

## **How openness and regulation shapes firm productivity and creative destruction in OECD countries**

Sean Dougherty and Sarra Ben Yahmed

OECD Economics Department

Submission for the DEFI Workshop on Firm Productivity, Trade and Development

Aix-en-Provence, 8 and 9 July 2009

### **Abstract**

New theoretical literature and country-specific studies on trade and openness suggests that firm dynamics, or creative destruction, is fundamental to understanding the evolution of productivity at the firm and more aggregate levels. This literature identifies a series of reallocative mechanisms across firms and sectors that product and labour market regulation directly interfere with, and include the effects of market entry barriers and stringent employment protection. Previous OECD work on these areas suggests that regulation can have pernicious effects that deter firm entry and adjustment of firms' employment. While it is highly likely that trade plays a role in amplifying the effects of product and labour market regulation – in part by increasing the extent of competition with other jurisdictions – there is precious little empirical evidence in this area. This study seeks to understand how trade and regulations interact in shaping productivity gains, controlling for the possible endogeneity of trade openness through instrumentation. Firm data (incl. structural demographics) for more than half of the OECD countries, and robust productivity measures, are combined with Comtrade and product and labour market regulatory data in the analysis. Early results at the sectoral level suggest differential effects of product and labour market regulation depending on the extent of trade intensity, for firm-level entry, exit and adjustment dynamics. This work is supportive of new theoretical models that take account of firm-level heterogeneity and trade costs.