



This project is co-funded
by the European Union

WHAT HELPS FIRMS GROW IN REGIONS?

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17 November 2022

XXXVI RENT Conference Naples, Italy

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Going beyond “(regional) institutions matter”

National institutions

Acemoglu et al. (2001)

Institutions matter
Private property
Checks on power

Rodrik et al. (2004)

Institutions “trump”
everything else
(geography, trade, ...)

Giavazzi and Tabellini (2005)

National institutions matter for
trade openness

Gwartney et al. (2006)

National institutions matter for
private investment

Regional institutions

Charron et al. (2011)

Importance of regional
governance

Rodriguez-Pose and Di Cataldo (2015)

Regional institutions matter for
innovative performance

Revoltella et al. (2019)

Regional institutions matter for
productivity growth

**Which
institutions
matter?**

**For which
outcomes?**

Why?



Outcomes and factors

OUTCOME: REGIONAL FIRM PERFORMANCE

Business demography

Birth rate
Death rate
3-year survival rate
Size of active firms

Employment

Employment growth
Employment rate
...

Economic value

Productivity (GVA/worker) growth
GVA growth

REGIONAL BUSINESS ENVIRONMENT

Rule of law

Corruption
Legal system

Regulatory environment

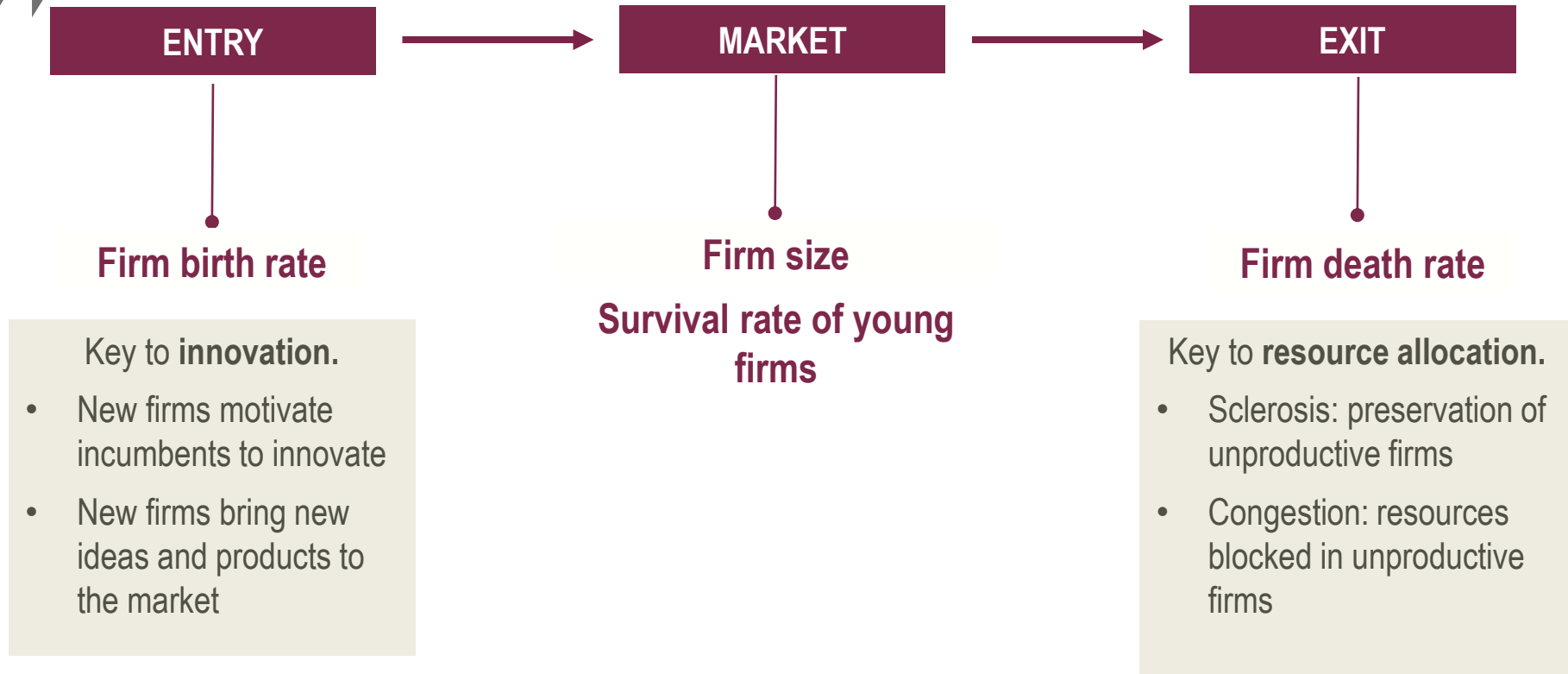
Trade regulation
Business licensing
Tax rates & administration

Access to resources

Access to finance
Qualified workforce
Transport
Electricity
Land



Business dynamics





Business dynamics and the rule of law

CORRUPTION

**Fewer firm
births**

- Higher costs of doing business
- Corrupt deals not formally enforceable

**More firm
deaths**

- Fewer resources left for investment

INEFFICIENT LEGAL SYSTEM

**Fewer firm
births**

- Higher TC & risks
→ lower investment
- Transactions rely more on trust → no incentive to diversify suppliers

**Smaller firm
size**



Institutional data: World Bank Enterprise Surveys (WBES)

Is corruption no obstacle, a minor obstacle, a moderate obstacle, a major obstacle, or a very severe obstacle to the current operations of this establishment?

| | No obstacle | Minor obstacle | Moderate obstacle | Major obstacle | Very Severe Obstacle | Do Not Know (spontaneous) | Does Not Apply (spontaneous) |
|------------------------|-------------|----------------|-------------------|----------------|----------------------|---------------------------|------------------------------|
| Corruption g30a | 0 | 1 | 2 | 3 | 4 | -9 | -7 |



Share of firms which answered "major" or "very severe" obstacle

The higher the indicator, the more severe the problem

34 countries
28 OECD

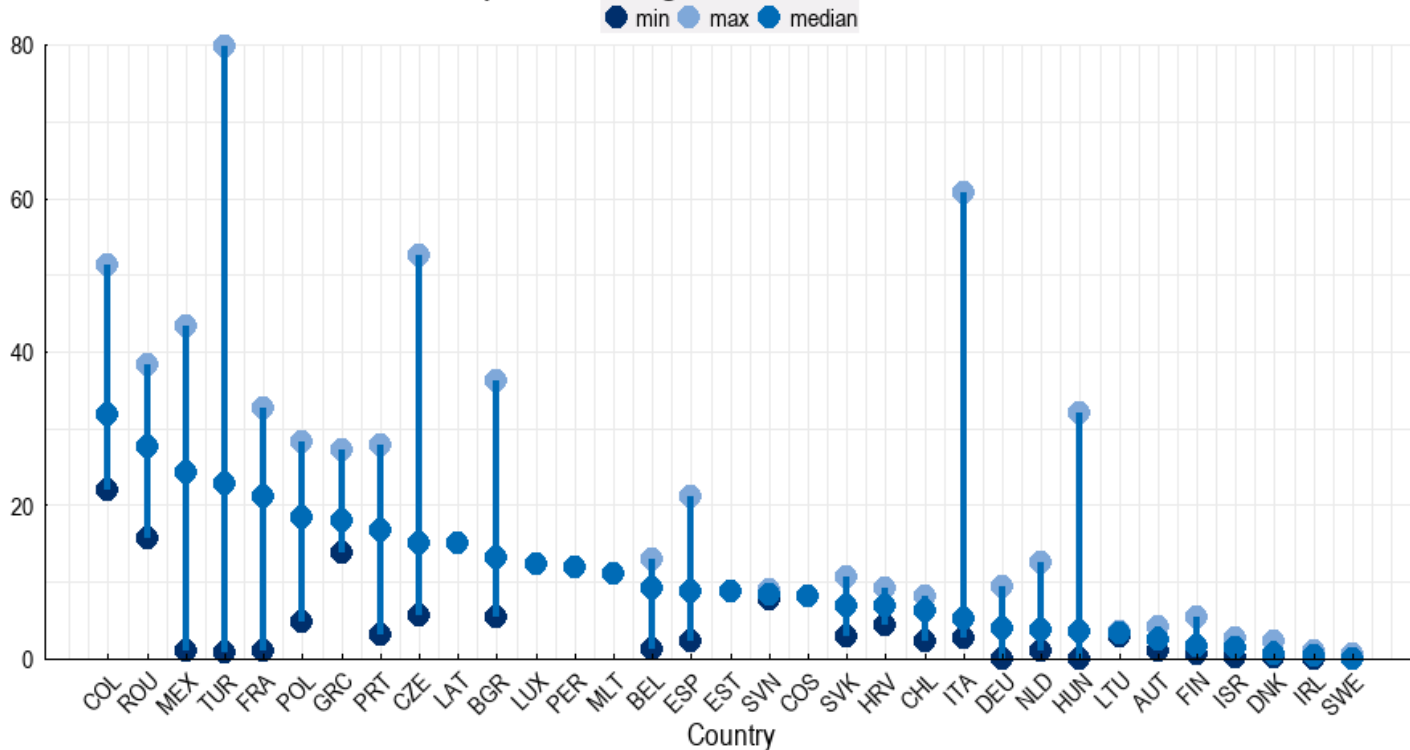
4 waves
2009-2021

Most countries covered
once



Significant regional dispersions in how firms perceive institutional quality

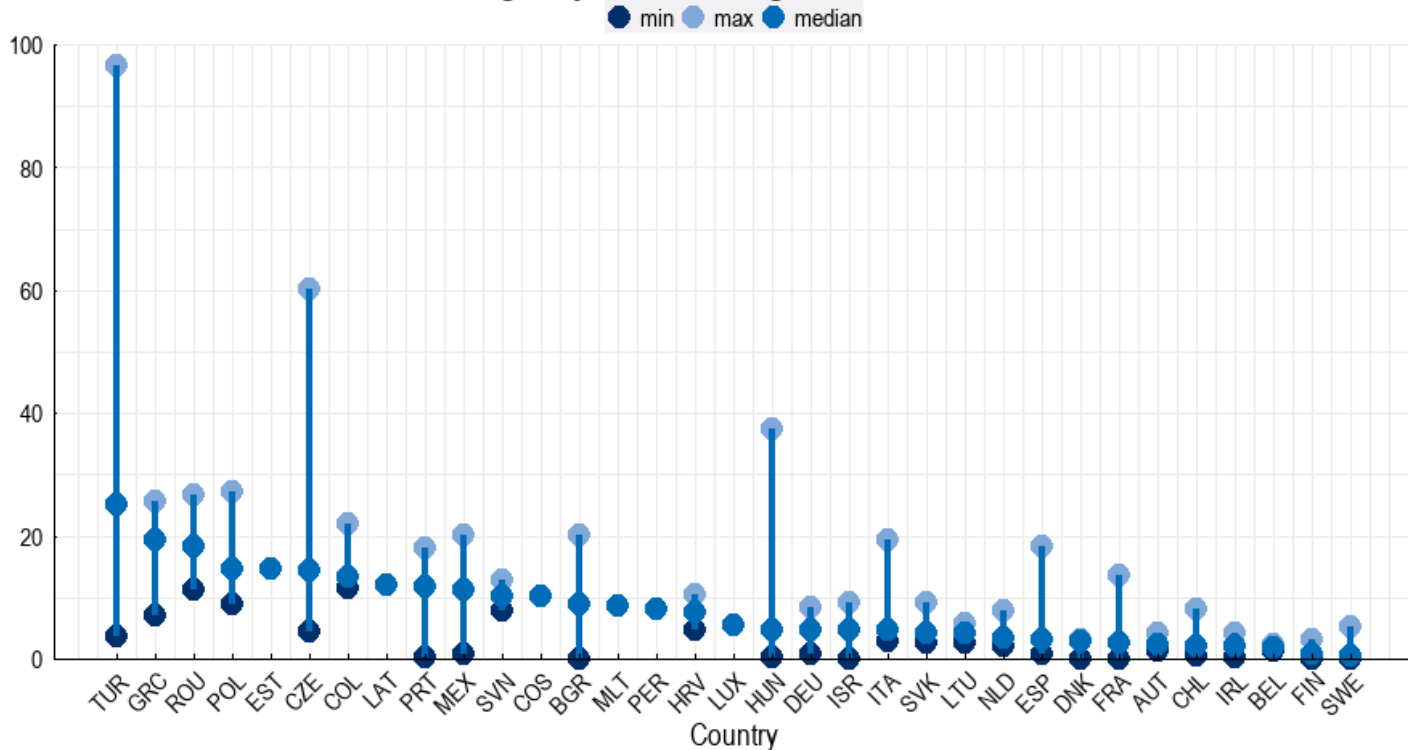
Share of firms that find corruption is a big obstacle





Significant regional dispersions in how firms perceive institutional quality

Share of firms that find the legal system is a big obstacle





Empirical specification

Main empirical specification: cross-section

$$Y_{rc} = \beta_0 + \beta_1 Inst_{rc} + \gamma X_{rc} + \varepsilon_{rc}$$

- r = TL2 region. $N = 128 - 153$
- c = country. $N = 16 - 22$

Business dynamics (TL2):

- Birth rate
- Death rate
- 3-year survival rate
- Avg. firm size

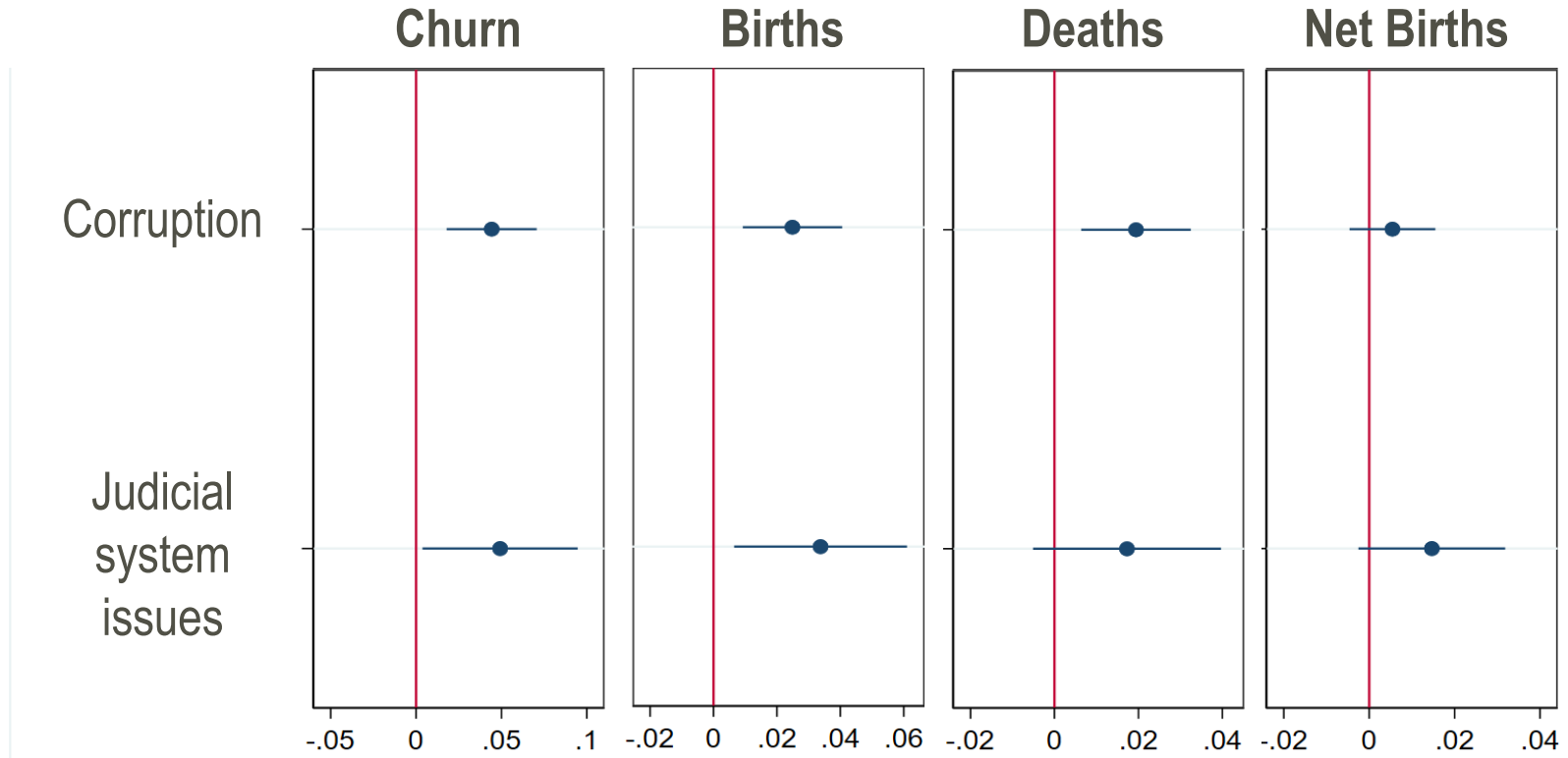
Institutions (TL2)

Set of control variables (TL2):

- Initial GDP per capita (2005)
- % Population living in Functional Urban Areas
- Capital region
- Human capital
- Digital/Transport infrastructure

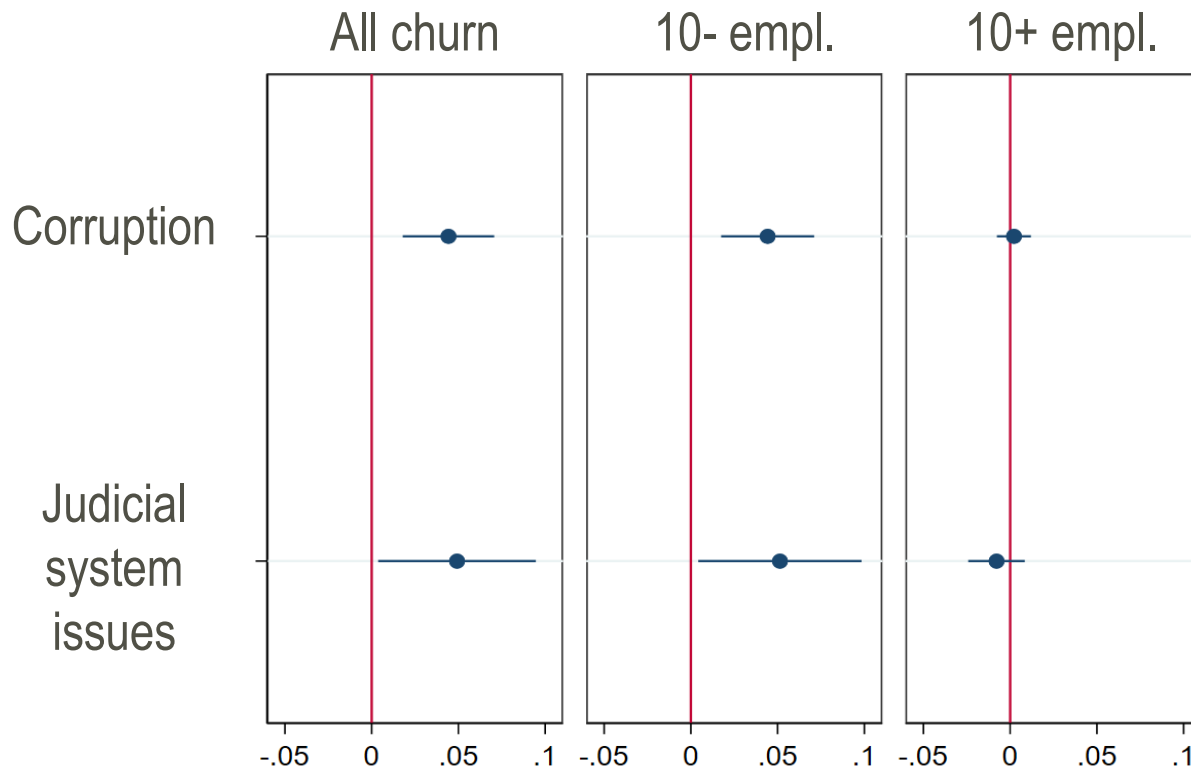


Regions with weaker rule of law have more firm churn



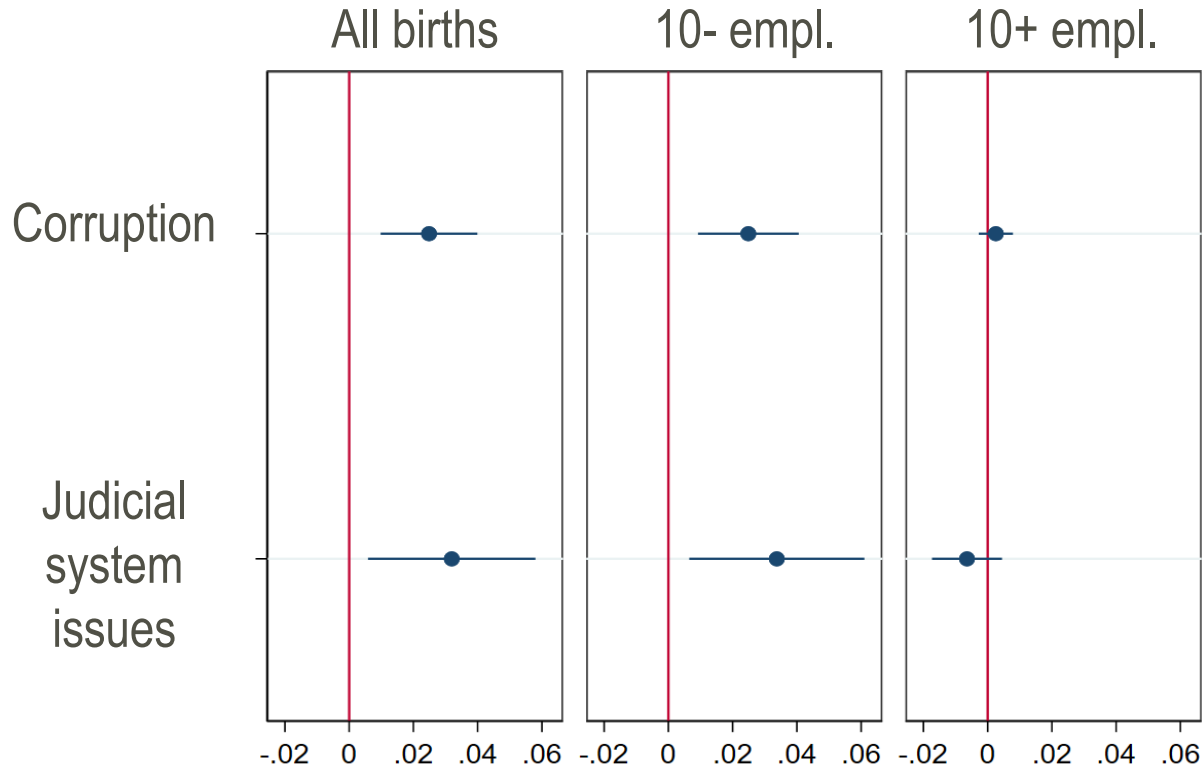


Effects on churn are driven by micro firms



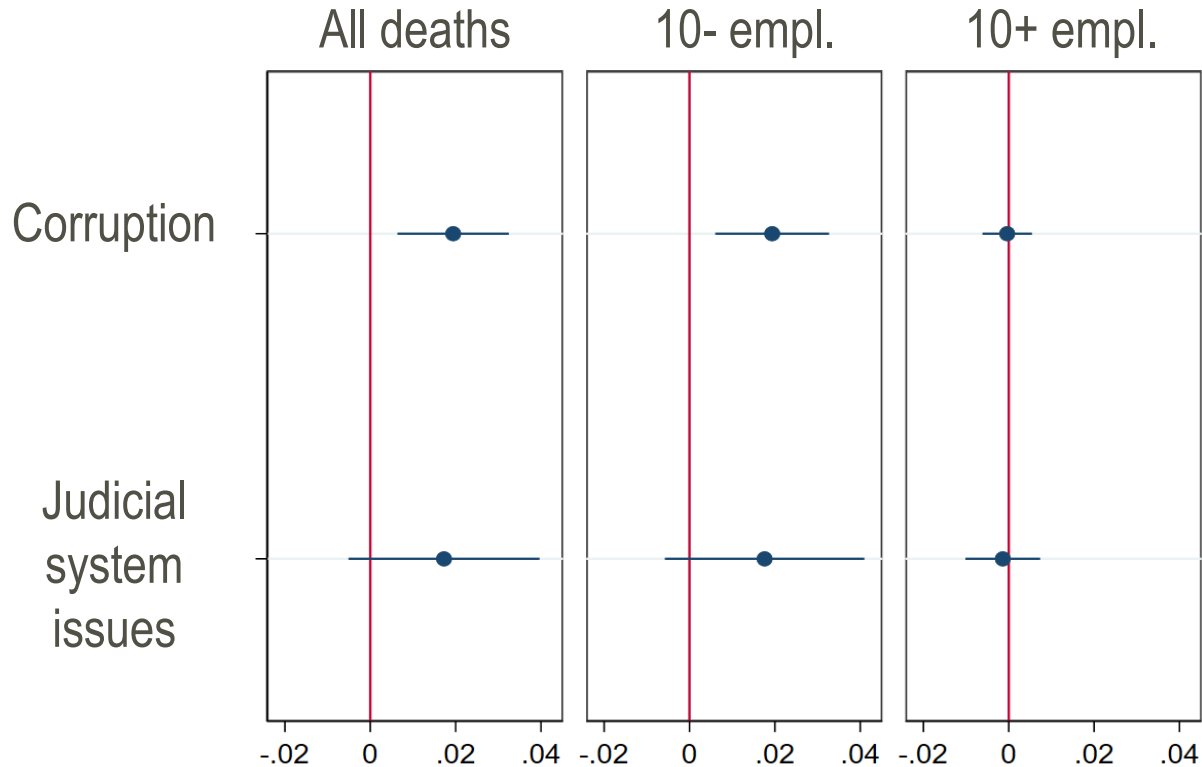


Effects on births are driven by micro firms



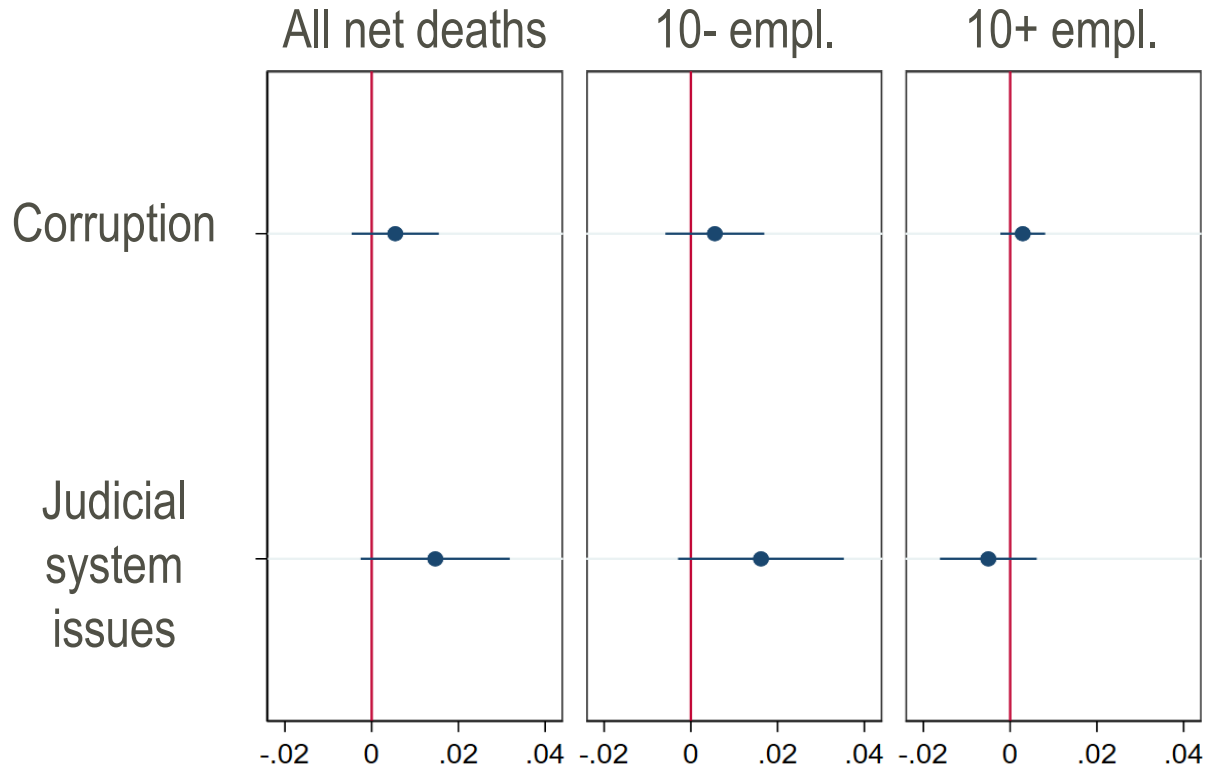


Effects on deaths are driven by micro firms



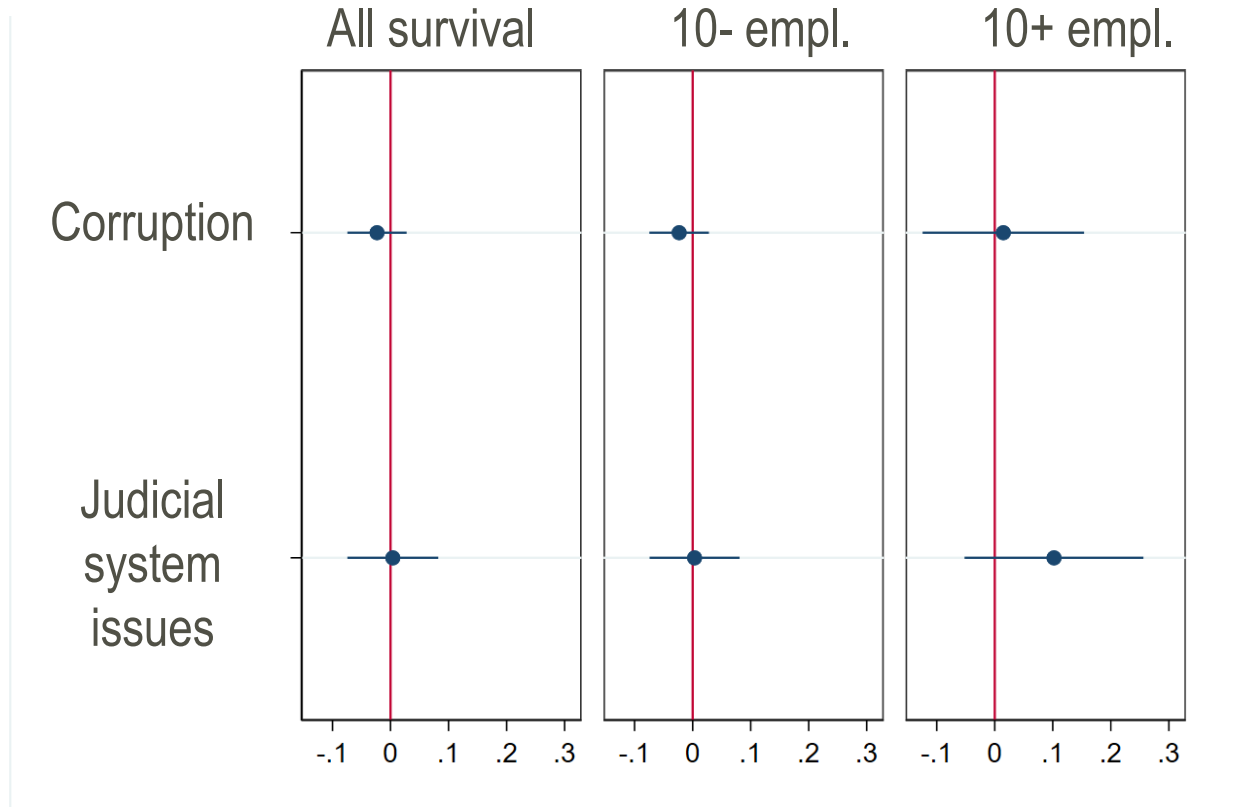


No significant effect of rule of law on net deaths



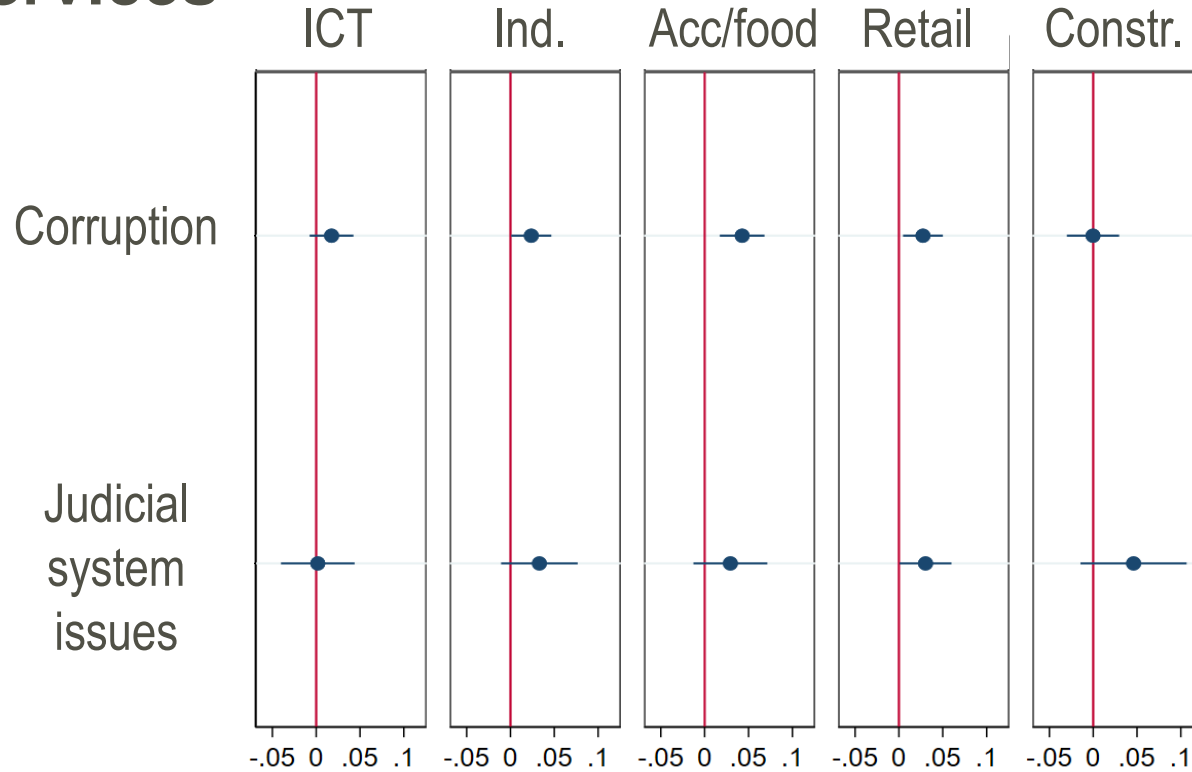


No effects on 3-year survival rates



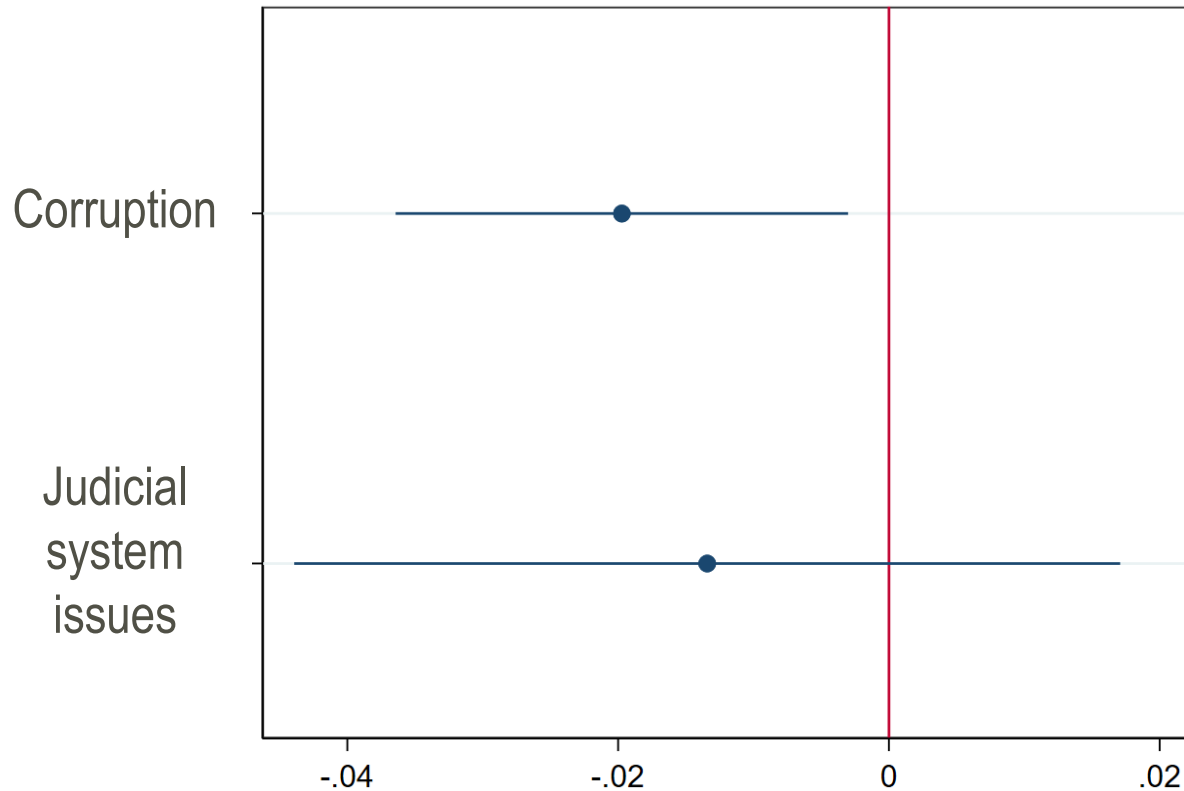


Churn most responsive in industry and low added value services



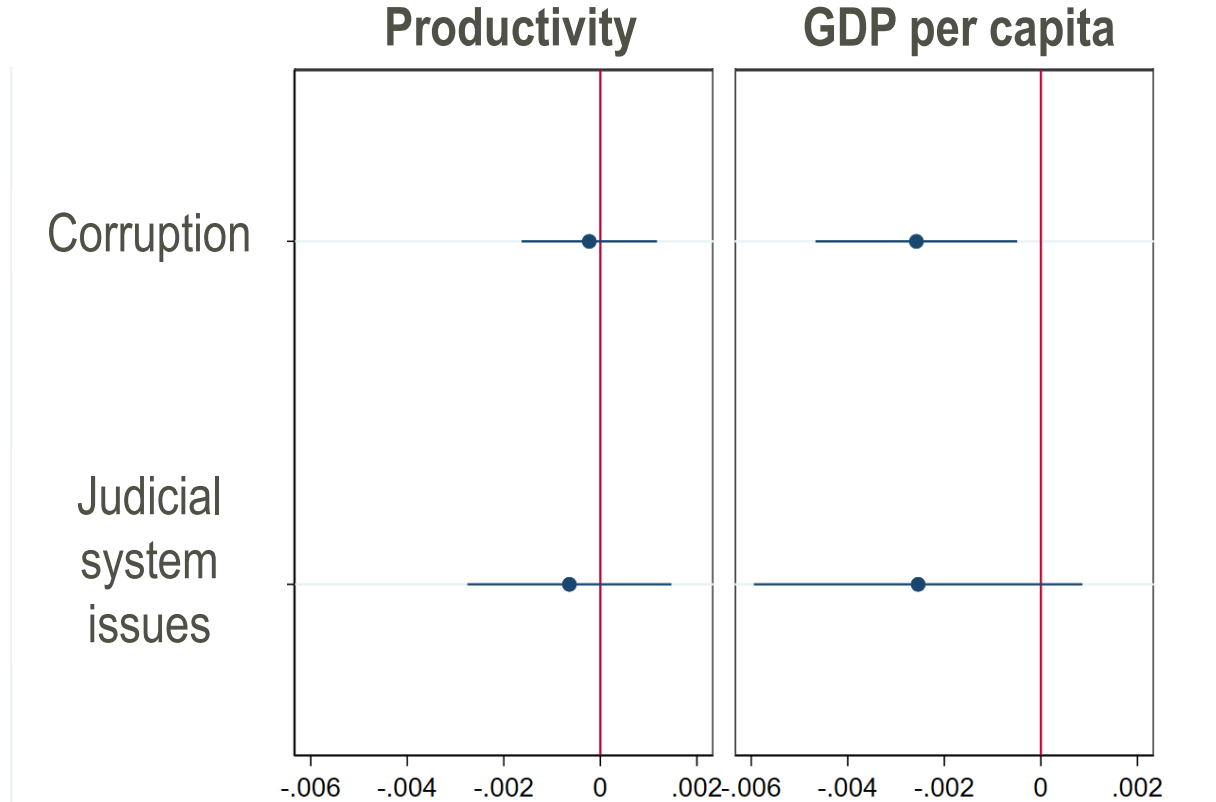


Regions with weaker rule of law have smaller firms



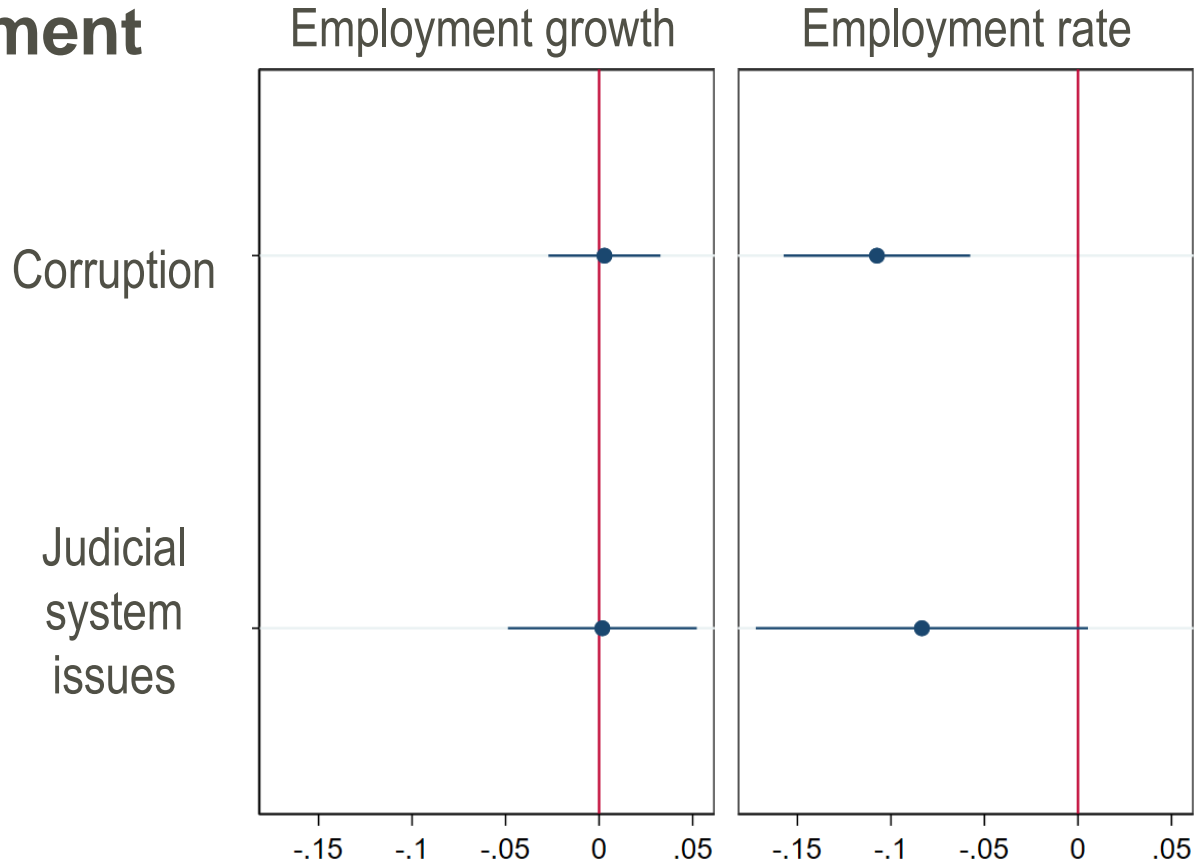


Regions with more corruption have lower GDP/capita





Regions with weaker rule of law have lower employment





Conclusions

- **Higher churn** in regions with weaker institutions: higher deaths, but also higher births
- No statistically significant effect on net firm births (effects on births & deaths cancel out)
- Effects driven by small firms
- Stronger effects in manufacturing and non-tradeable services such as accommodation & food

- Corruption negatively affects average firm size



The dark side of churn?

- Some evidence that there is a dark side of churn:
 - Institutionally weak regions have lower GDP per capita levels
 - They also have lower employment outcomes: participation, employment, unemployment
 - ... But no statistically significant effect of corruption on growth rates (employment, productivity, GDP per capita)

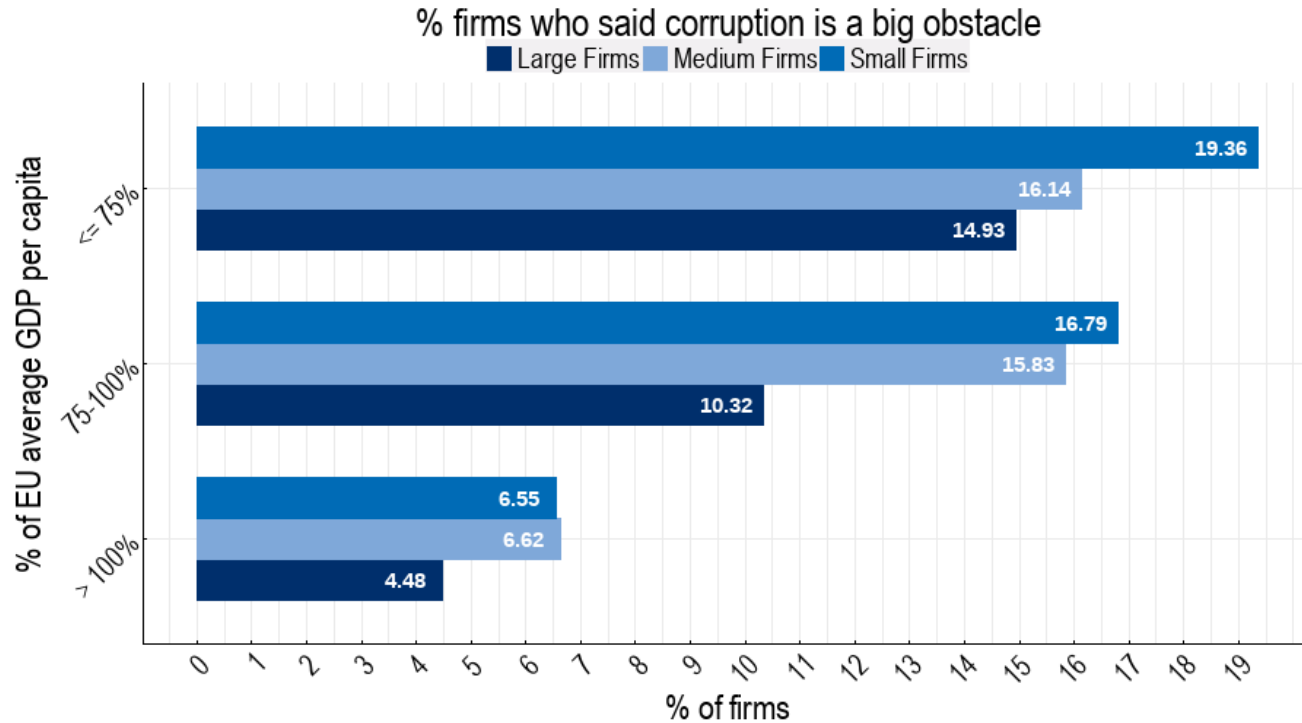


Thank you

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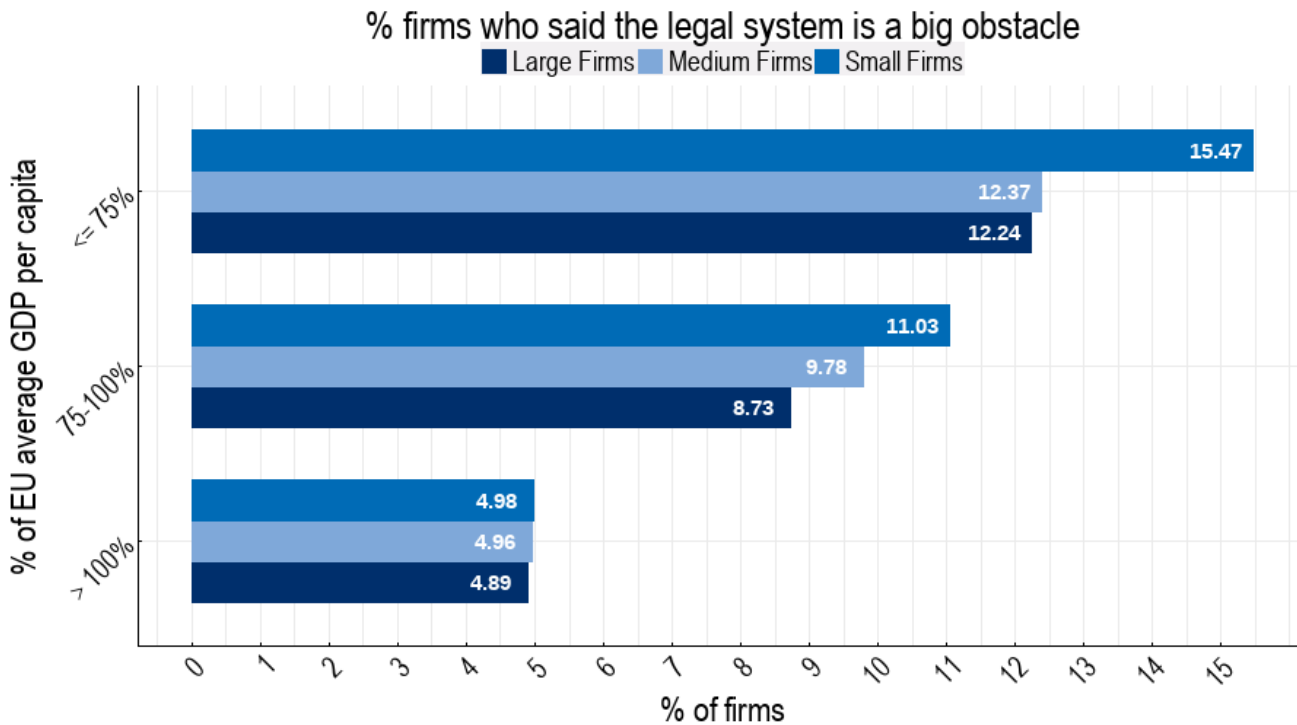


Small firms in regions with relatively low incomes most likely to find corruption a severe obstacle



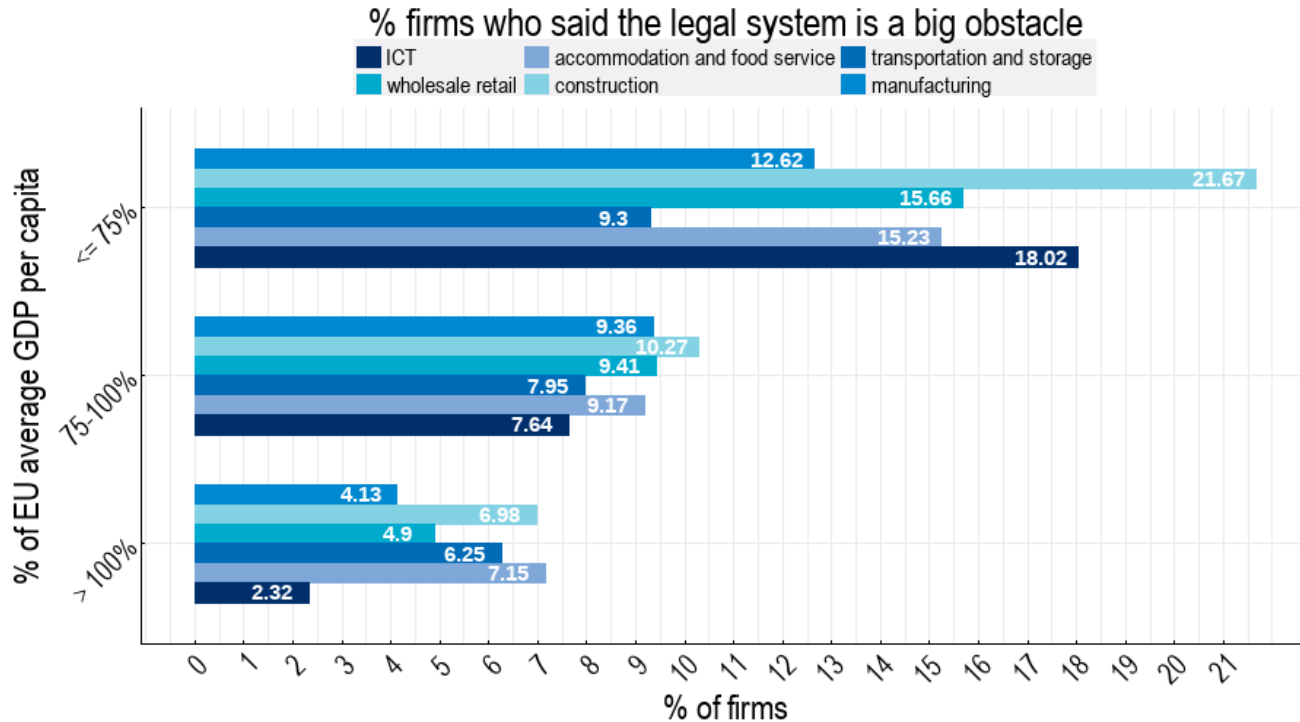


Small firms in regions with relatively low incomes most likely to find the legal system a severe obstacle



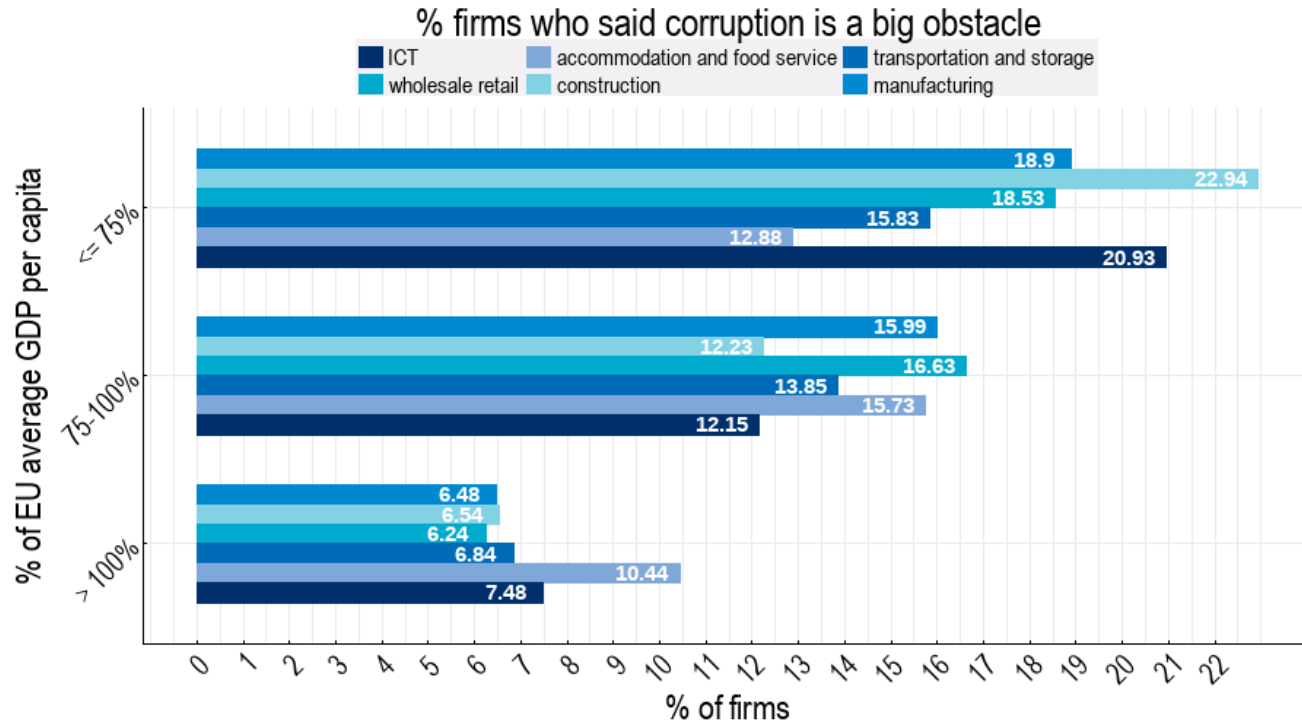


Firms in ICT and construction in low-income regions most likely to find the legal system a severe obstacle

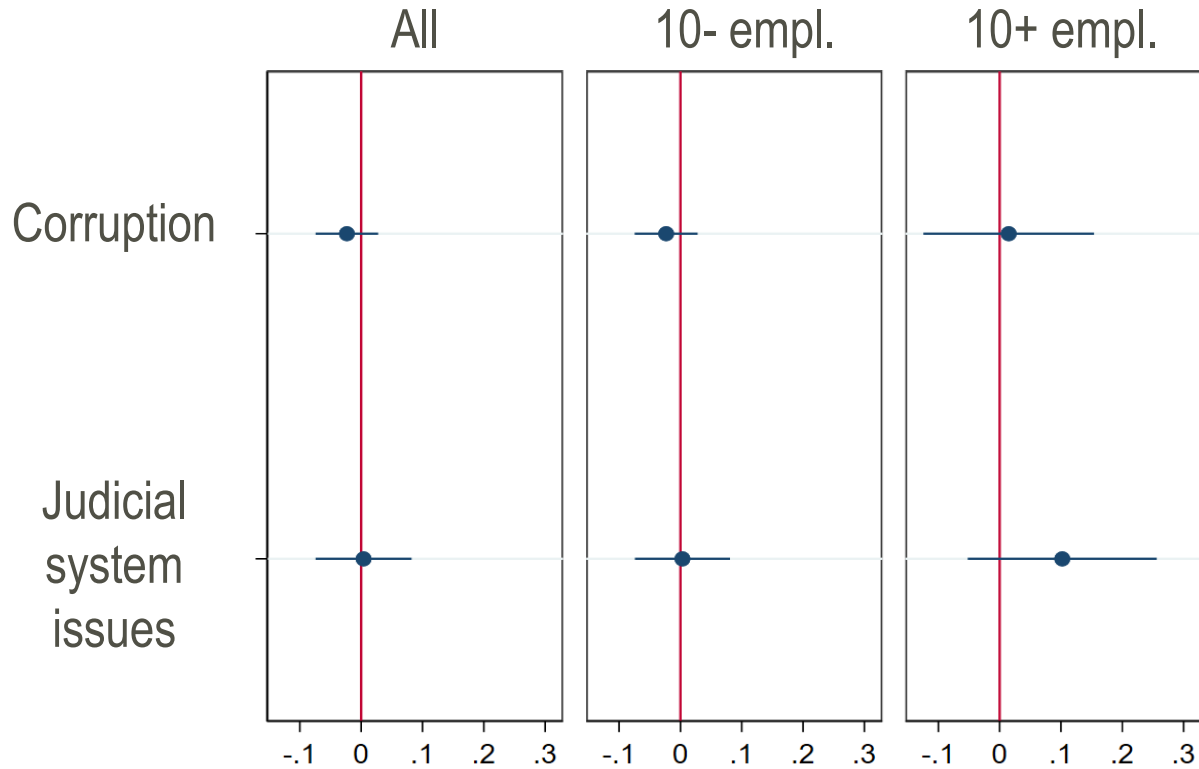




Firms in ICT and construction in low-income regions most likely to find corruption a severe obstacle



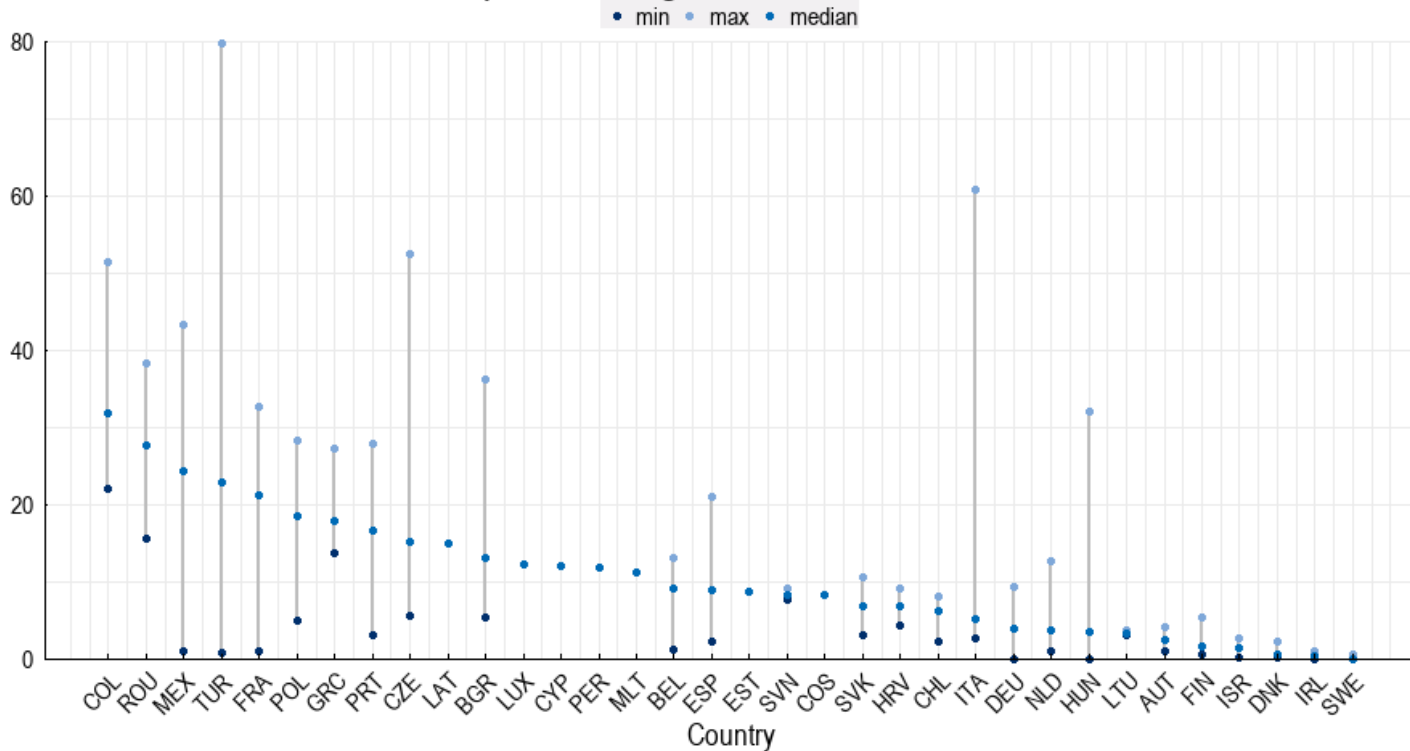
No effects on survival of young firms





Significant regional dispersions in how firms perceive institutional quality

Share of firms that find corruption is a big obstacle





Significant regional dispersions in how firms perceive institutional quality

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