serves as a second-best substitute for inefficient institutions but also often induces efficiency-enhancing reforms of those institutions.

5.1 Policy implications

The study's exploration of the effects of evasive entrepreneurship has important implications for policymaking aimed at economic development. By emphasizing the existence and challenges associated with evasive entrepreneurship, we wish to inform policy makers engaging in institution building. Our research highlights the elusive character of Schumpeterian entrepreneurs, and that institution building must be informed by the fact that such entrepreneurs are rule-breakers that often create alternative arrangements in face of rules that limit the scope for profitable venturing.

This being said, our study does not go against the institutional economics literature's argument that improved regulatory efficiency stimulates economic development. Rather, it identifies a mechanism by which institutional inefficiencies can be circumvented, thereby mitigating the negative consequences of poor institutions. Furthermore, this mechanism may exert pressure for or give guidance to efficiency-enhancing reforms.

Evasive entrepreneurship, even when welfare-enhancing, is thus a *second-best* substitute when institutions are inefficient. Wide-spread evasive activities and the existence of large rents earned by evasive entrepreneurs can therefore be seen as a good diagnostic indication that institutional reform is needed, and that governments seeking to foster entrepreneurial abidance need to improve their governance systems and relax regulations to facilitate new firm entry. This task can be daunting for any government, especially for developing countries locked into institutional traps. In developing countries, the regulatory environment is usually weak and people are more likely to remain in the informal sector because they may doubt the government's ability to protect them, or even fear such protection.

Nonetheless, if reforms fail to materialize, evasive entrepreneurship can still be economically important. Notably, it may help in explaining the enigma that differences in institutional quality across countries tend to be greater than differences in wealth. In fact, countries frequently function surprisingly well in spite of great institutional inefficiencies. An important point of this paper is that the evasive actions of entrepreneurs provide second-best substitutes in the presence of such inefficiencies.

5.2. Limitations and directions for future research

Like all research, our paper has a number of limitations. Notably, we explore evasive entrepreneurship as an empirical phenomenon by using a number of illustrative examples, in the vein of many previous entrepreneurship scholars. Such a reliance on anecdotes risks biasing our results in several ways. While our sample consists of instances of evasive entrepreneurs from a number of different contexts and time periods, there is nevertheless a clear possibility that we are in fact focusing on “winners”, i.e. on evasive entrepreneurs that are easy to identify and whose contributions are easy to quantify because their accomplishments are far-reaching.

Hence, there is a risk that we exaggerate the importance of evasive entrepreneurship. Undoubtedly, there are a number of entrepreneurs engaged in evasive activities who do poorly, and whose ventures have little or no economic impact and therefore exert little or no institutional pressure. By putting the spotlight on them, much could be learned about the attributes of evasive entrepreneurship, and the context in which it is more or less successful and relevant.

One avenue for future research would be a more systematic study of how evasive entrepreneurship interacts with existing institutions. Peer-to-peer firms, such as Uber, Lyft, and Airbnb, may offer one such opportunity. Although these firms may be international in scope, the evasive service they provide is local in nature. Hence, it is subject to local laws. This contextual variability could provide a fertile empirical ground for future studies. Such studies could broaden our knowledge of the mechanisms that underlie the interaction between evasive entrepreneurship and institutional evolution, when (or if) the smoke from these regulatory struggles settles.

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