

**External Imbalances and Resource  
Allocation: how do we reconcile short-  
and long- term perspectives?**

**CompNet's contribution on the role of  
reallocation / misallocation**

Antoine Berthou  
Banque de France

# Current account imbalances: is there a role for capital and labor allocation?

- **Euro integration stimulated financial flows across European countries**  
[Martin and Coeurdacier (2009)]
- **Resulted in large current account imbalances, mostly driven by the income channel and imports growth**  
[Gaulier and Vicard, CompNet policy brief 02/2013]
- **Productivity growth was stagnant or even declined in countries with Current Account deficit before the crisis**
- **Need to better understand the role of capital and labor misallocation across or within sectors**
  - Important implications both for the rebalancing process and long-term economic growth

# Evidence on misallocation before the crisis

**Frictions in input and output markets can distort price signals and generate misallocation of resources, leading to lower output and unemployed resources**

**Ricardo Reis (Brookings Papers, 2013)** focuses on the Portuguese slump in production and employment during the period 2000-2007

- Credit market imperfections tend to modify the benefits from greater financial openness by generating capital misallocation across firms

**Gopinath, Kalemli-Ozcan, Karabarbounis, Villegas-Sanchez (mimeo, 2015)**

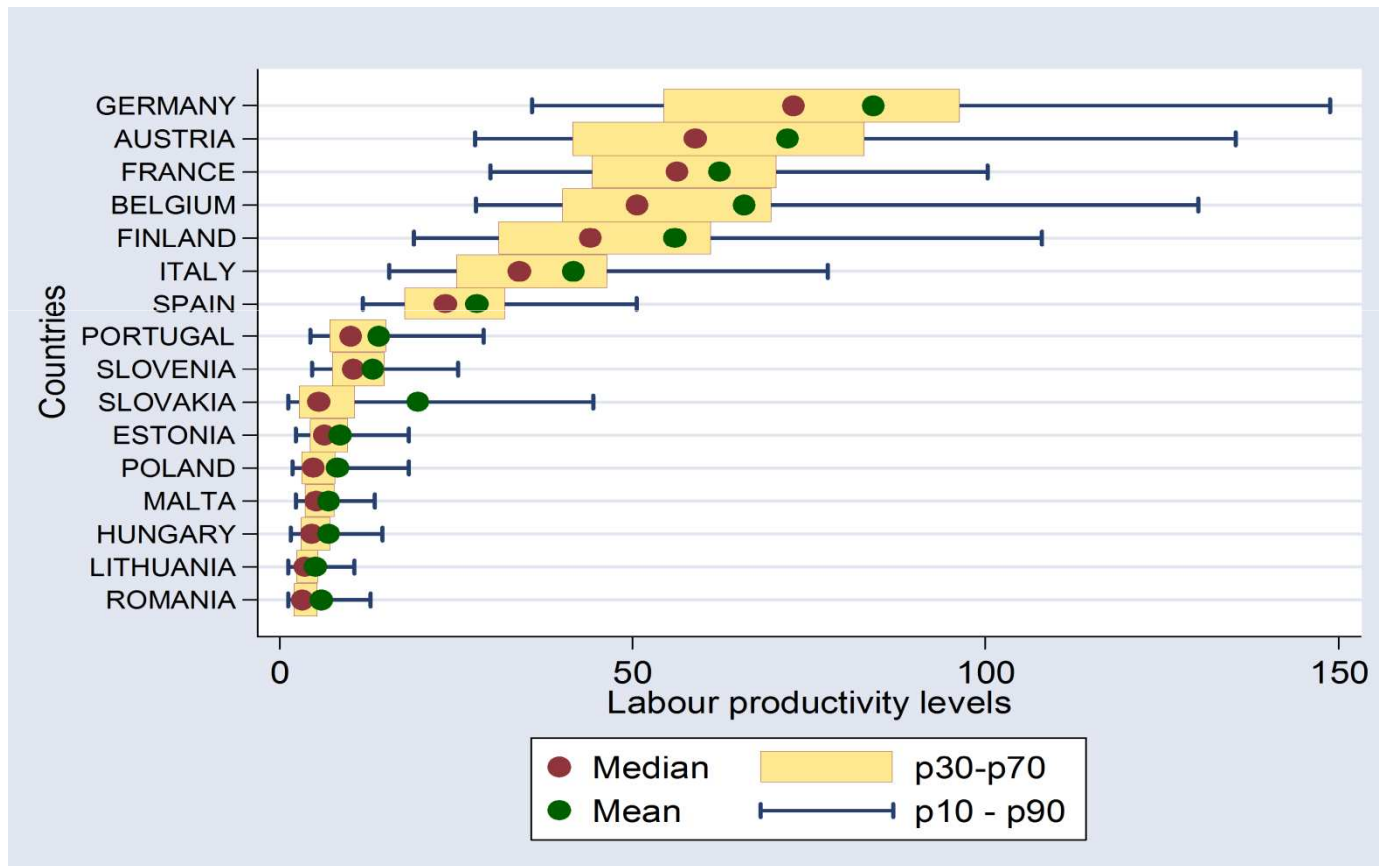
- Document a large increase in the dispersion of capital productivity before and during the crisis (a measure of capital misallocation)
- Role of size-dependent borrowing constraints before the crisis, and investments adjustment costs

# What did we learn? What do we need?

- We need to understand more why capital (and labor) may be misallocated under some circumstances
  - Policies keeping capital mobility high, and ensuring that capital is allocated to the right countries, sectors, and firms, may have great impact on long term economic growth
- We need up-to-date indicators of allocative efficiency in labor and capital markets for multiple countries for policy analysis
  - This has been the work of CompNet for the past 3 years
- We need more theoretical and empirical evidence about the economic mechanisms driving the allocation of resources

# Evidence #1: The great within-sector dispersion of productivity

- Within-sector reallocation towards best firms can generate substantial aggregate productivity gains

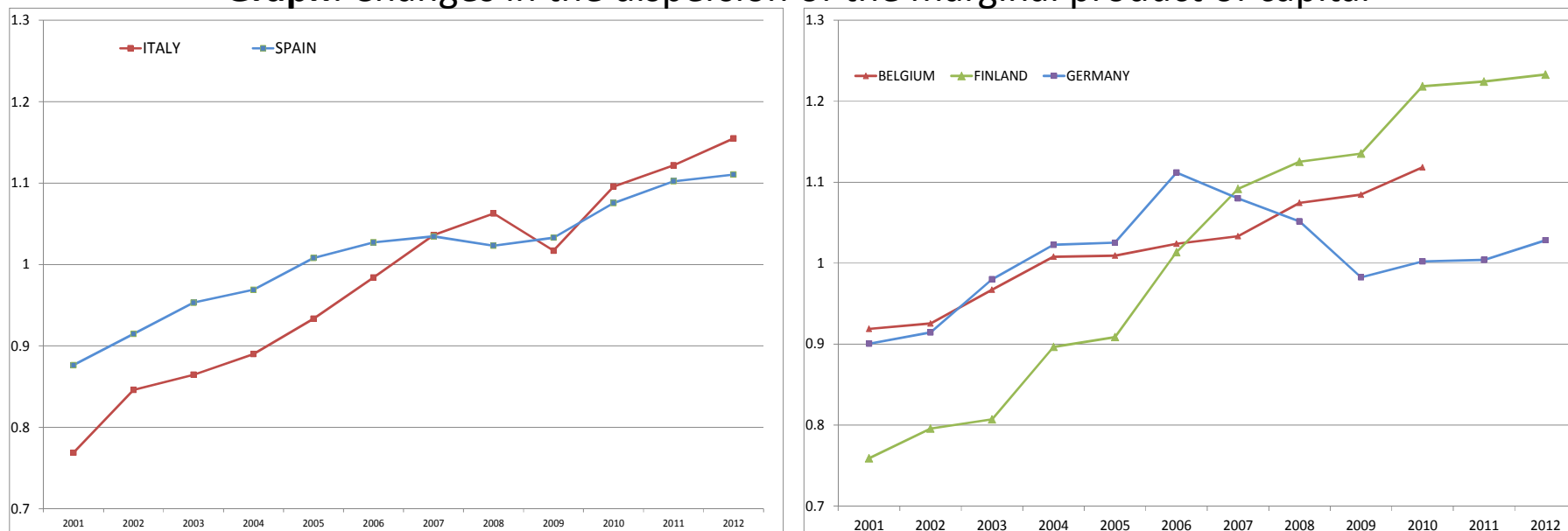


Source: CompNet Task Force (2014), Micro-based evidence of EU competitiveness: the CompNet database, ECB WP N.1634

## Evidence #2: The increased dispersion of capital productivity before the crisis

- **Allocation of capital deteriorated within sectors before the crisis** (as in Gopinath et al. 2015)
- Some firms with high returns are not able to get enough capital → Negative impact of Total Factor Productivity

**Graph:** Changes in the dispersion of the marginal product of capital



Source: CompNet final report, chapter 3 (2015)

## Evidence #3: misallocation and productivity before the crisis

**Garcia-Santana, Moral-Benito, Pijoan-Mas, Ramos (2015)** « Growing like Spain: 1995-2007 »

- Decline of Spanish TFP before the crisis explained by the rise of misallocation of labor and capital across firms within sectors
- Spanish TFP fell at an annual rate of 0.7% over the years 1995-2007
- Within-sector misallocation increased at an annual rate of 1.5%.
- **Absent such deterioration, TFP growth would have been around 0.8% per year.**

**Dias, Robalo-Marques and Richmond (2014)** document similar trends for Portugal before the crisis

- Highlight the role played by capital distortions, esp. in the services sectors

## Evidence #4: Cleansing effect during the crisis

**Bartelsman, Lopez-Garcia and Presidente (2015)**, « Assessing labour reallocation process in Europe: productivity enhancing or not? », mimeo

- Provide evidence about the role of within and between sector reallocation
- More productive sectors created more jobs during the crisis (between sector reallocation)
- Initially more productive firms also create more jobs (within-sector reallocation)

**Berthou (2015)**: « Reallocation and current account adjustment during the crisis »

- There is strong heterogeneity in the pattern of within-sector reallocation across European countries during the crisis
- Between 2008 and 2012, within-sector reallocation across firms was more sizeable among European countries with larger current account adjustment.



## Evidence #4: Cleansing effect during the crisis

- Within-sector reallocation across firms is more sizeable among European countries with large current account adjustment.



### Potential suspects :

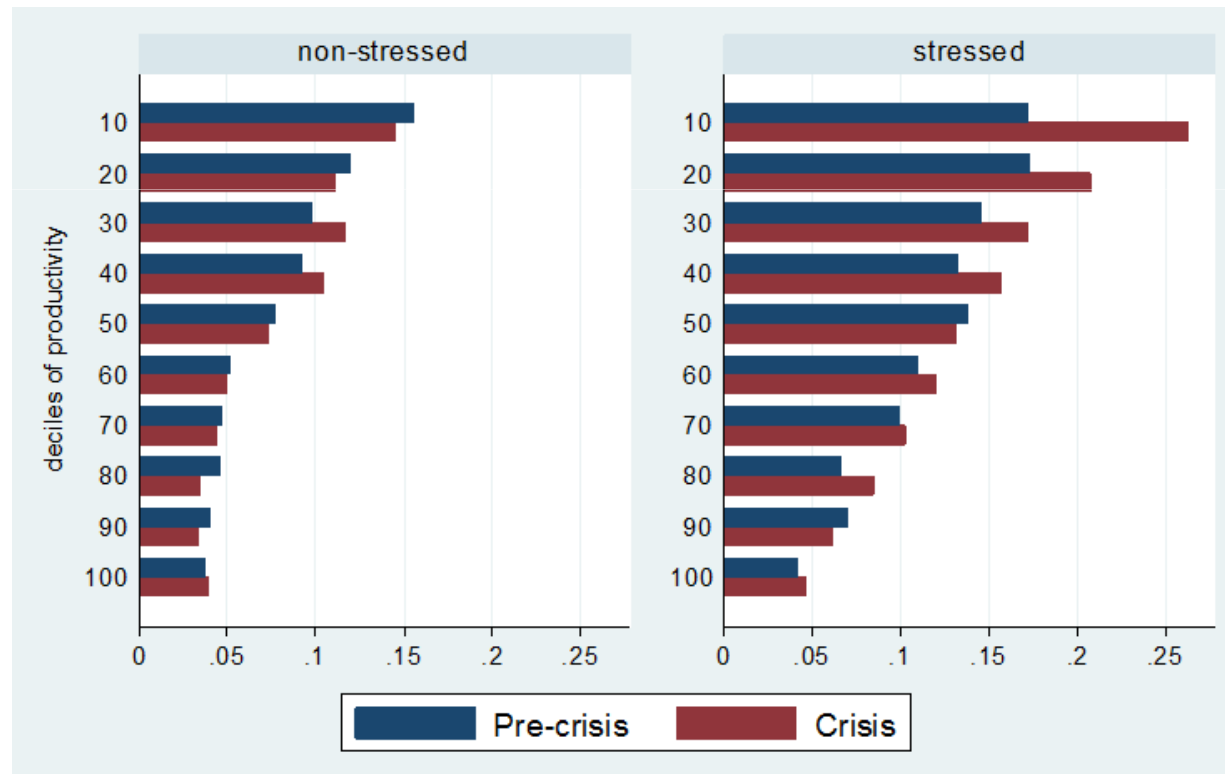
- Foreign and domestic demand shocks?
- Credit constraints?
- Structural reforms?

Berthou (2015), ongoing work

## Evidence #4: Cleansing effect during the crisis

**Bartelsman, di Mauro and Dorrucchi (2015)**, “Eurozone rebalancing: Are we on the right track for growth? Insights from the CompNet micro-based data”

**Graph:** Percentage of credit-constrained firms by labour productivity decile in stressed and non-stressed economies



Source: Bartelsman et al. (2015a), based on CompNet data (sample with 20+ employees). Notes: CompNet The non-stressed countries are Belgium, Germany, Finland and France, while the stressed countries are Spain, Italy and Slovenia. Pre-crisis data cover the period 2004-08 (with the exception of Spain, for which only 2008 data are available), while crisis period data cover the period 2009-12.

# Ongoing research and way forward

- **Great need to better understand the mechanisms driving the allocation of capital across countries, sectors and firms in Europe**
  - Important for both rebalancing process and long-term growth
  - Need to continue data collection to provide up-to-date analysis
- **Berthou, Manova and Sandoz (2015), « Productivity, misallocation and trade »**
  - Gains from trade (in terms of aggregate productivity) can be modified in the presence of capital market imperfections
- **Di Mauro, Hassan and Ottaviano (2015), “Banks, Credit and Productivity Growth”**
  - Are bank loans rightly allocated across firms?
  - Preliminary evidence based on Italy shows that credit allocation tends to respond very little to key variables such as the capital productivity or TFP