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

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   - Core performed better in terms of TFP after trade liberalization - maybe because of higher R&D spending?

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   - Core performed better in terms of TFP after trade liberalization - maybe because of higher R&D spending?
2. Financial friction
   - Collateral constraint - capital valued at the previous period price. What about alternative formulations?
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

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   - 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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   - Why does this distribution change? Shouldn't it be exogenous and fixed? Can't we get any TFP change by manipulating this distribution?
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