More companies should go bust [1]

Written by **Tim Worstall** [2] | Sunday 13 July 2008

No, really, the way to improve the European economy is to allow (or perhaps insist upon is better?) more firms to go bankrupt. That's the highly amusing and true result of this paper [3] over at Vox.eu.

In a nutshell the author divides growth in Europe into two parts. Pre-1995, when the European economies were essentially trying to catch up with the US (and to a lesser extent, the UK). In this period the rigidities, the restraints, the protections for incumbent firms, mattered little as catch up growth is easier than when one is at the technological production frontier.

However, once the catch up is complete, then those restrictions become progressively more expensive in their constraints upon future growth. Thus the period after 1995, when it was indeed complete. The effects of this can be seen in both total factor productivity and in labour productivity in services.

> The real European problem is in sluggish labour productivity growth - over the same period it averaged 1.4% per year compared with 2.1% in the United States, so that Europe has been falling behind rather than catching up during the last decade, in contrast with the whole of the post-war period until the mid-1990s.
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> Again, the variation in the contribution from labour productivity growth in the service sector is considerable, from 1.6% per year in United Kingdom to 0.1% in Italy during 1995 to 2004.

What we need is a great deal of the tearing down of those barriers that prevent Schumpeter's creative destruction from sweeping through the European economies:

> More progress would be made if the dark side of productivity improvement implied by creative destruction ? exit of established producers and re-deployment of labour ? were accepted and facilitated. If only ministers could bring themselves to think (better still occasionally to say) ?these job losses are good news".

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[3] http://www.voxeu.org/index.php?q=node/1393
[4] http://disqus.com/?ref_noscript
[5] http://disqus.com