

The productivity slowdown
Attack of the zombie firms

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WHY has economic growth been so sluggish in the developed world? The [previous post](#) showed that productivity in the global economy had been flat or falling in the last three years. And it suggested that the existence of "zombie" firms—uncompetitive survivors—might be one explanation.

As it happened, the OECD published [a new paper](#) yesterday which showed that might indeed be the case. The paper concludes that "the prevalence of, and resources sunk in, zombie firms have risen since the mid-2000s, which is significant given that recessions typically provide opportunities for restructuring and productivity-enhancing allocation" and that "a higher share of industry capital sunk in zombie firms tends to crowd out the growth—measured in terms of investment and employment—of the typical non-zombie firm". All in all "a 3.5% rise in the share of zombie firms—roughly equivalent to that observed between 2005 and 2013 on average across the nine OECD countries in the sample—is associated with a 1.2% decline in the level of labour productivity across industries".

So what is going on? The paper defines zombie firms as those aged ten years or older with an interest-coverage ratio (the ratio of operating income to interest expenses) of less than one in each of the preceding three years. In short, these firms depend on the kindness of their creditors. This may be down to the efforts of governments and central banks to stabilise their economies after the crisis, including pressuring commercial banks to extend credit and the use of ultra-low interest rates.

Zombie firms could drag down productivity in three ways. First, just by being inefficient, they drag down the productivity average for the whole economy. Second, they may crowd out investment by non-zombie firms. And third they may prevent efficient resource allocation by preventing more efficient firms from gaining market share.

The OECD paper finds a whole host of effects. For example, there has been a decline in business dynamism, including the creation of new firms. Also there has been a widening gap between the most productive and the less productive firms. This is not just because the Googles and the Apples have unique capabilities. The OECD finds that the ability of other firms to adapt best practices from the industry leaders has declined.

Worse still "the employment growth of young non-zombie firms is particularly sensitive to zombie congestion. Thus zombie congestion not only discourages entry but also constrains the ability of those particularly productive young firms to upscale post-entry".

In a sense, the zombie firm phenomenon mirrors the European labour-market problem. Well-intentioned reforms designed to protect workers' rights create a two-tier market; well-paid insiders and unemployed outsiders, with firms reluctant to hire the latter because of the costs of getting rid of them. The developed world may have created an inflexible business market.

That makes the sudden enthusiasm for "industrial policy" on both sides of the Atlantic all the more worrying. Governments tend to back existing firms, since they have the power to lobby; small start-ups don't get a hearing. But protecting the interests of corporate insiders may, in the long run, make the whole economy as sluggish as one of the walking dead.