Discussion of

Capital Allocation and Productivity in South Europe

by Gopinath, Kalemli-Ozcan, Karabarbounis and Villegas-Sanchez

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Two big literatures

1. Misallocation literature (Hsieh and Klenow, 2009)
   - Measurement of misallocation in capital and labor across firms
   - Large differences across rich and poor countries
   - Large potential contribution to TFP differences
   - **But**: no evidence in the time series
     (and no exploration of panel data properties of misallocation)

2. Financial frictions literature (Kiyotaki and Moore, 1997)
   - A natural model for thinking about misallocation of capital
   - Baseline framework for modeling Great Recession
   - Strong micro-data implications for patterns of misallocation
   - **But**: no empirical test so far of the macro effect of financial frictions through misallocation
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3. This paper: happy marriage of the two!
This paper

1. Misallocation is an important driver of \textbf{TFP dynamics}
2. Financial frictions are a likely \textit{cause} of this misallocation
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1 Misallocation is an important driver of TFP dynamics
2 Financial frictions are a likely cause of this misallocation

- Focus: South Europe experience since the Euro
- Stylized facts:
  (a) Large capital inflows in the 2000s, then sudden stop after 2008
  (b) Stagnant (somewhat declining) TFP until 2008, then a drop
  (c) New fact: patterns of capital misallocation track TFP

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A calibrated model with collateral constraints and adjustment costs can rationalize these facts as a result of:
→ a reduction in interest rate in 1995
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- What’s **missing** from the story:
  - (a) Misallocation across sectors: construction vs manufacturing
  - (b) Nominal and real wages inflation
  - (c) Welfare evaluation
Misallocation accounting I

• Complaint about the misallocation literature:
  — We know only about \textit{MRPK} dispersion
  — not about the panel properties of \textit{MRPK} wedges
  — which contain a lot of information about the mechanism
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• Panel properties of misallocation wedges in the data:
  1. Firm fixed effects dominate the dispersion of wedges (70%)
  2. Large firms too small and small firms too large (corr of 0.25)
  3. Little evidence of dynamic misallocation: the large constrained firms were large for a long time
  4. In time series, to a large extent output and wedges move together, and inputs move very little
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• To me this suggestions small relative role for misallocation on the input side (adjustment costs or financial frictions) and large role for either markups or technology differences

• This, however, does not mean that input misallocation is not important for dynamics over time
Misallocation accounting II

• The time-series relationship between capital misallocation and TFP in South Europe is astonishing.

• But the authors can go a lot deeper inside the mechanism at the micro level. For example:
  (a) Basic decompositions:

\[
\text{var}(y - k) = \text{var}(y) + \text{var}(k) - 2\text{corr}(y, k)\sqrt{\text{var}(y)\text{var}(k)},
\]

\[
\text{var}(a + \varphi_L(\ell - k)) = \text{var}(a) + \varphi_L^2\text{var}(\ell - k) + 2\varphi_L\text{cov}(a, \ell - k),
\]

\[
\text{var}(a - \varphi_K(\ell - k)) = \text{var}(a) + \varphi_K^2\text{var}(\ell - k) - 2\varphi_K\text{cov}(a, \ell - k),
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Why dispersion in MRPL did not change?

(b) Between vs within dispersion:
— Small vs Large firms
— Financially Constrained vs Unconstrained firms
— Firms with Small vs High wedges

(c) Track the firms that received capital. Who were they?

(d) Can you say more on entry and growth of new firms?

• The model can guide this slicing of the data and these patterns should discipline the modeling choices.
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Arellano-Bond for productivity estimation