Business dynamism and regional productivity: Evidence from European regions

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Abstract

The strong and positive link between business dynamism and productivity is well-documented in both theoretical and empirical literature focusing on industries or firms. For example, Foster, Haltiwanger and Krizan (2001[93]) estimate that during the 1977-87, net entry accounted for 25% of productivity growth in the U.S. manufacturing. Asturias, Hur, Kehoe and Ruhl (2019[97]) come to a comparable conclusion using manufacturing data for South Korea and Chile. Business entry enhances productivity via several channels. Start-ups tend to bring new technologies and production processes to market driving up the overall efficiency of the economy (if start-ups are more efficient than incumbents). If new firms are indeed more efficient and market reallocates resources to such companies, overall efficiency will increase due to an expanding market share of more efficient firms. Besides, entry (and a threat of entry and exit) imposes competitive pressure that forces incumbents to become more innovative (Aghion et al., 2005[99]) and to improve their business processes and production practices (Nickell, 1996[100]).

The link between business dynamism and productivity at the *regional* level is less well-understood. Many of the mechanisms postulated in the industry-level literature would apply only to non-tradable sector, where regional competition effects are more likely to be present. In less dynamic places, for example in rural areas, business entry might be predominantly of the necessity type and in lower productivity industries such as services, driving down overall productivity performance of a region.

This paper fills this gap by studying the link between business dynamism and productivity in European regions. Preliminary results point to the negative effect on average but results differ by sector with possible inter-sectoral spillover effects.