Discussion: *Cyclical Fluctuations, Financial Frictions, and Productivity Differences across Firms* by Guerrieri, Kim, and Mishin

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Overview

- What drives TFP dispersion?
  - A macro-finance model with information asymmetry and strategic default
- Goal: simple building block
- Potential applications:
  - scarring/cleansing effect of recessions and financial crises
  - supply-side effect of monetary policy
  - firm heterogeneity

Main Mechanism

- Firms receive identical bank financing and sort themselves out into three categories based on their productivity
  1. $[0, \bar{w}]$: lenders
     - Main factor: default rates as a measure of risk
  2. $[\bar{w}, \bar{\bar{w}}]$: borrowers who strategically default
     - Main factor: government bond interest rate
  3. $[\bar{\bar{w}}, 1]$: producing firms
     - Main factor: costs vs return on capital
     - $\bar{\bar{w}}$ determines TFP dispersion

- Two shocks with cleansing effect:
  - TFP $\uparrow \rightarrow$ defaults $\downarrow$, TFP dispersion $\downarrow$
  - Cost of borrowing $\uparrow \rightarrow$ defaults $\uparrow$, TFP dispersion $\downarrow$

Alternative Sources of TFP Dispersion

- This paper: heterogeneity is iid and firms only produce for one period
  - Benefit: tractability
  - Captures extensive but not intensive margin
  - The data measures TFP as outputs/inputs ratio, so may have both
- Alternative interpretation: fluctuations can be driven by heterogeneity in exposure to the aggregate shock
  - e.g. small/large firms due to differences in markups or access to funding
- Firms with a longer life would generate information and decrease the importance of the key friction
  - How much TFP dispersion can be plausibly explained by information asymmetry? How persistent is relative TFP of a firm?
- This paper fits unconditional moments with two shocks
  - Can it happen that an alternative mechanism(s) also manages to fit the unconditional moments *while* having different conditional responses?

Ambiguity in Literature

- No consensus on how financial conditions affect misallocation:
  - easier credit can direct funds to unconstrained but less productive firms, e.g. Gopinath et. al. (2017)
  - tighter credit can lead to higher dispersion in borrowing costs, e.g. Gilchrist et. al (2013)
- Both sound plausible and empirically relevant, so the sign of TFP response is ambiguous ex-ante
- Similarly, recessions can be associated with cleansing as low-TFP firms are the ones exiting the market, e.g. Caballero and Hammour (1994)

Response to Financial Tightening

- After a financial tightening, output increases
  - Output = TFP & TFP dispersion & available funds
  - Efficient model: lower investment lead to lower output
  - Baseline model: an improvement in allocative efficiency is stronger
- Would that affect the non-targeted moments fit?
  - In the model, output almost fully determined by TFP shock
  - In the data, tighter financial conditions are typically associated with a recession
- Limits quantitative exercises, e.g. how well does the model fits the data compared to other models?
- How volatility of TFP dispersion compares to the one in the data?

Response to TFP Increase

- Cleansing effect after a positive TFP shock
  - Returns to capital drop due to lower expected price of selling undepreciated capital
- Intuitively, would expect higher aggregate TFP lowering the bar as return from production increases
- The paper would benefit from a more detailed discussion the drivers of the result
  - e.g., are results sensitive to 2-period OLG structure?

Additional Evidence?

- Comparing performance against other misallocation frameworks
- TFP dispersion/misallocation response to financial and productivity shocks
  - Sparse literature, probably outside the scope of this paper
- The model delivers moments on financial variables
  - Time-varying share of bank credit
  - Interest rate spreads

Conclusion

- Since financial markets are clearly connected with misallocation, makes a lot of sense to look at defaults
- The paper introduces a new misallocation mechanism
  - Parsimoniously captures the unconditional comovements of TFP dispersion with Y, r and defaults
  - Minor issue with conditional responses
- The goal is to use the model as a building block
  - Would alternative stories fitting the unconditional moments give the same conditional moments?