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'Zombie' companies threaten EU recovery, says think-tank

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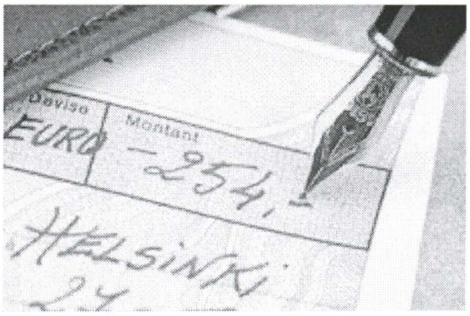
An influential Brussels-based think-tank says "zombie" companies – enterprises badly in need of structural reform but kept alive by state subsidies – risk hampering EU growth levels once the economic crisis comes to an end.

"They stifle economic growth, while preventing reallocation of resources to sectors with higher growth potential," say authors Jean Pisani-Ferry and Bruno van Pottelsberghe of Bruegel in a publication released last week.

"There will always be a political temptation to rescue particularly large industrial companies using government funds."



Europe's future growth rate depends on the implementing the correct policy measure during the crisis, says Bruegel (Photo: European Community)

The danger risks being compounded by "zombie lending" say the authors, a situation where EU banks prioritise lending to big failing companies as opposed to smaller ones with frequently much higher growth potential.

As banks increasingly rely on bailouts from EU governments, so their lending criteria become more politically motivated while frequently ignoring good economic logic, warn the authors.

Instead Europe should take account of the lessons learnt from Japan in the 1990s where such "zombie" companies stifled growth and added to a period in Japan's economic history known as the lost decade.

As economic leaders make tentative comments regarding the emergence of the green shoots of recovery, the shape of that recovery and the longer-term consequences of the crisis will depend on current policy choices, says the Bruegel report.

"It is during crises that the seeds of future performance are sown – or not sown," warn the authors.

Focusing on research and innovation is essential to promoting future growth, an area where the EU is so far coming up short.

"It would be hard to characterise the European stimulus as innovation-friendly," says the study, which estimates that the proportion of current stimulus spending going towards boosting innovation is between 1 and 10 percent.

"This is unlikely to deliver the innovation boost that was called for in the EU's Lisbon strategy."

The correct labour market policies will also have a huge impact on future growth potential says the paper, with the key being to keep people at work in order to enable a return to high productivity once the economy picks up.

Early retirement schemes and excessive unemployment benefits that reduce incentives to find work are therefore to be avoided, while government-subsidised short-term work such as the so-called "kurzarbeit" scheme in Germany is advantageous.

The report's authors are critical of the limited size of the EU stimulus to date, which they claim will be close be approximately 1.1 percent of EU GDP in 2009 when unemployment benefits are taken into account.

This compares with the 2 percent advocated by the International Monetary Fund and the 3.3 percent for 2009 and 2010 claimed as being the level by the EU institutions and member states.

The reasons for the EU's timid response, says the study, is the belief that the benefits of national stimulus programmes will largely be reaped by trading partners, while some member states are constricted by already high debt levels.