Financial Heterogeneity and Trade Liberalization in Europe
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Summary of the paper

- Interactions between trade liberalization, financial markets development and capital market openness
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- Interactions between trade liberalization, financial markets development and capital market openness

- Empirical evidence:
  - Trade liberalization does not necessarily lead to higher TFP - only if sufficient financial sector development (credit to GDP)
  - Sectoral TFP negatively correlated with capital misallocation measures
  - Higher export exposure decreases misallocation only in sectors with higher financial development (trade credit to assets)
  - Trade increases probability of zombie firms survival if financial sector underdeveloped
Summary of the paper 2/2

- Calibrated model and comparison of two steady states (before and after trade liberalization):

  - Financial friction: borrow up to a fraction of the value of their capital

  - Trade liberalization: GDP higher but TFP lower due to increased dispersion of capital resulting from financial frictions

  - Constrained firms even if productive will not expand capital
Key insights

▶ Main take-aways:

▶ Gains from trade in a form of enhanced productivity may not be fully realized if insufficient financial market development

▶ Benefits of trade liberalization can be hampered by credit market friction

▶ Performance of European countries after trade liberalization can be attributed to heterogeneity of their financial sectors
Key insights

▶ Main take-aways:

▶ Gains from trade in a form of enhanced productivity may not be fully realized if insufficient financial market development

▶ Benefits of trade liberalization can be hampered by credit market friction

▶ Performance of European countries after trade liberalization can be attributed to heterogeneity of their financial sectors

▶ Mechanism:

▶ More productive firms survive trade liberalization

▶ However, with credit constraints binding productive firms do not expand capital as much as they want

▶ Relative capital intensity increases in less productive, unconstrained firms which results in higher misallocation and lower overall TFP
Main comments 1/2

1. R&D spending
   ▶ Core performed better in terms of TFP after trade liberalization - maybe because of higher R&D spending?
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Main comments 1/2

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2. Financial friction
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3. Labor market institutions
   ▶ Claim: since labor misallocation did not increase, labor frictions did not contribute to productivity loss - however, significant differences in labor market institutions should be taken into account
Main comments 2/2

4. Zombie firms survive

- Unproductive firms do not enter or downsize - then why does capital dispersion increase if they don’t expand? Why do profits for unproductive agents increase?
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5. Distribution of idiosyncratic productivity across firms

- Why does this distribution change? Shouldn’t it be exogenous and fixed? Can’t we get any TFP change by manipulating this distribution?
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6. Welfare and policy perspective

- GDP increases, TFP decreases - is anybody worse off? Should financial markets development come before trade liberalization?
Minor issues

1. Evidence on exporters relying heavily on external financing

2. Data on export to GDP and intra-European trade

3. Share of exporters - over 100%?

4. Calibration: sales growth rate - where does it enter the model?

5. Subjective discount factor $\beta = 0.84$ - isn’t it too small?
Thank you