

# Business Dynamics and Red Tape Barriers

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Enhancing competition through policies that aim at improving the functioning of product markets by deregulating and facilitating entry is generally considered a fundamental channel through which stimulating business dynamics and, through it, firms' productivity. Overall, the empirical evidence points out that product market reforms that ease entry, reduce trade barriers, remove price controls and reduce public involvement in production, positively affect productivity and employment and negatively affect the average level of economic rents in the economy.

This business dynamic process is therefore an important aspect of the chain of events triggered by market reforms. It could be argued, indeed, that entry into a market is one of the key elements of the transmission mechanism through which product market reforms ultimately affect productivity: the entry of new firms, or the threat of it, induces existing firms to become more efficient by setting their prices closer to marginal costs and reducing mark-ups through reallocation of resources within the firm. In addition, less productive firms are supposed to be pushed out of the market, while more efficient ones grow and gain market share thus leading to further efficiency gains. Reforms aiming at facilitating firms' entry can thus be seen as giving an extra bonus in the sense that they facilitate the materialization of the full effect of other competition-enhancing reforms. They affect directly the cost of entry and are generally supposed to "quickly" influence business dynamics.

This study contributes to this debate analysing the extent to which entry of new firms into the market responds to changes in the regulatory framework aiming at reducing administrative regulations and bureaucratic procedures to start a new business and the administrative cost to start operating in international markets (the so-called "red tape" entry barriers). It does it evaluating the impact of these reforms on entry dynamics in 17 European member countries (AT, BE, CZ, DE, DK, EE, ES, FI, FR, HU, IT, NL, PL, PT, SE, SK and UK) during the period 2004-2011.

Results confirm the theoretical expectation and previous empirical evidence: the higher the level of red tape barriers, the lower entry dynamics. In addition, recent reforms should have fostered entry dynamics to a significant extent. For instance, in Italy, as consequences of the changes in the cost of starting a business birth rates may increase from 6.7% to 7.2% and in Spain from 7.9% to 9.2%. In the case of Portugal, if the combined effect of the observed reduction in the cost of starting a business and in the number of days needed to start exporting is considered, the potential birth rates in 2014 could increase to 13.6% (starting from a birth rate of 12.4%). Overall, once the combined effect of the observed changes in the level of red tape barriers is considered, the empirical evidence points out that, among these three countries, the most significant impacts on entry dynamics should potentially occur in Portugal.

The general policy conclusion that can be drawn from these results is that birth rates in Europe have positively and robustly reacted to changes in the cost of starting a business and exporting which have been introduced during the period 2004-2011. This key channel of business dynamics

has shown to *work*, even in crisis time, suggesting that further steps in this direction will significantly and further increase birth rates leading, *ceteris paribus*, to a more efficient allocation of resources. Furthermore, given the established positive link between business dynamics, on the one side, and allocative efficiency and productivity, on the other side, our results confirm that the former channel is able to transmit the effect of reforms easing entry in domestic and foreign markets on the whole economy.