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Entrepreneurial Ecosystems and Tax Structures in India: Lessons From Selected OECD Countries

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Abstract

This study examines the impact of taxation policies on entrepreneurship and entrepreneurial activities in India by comparative study with selected OECD countries using secondary data from the Global Entrepreneurship Monitor (GEM), OECD's reports, and various ministries of the Government of India. The study uses multiple regression models to study the impact of corporate tax, tax bureaucracy, and venture capital investment on new business registration. The results indicate that India's complex taxation policy and high compliance costs negatively impact entrepreneurship, although entrepreneurship in India depends on various other factors such as ease of doing business, a favourable political and bureaucratic atmosphere, and advanced infrastructure. This study also revealed that simple, predictable, and favourable taxation policy, low compliance burden, advanced and developed infrastructure, and political stability create a favourable atmosphere for entrepreneurial activities in OECD countries, which promotes entrepreneurial activities.

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The findings of the study also suggested that India should adopt best practices and policies from OECD countries to create a favourable atmosphere for entrepreneurship and entrepreneurial activities.

Keywords: Entrepreneurship, India, OECD, GEM, TEA

Introduction

The roots of entrepreneurship trace back to the economic theory of mercantilism¹. Mercantilist economic doctrine believed that capital accumulation can be increased only through export; they encourage individuals and domestic producers to participate in production, innovation, and foreign trade (Heilbroner, 1980). The Industrial Revolution (1760-1840) is considered an important turning point in the development of entrepreneurship, as it gave rise to capitalism, which started investing in the economy with the aim of earning more profits, which led to innovation, technical advancement, and a significant reduction in the cost of production, which gave a new impetus to economic growth (Schumpeter, 1934). In the globalised world, entrepreneurship is one of the basic requirements of economic growth, as entrepreneurs bring with not only investment but also skilled labour, advanced production techniques, and innovation. According to the concept of "creative destruction", entrepreneurship disrupts industries for innovation and develops new and advanced techniques of production, making it the driving force of economic growth (Schumpeter, 1942). It promotes innovation and new techniques of production, which adversely affects traditional industries, production techniques, and employment opportunities; hence it is also called a double-edged sword that destroys traditional systems and creates a new economic landscape (Aghion & Howitt, 1992).

In the modern era, entrepreneurship often acts as a catalyst for economic growth, innovation, technical advancement, employment generation, and inclusive growth, but the activities of entrepreneurs depend on numerous factors such as expected profits, ease of doing business, the economic status of a country,

1 *Mercantilism was an economic ideology that prevailed from 16th – 18th century in Europe, that sought to make country strong through export (restrictive trade policy).*

and taxation policies. Taxation is a vital and important tool of fiscal policy, which is not used only for revenue generation but also for maintaining various macroeconomic variables, including overall economic stability. Taxation policies of countries significantly affect the entrepreneur's decisions regarding business establishment and expansion and other business activities (Djankov et al. 2010). Unforeseeable taxation policies create instability in the economy, which negatively impacts long-term investment, innovation, and economic growth. Hence, the government must adopt an effective taxation mechanism that strikes a balance between revenue generation and entrepreneurship, fostering investment, innovations, and economic growth (OECD, 2021).

The OECD² plays a key role in shaping global economic policies. OECD is known for its diverse macroeconomic policies and group of developed countries and hence provides a compelling context for a comparative study of the impact of taxation on entrepreneurship. Taxation policies directly affect entrepreneurship, including establishment of businesses, investment, innovation, etc. OECD countries have diverse tax regimes; some countries adopt favourable tax regimes such as low corporate taxes and easy taxation systems to promote entrepreneurship, innovation research and development (R&D), and economic growth (Djankov et al., 2010). While some do the opposite by imposing a higher tax burden on entrepreneurs, which adversely affects entrepreneurship, R&D, innovation, and economic growth (OECD, 2021).

Taxation policies play an important role in creating a conducive environment for entrepreneurs, as they directly affect the decision to set up an industry, investment, cost of production, profit, innovation, R&D, and other macroeconomic variables. As of July 2024, India's corporate tax stands at 25.17 percent, which is higher than the OECD average of 21.1 percent (OECD & OGD, 2024). India's complex, unpredictable, high tax rates and narrow tax base negatively impact the MPI³, which slows down the pace of startups. Although the Indian government has launched

- 2 *The Organisation for Economic Co-operation and Development (1961) is a group of 38 developed and advanced economies known for stable macroeconomic policy and better business environment.*
- 3 *Marginal Propensity to Invest (Keynes, 1936) defined as change in investment due to change in Income ().*

various schemes and policies, like the Make in India mission, Startup India mission, PLI⁴ schemes, etc., to increase the pace of entrepreneurship in India in the last few years, it could not succeed due to complex processes, weak will, and red tapism. In contrast, OECD countries have streamlined their taxation policy over the past few decades, which encourages investment, startups, innovations, R&D, and overall economic growth. OECD countries that have adopted simpler tax systems and economic policies that encourage investment, startups, and innovation have seen significant growth in entrepreneurial activity (OECD, 2024). The Indian government has taken significant steps towards tax reforms in the last few years, including reducing corporate tax from 30% to 25.17%, abolishing the equalisation levy, etc. Administrative and predictability challenges are the biggest problems of India's tax system. Simple tax compliance and transparent policies can further enhance the favourable scenario for entrepreneurship in India.

Significance of the Study

This paper attempts to understand the impact of taxation on entrepreneurship. Taxation policy directly affects success and failure of businesses; it has a direct impact on MPI, startup establishment, expected profit, innovation, and R&D. OECD countries are known for their stable economic policies and group of developed countries; hence, comparative study with OECD countries helps to understand how stable taxation policy encourages startups, investment, innovation, and R&D. This study also attempts to understand how revenue generation can be balanced with entrepreneurship development so that a better ecosystem can be developed for entrepreneurship and economic growth.

Literature Review

Entrepreneurship is recognised as a driver of economic growth in both developed and developing economies because it innovates new commodities, techniques, and factors of production; generates employment; and it also increases competition among

4 *Production Link Incentives (2021) is performance based financial scheme that motivate and encourage entrepreneurs to production of endogenous, cost effective and import substitution goods and services.*

commodities as well as among countries and firms Schumpeter (1942).

Djankov et al. (2010) studied the impact of corporate tax on entrepreneurship and found an inverse relationship between tax rate and the establishment of new firms, expansion of existing firms, startups, innovation, and R&D. Progressive taxation policy reduces the willingness to invest because it reduces the expected profit, which negatively impacts entrepreneurship, while simplified, transparent, and stable taxation policies encourage long-term investment and economic growth Gullen & Gordon (2007).

Tax rebate fostering the investments, startups and, R&D. Tax rebate and R&D enhance the techniques of production and boost the innovation as well as the output in the OECD countries Bloom et al. (2019). The government of India also starts various initiatives for entrepreneurs such as income tax exemptions, production link Incentive under certain conditions.

Unpredictable tax policy, high tax rates, a narrow tax base, and an unstable tax system are the biggest challenges facing emerging economies like India, which directly or indirectly affect all macroeconomic variables. Agarwal & Sengupta (2021). A comparative study of OECD economies makes it clear that if taxation policies are kept simple and easy, stable, and favourable to entrepreneurs, then entrepreneurship and the rate of economic growth can be increased.

Previous theoretical and empirical studies revealed a direct relationship between economic growth and entrepreneurial activities. A stable and streamlined tax system and a predictable and low tax rate encourage entrepreneurial activities such as investment, innovation, and R&D, which foster long-term economic growth. Schumpeter's Creative Destruction Theory (1942).

The study suggests that economies should learn from OECD countries and simplify and stabilise their tax systems in line with global standards to ensure innovation, investment, and policy stability. India has made significant reforms in its tax policy in the last few years, and reducing corporate tax from 30% to 25% is an important step in this direction. However, structural reforms are

required to align the Indian tax system with global standards and create an ecosystem conducive to entrepreneurial activities.

Objective of the Study

This study has following objectives

- i. To study the impact of taxation policies on entrepreneurial activities.
- ii. To compare the taxation policies of India and OECD to analyse the best practices and gaps.

Data Source and Research Methodology

This study used quantitative research techniques to analyse the impact of taxation policies on entrepreneurship. The study is based on secondary data gathered from global entrepreneur mentor (GEM), OECD's reports, central statistics organisation, world bank report, economic surveys and officials reports of Government of India. To analysis the impact of taxation policies and investment policies multiple regression model has been used. The data has been analysed by using MS Excel and E-Views 12 student version software.

Model of the Study

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where:

Y: New Business Registration (Per 10000 Population)

X_1 : Effective Average Corporate Tax

X_2 : Taxes and bureaucracy

X_3 : Investment in Billion (USD) Investment in Billion USD [Venture Capital]

$\beta_1, \beta_2, \beta_3$: Regression Coefficient

ϵ : Error Term

Result and Analysis

Taxation Policies and Entrepreneurial Activities

Taxation policy is one of the important variables of entrepreneurial activities; it significantly affects propensity to investment, administrative and compliance costs and burdens, research and development, and innovation. India's complex taxation policies, high tax rates, and compliance costs, combined with limited benefits for new businesses and an increased administrative burden, pose significant challenges for entrepreneurs and discourage entrepreneurial activities in the country. On the contrary, OECD countries have made their tax systems very easy, simple, and predictable, which has reduced the tax compliance cost significantly. At the same time, OECD countries have launched many initiatives to promote R&D and innovation, which has given a new impetus to the growth rate of entrepreneurship. Comparatively high tax rates, a narrow tax base, high compliance costs, complex bureaucracy, limited tax benefits and economic support for startups and R&D, and uncertain and unpredicted macroeconomic policies are hindering the growth of entrepreneurial activities in India. If India improves its taxation policies by adopting the best policies of OECD countries, it could enhance the favourable ecosystem for entrepreneurial activities in India.

Table 1: Impact of Taxation Policies on Entrepreneurial Activities

Parameters	India as of (Sep. 2024)	Average of OECD Countries (As of Sep. 2024)	Impact on Entrepreneurial Activities
Rate of Corporate Tax	25.17 % (22 % +3.17 % Surcharge)	21 %	High Corporate tax reduce the marginal propensity to invest (MPI) which discourage the entrepreneurial activities

R& D Tax Credit	0	10-15%	Investment in R&D can reduce the cost of production and upgrade the techniques of production which encourage investment in startups and new businesses. Lack of incentives and benefits to R&D limits the innovations and reduce the investment.
Time Taken in Tax Compliance	254 Hours	159 Hours	Complex taxation policies increase the administrative cost and burden which deters the entrepreneurial activities.
Frequency of Tax Filling	G S T (Monthly) IT (Yearly)	Quarterly and annually	Frequents tax filings system increase the administrative burden.
Tax Exemptions for Startup	3- Years	5-10 Years	Small and limited tax benefits to startups reduce the MPI and restrict the long-term investment as well as growth.
Cost of Tax Compliance	1.7 %	0.8%	High tax compliance cost reduces the profits of entrepreneurs which discourage the investment.

Rank in World Bank's Ease of Doing Business Index (till 2020)*	63	25 (Average of OECD Countries)	The Ease of doing business index shows that complex, unpredictable, and high tax rate creates barriers to starting and running new business
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Source: Author's Estimation Based on data of OECD, World Bank and, Ministry of Finance Government of India.

Entrepreneurial Activities in India and OECD Countries

Table 1 shows that entrepreneurial activities in India and OECD countries are significantly different due to different macroeconomic policies, different consumer bases, and their demand. In India, entrepreneurship is driven by necessity due to lack of innovation, income, awareness, and competition among industries. In past few years, the Indian government has started various schemes, and initiatives such as Startups India, Production Link Incentives and the make in India Schemes for small and medium businesses to encourage entrepreneurial activities, but unfavourable business environments, limited access to formal banking systems, lack of skilled labour, administrative and bureaucratic hurdles, and inadequate infrastructure are the major obstacles to the growth of entrepreneurship. In the contrary, OECD is a group of 38 highly developed economies. Entrepreneurship in most of the OECD countries is driven by opportunity due to stable and predictable macroeconomic policies, skilled labour, organised banking system, highly developed infrastructure, and well-defined intellectual property laws that foster a business-friendly ecosystem.

Table 2: Indicators of Entrepreneurial Activities of India and Average of OECD Countries

Year	Average of OECD Countries				India			
	TEA1	Governmental support and policies	Taxes and bureaucracy	Governmental programs	(TEA) of India	Governmental support and policies	Taxes and bureaucracy	Governmental programs
2013	9.477	4.486	4.153	4.731	9.88	6.63	6.22	6.70
2014	9.550	4.434	4.206	4.741	6.60	6.62	6.21	6.30
2015	10.452	4.413	4.048	4.611	10.83	5.31	4.69	4.83
2016	10.662	4.303	4.084	4.674	10.59	5.70	5.45	5.62
2017	10.932	4.466	4.046	4.748	9.28	5.77	5.08	5.42
2018	10.695	4.530	4.062	4.871	11.42	6.32	4.73	5.73
2019	12.149	4.708	4.386	4.964	14.97	5.37	3.53	4.68
2020	11.005	4.651	4.243	4.983	5.30	5.57	4.35	4.70
2021	10.476	4.639	5.012	5.140	14.37	5.52	4.03	4.53
2022	11.281	4.562	4.854	5.230	11.52	5.00	4.05	4.90
2023	11.837	4.074	4.672	4.856	12.00	3.15	3.07	3.42

Source: Author's Estimation and Global Entrepreneurship Monitor.

Table 2 shows that TEA of India is comparatively higher than the average of OECD countries due to rapid economic growth, emerging and huge market, larger consumer base, urbanization, and high MPC⁵, whereas it experiences decline in government support and policies and governmental program from 6.22 -3.15 and 6.70 -3.42 respectively from 2013-2023, due to complex taxation policies, high compliance costs, policy inconsistency, and lack of accountability. Tax bureaucracy of India decreased from 6.22 to 3.07 during the same period. Almost all entrepreneurial activities indicators of OECD countries are stable due to stable economic policies, easy and predictable taxation policies, and consistency in policy implementation and accountability of government as well as entrepreneurs.

5 *Marginal Propensity to consume (Keynes,1937) is define as the change in consumption due to change in income (). Direct relationship exists between value of MPC and demand. The value of MPC lies between 0 to 1.*

Table: 3 Status of new Business Registration, Fear of Failure, Effective Corporate tax, and Venture capital Investment

Year	India				OECD Countries					
	New Business Registration (Per 10000 Population)	Fear of Failure Rate	Effective Average Corporate Tax	Venture Capital		New Business Registration (Per 10000 Population)	Fear of Failure Rate	Effective Average Corporate Tax	Venture Capital	
				No of Deals	Investment in Billion (USD)				No of Deals	Investment in Billion (USD)
2013	0.1	38.91	34.0	450	6.0	2.9	39.54	23.5	41	700
2014	0.1	37.67	34.0	500	6.5	3.2	40.15	23.2	50	780
2015	0.1	44.01	34.0	600	8.0	3.3	39.37	23.0	65	920
2016	0.1	37.53	34.0	650	9.0	3.6	39.29	22.8	60	880
2017	0.1	39.56	34.0	700	10.0	3.6	39.01	22.5	70	950
2018	0.1	50.06	34.0	800	12.0	4	39.56	22.3	90	1020
2019	0.1	62.37	25.2	900	14.0	4	39.65	22.1	100	1080
2020	0.2	56.80	25.2	750	10.0	4.2	39.38	21.9	85	9500
2021	0.2	54.14	25.2	1200	25.7	4.7	71.98	21.7	150	1100
2022	0.2	53.97	25.2	1300	25.7	4.5	41.94	21.5	120	1000
2023	0.3	62.82	25.2	1000	9.6	4.5	42.73	21.3	NA	NA

Source: OECD Library, Statista Indian and OECD VC Deal Data Database, IVCA, Global Entrepreneurship Monitor and Economic Survey of India.

Note: Fear of failure rate include percentage of 18-64 years population who see good opportunities in businesses but do not start business due to fear of failure.

Table 3 shows the comparative analysis of new business registration, fear of failure rate, effective average corporate tax, and venture capital between India and selected OECD countries. The above table revealed that new business registration in India was just 0.1 percent until 2019; after 2019, India experienced a slight rise from 0.1 percent to 0.3 percent due to policy reforms and a significant reduction in corporate income tax. In the last 10 years, the fear of failure rate of startups rose to 68.82 percent from 38.91 percent due to economic uncertainties, unpredictable taxation policies, and rising competition from foreign enterprises. In the last few years, the Indian stock market has registered tremendous growth, and investors have made substantial profits, which attracted the attention of foreign investors. From 2013 to 2022, India registered a 166.6 percent growth rate in venture capital investment.

Table 4: Result of Regression Analysis

Result of Regression Analysis of India				
Dependent Variable: New Business Registration (Per 10000 Population)				
Method: Least Squares				
Sample (adjusted): 1 11				
Included Observation: 11 after Adjustment				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.549221	0.170592	3.219496	0.0147
Effective Average Corporate Tax	-0.012832	0.004819	-2.662875	0.0323
Taxes and Bureaucracy	1.22E-06	0.000107	0.011458	0.9912
Investment in Billion USD [Venture Capital]	-0.001522	0.003090	-0.492361	0.6375
Model Summary				

R-squared	0.591085	Mean dependent var	0.145455	
Adjusted R-squared	0.415835	S.D. dependent var	0.068755	
S.E. of regression	0.052550	Akaike info criterion	-2.778814	
Sum squared resid	0.019331	Schwarz criterion	-2.634125	
Log likelihood	19.28348	Hannan-Quinn criter.	-2.870020	
F-statistic	3.372818	Durbin-Watson stat	1.406267	
Prob(F-statistic)	0.083951			
Result of Regression Analysis of Average of Selected OECD Countries				
Dependent Variable: New Business Registration (Per 10000 Population)				
Method: Least Squares				
Sample (adjusted): 1 11				
Included Observation: 11 after Adjustment				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
c	19.97180	3.173720	6.292867	0.0008
Effective Average Corporate Tax	-0.765403	0.109289	-7.003463	0.0004
Taxes and Bureaucracy	0.234870	0.198453	1.183504	0.2814
Investment in Billion USD [Venture Capital]	-3.55E-07	-1.90E-05	-0.018650	0.9857
Model Summary				
R-squared	0.965031	Mean dependent var	3.800000	
Adjusted R-squared	0.947547	S.D. dependent var	0.581187	

S.E. of regression	0.133107	Akaike info criterion	-0.906156
Sum squared resid	0.106305	Schwarz criterion	-0.906156
Log likelihood	8.530778	Hannan-Quinn criter.	-1.038930
F-statistic	55.19418	Durbin-Watson stat	2.978571
Prob(F-statistic)	0.000092		

Source: Author's Estimation

Table 4 shows the result of multiple regression analysis, to understand the impact of effective corporate tax, tax bureaucracy, and venture on new business registration (per 10,000 population), multiple regression analysis has been used. The overall regression model of the study is statistically significant at the 10 percent level of significance. The regression analysis shows that in India, a high effective average corporate tax negatively associated with new business registration means that if the rate of effective corporate tax increased, the new business registration decreased. On the other hand, venture capital and tax bureaucracy do not significantly affect the new business registration in India. In India, new business registration depends on other factors such as political and administrative atmosphere, ease of doing business, market competition, and infrastructure because only 59.1 percent of the variation in new business registration is explained by the dependent variable.

While the regression model of selected OECD countries signifies high explanatory power. The result revealed that effective tax rates and venture capital significantly affect new business registration in selected OECD countries. The values of adjusted R^2 (0.947547), F-Statistic (55.19478) P-value (0.00092) and the D-W statistic (2.97857) validate the robustness of the model.

Tax Composition of India and OECD

India's tax composition is significantly different from OECD countries due to different economic structures and priorities.

India's approx. 45 percent of total government revenue came from indirect tax. On the contrary, the tax system of OECD countries is more balanced and stable compared to India. In India, 35 percent of total government revenue came from the Goods and Services Tax and corporation tax, which indicates the high tax rate and narrow tax base. While in OECD countries, 50 percent of its revenue came from direct taxes and contributions to social securities, 25 percent from value-added tax, and only 10 percent from corporation tax. The diversified source of revenue helps to maintain stable tax policies that promote inclusive growth.

Table 5: Tax Composition of India and OECD

Parameters	India	OECD (Average of Countries)
Tax-GDP Ratio	11.7% (2024)	34.1% (OECD average)
Share of Direct Taxes in Total Tax Revenue	37%	67%
Share of Indirect Taxes in Total Tax Revenue	63%	33%
Corporation tax Rate	25%	21% (OECD average)
Personal Income Tax Rate	30% for income above ₹10 lakh	Rates vary, often exceed 40%
Indirect Tax (GST/VAT).	GST at 5%, 12%, 18%, 28% slabs	VAT between 10%–25%

Source: OECD tax Data Base and Ministry of Finance, Govt of India

Table 5 shows the different taxation policies of India and OECD countries are impacting their macroeconomic policies. India's tax-GDP ratio is significantly low compared to 34.1 percent of OECD countries, showing a narrower tax base and a low propensity to spend. 67 percent of India's total tax revenue came from indirect taxes, whereas OECD countries rely more on direct taxes; 63 percent of total tax revenue in OECD countries came from direct taxes. The structural difference shown in Table 4 highlights the reform area of India's taxation system. A more stable, balanced, and predictable tax structure with an expanded

tax base could enhance the mobilisation of domestic as well as foreign investment and create a more favourable landscape for entrepreneurial activities.

Conclusion

The comparative study of India and selected OECD countries highlights taxation policies as a catalyst for entrepreneurial activities. The study revealed that the high rate of corporate, complex, and unpredictable tax structures and high tax compliance costs negatively hinder the entrepreneurial activities. Regression analysis shows that entrepreneurship in India also depends on other factors like political and administrative atmosphere, advanced and developed infrastructure, and ease of doing business environment. In contrast, selected OECD countries with simplified, predictable, stable, and favourable taxation policies experience higher entrepreneurial activities and innovation. To foster a favourable entrepreneurial ecosystem, India should adopt best practices from OECD countries, including simplified, predictable, stable, and streamlined taxation policies, eliminating red tape and bureaucratic hurdles, and increasing expenditure on research and development activities. These policy reforms can create a more conducive atmosphere for entrepreneurial activities and foster long-term economic growth with sustainability.

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