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Entrepreneurship under Institutional Constraints: The Role of Labor Taxation and Union Power

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Abstract

Entrepreneurship is a key driver of innovation, job creation, and long-term economic growth, yet its development depends not only on individual characteristics and macroeconomic factors but also on the institutional environment. As European countries seek to balance strong social protection with economic competitiveness, understanding how labor market institutions shape entrepreneurial activity has become increasingly relevant.

This paper examines the role of two major labor market institutions, labor taxation and labor union power, in influencing entrepreneurial dynamics across the 27 EU member states. While these institutions promote labor market stability and social welfare, they may also alter the costs, risks, and expected returns of entrepreneurial activity. The study further explores whether labor unions moderate the relationship between labor taxation and entrepreneurship. The empirical analysis is based on a panel dataset covering 2002-2021, combining information from the Global Entrepreneurship Monitor (GEM), the European Commission's Tax and Benefits Indicators, ILOSTAT, Eurostat, the World Development Indicators, and the Worldwide Governance Indicators. Labor taxation is measured using the tax wedge, providing a comprehensive indicator of the fiscal burden on labor. Entrepreneurial activity is analyzed across different stages of the entrepreneurial lifecycle and by entrepreneurial motivation, distinguishing between opportunity- and necessity-driven entrepreneurs.

The findings show that higher labor taxation discourages entrepreneurial activity, particularly among established businesses and opportunity-driven entrepreneurs. Although stronger labor unions are generally associated with lower entrepreneurial activity, they partially mitigate the adverse effects of labor taxation for established entrepreneurs. These results underline the importance of considering the interaction between fiscal and labor market institutions when designing policies that foster entrepreneurship while preserving social cohesion.

Keywords: Tax Wedge; Labor Unions; Entrepreneurship; European Union; Entrepreneurial Motivation