



EUROPEAN COMMISSION
DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS

Discussion of the paper ‘Does openness to international financial flows raise productivity growth?’

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Very interesting and plausible results

- Financial openness matters for TFP growth
- The composition of financial inflows matters: FDI and equity are TFP boosters, whereas debt is not
- The 'absorption capacity' of the recipient country matters: debt becomes less of a drag on TFP if financial development is more advanced
- Only beyond a certain level of financial openness are (further) increases in it beneficial (threshold effect, multiple equilibria? Big bang needed?)
- Basic results survive the robustness tests

These findings are complementing our own

- Financial openness (debt and equity) and financial development raise the sensitivity of investment to the return on capital (itself a function of TFP)
- Financial development (*de jure* and *de facto*) raises the re-election probability of reformist governments
- Threshold effect: tight regulation of product and labour market diminishes re-election probability of reformist government

A comment

- No distinction between convergence to the TFP frontier and impact of movements of the TFP frontier (latter more important in mature economies)
- Financial openness may interact with both as it diminishes the 'distance' from the frontier

Suggestion for a test

The basic specification:

$$\Delta y = -\alpha y_{t-1} + \beta'FO + \dots$$

- y_{t-1} to capture convergence effects
- α is a gauge of the speed of convergence (the larger it is, the higher the speed).

The EU Economy 2007 Review:

- **if financial regulation is tight, the speed of convergence to the frontier declines** (in services and ICT-related industries)
- Authors could test this also for their measures of *de jure* and *de facto* financial market openness, as follows:

$$\Delta y = -\alpha y_{t-1} - \gamma FO_t \cdot y_{t-1} + \dots$$

The EU Economy 2007 Review

Main effect confirms convergence

Interaction effect suggests tighter regulation reduces convergence

Table 2.4.3
The role of regulations

	All industries		Only manufacturing sector	Only private services sector	Only ICT-related sectors
	1	2	3	4	5
TFP growth at the frontier	0.171** (3.39)	0.175** (5.82)	0.368** (4.02)	0.138** (3.97)	0.153** (7.07)
Technological gap	-0.049** (5.09)	-0.047** (5.20)	-0.042* (2.26)	-0.026** (5.13)	-0.030** (6.95)
Product market regulation	-0.002 (0.96)	-0.000 (0.01)	0.126** (3.41)	-0.008 (1.65)	0.008** (2.81)
Labour market regulation	0.008 (1.45)	-0.004 (0.79)	-0.009 (1.46)	0.002 (0.36)	0.006 (0.95)
Financial market regulation	0.005 (1.31)	-0.007 (1.43)	-0.004 (0.36)	0.009 (1.73)	0.009* (2.01)
Interaction TFP growth at the frontier with product market regulation		0.016 (0.41)	0.416** (2.73)	-0.005 (0.23)	-0.040 (0.98)
Interaction TFP growth at the frontier with labour market regulation		0.060** (2.43)	0.080** (2.12)	0.069* (1.85)	0.014 (0.35)
Interaction TFP growth at the frontier with financial market regulation		-0.078 (1.82)	-0.127** (2.80)	-0.063** (2.55)	-0.081** (2.57)
Interaction technological gap with product market regulation		-0.007 (0.90)	0.064 (1.17)	-0.013* (2.07)	0.002 (0.38)
Interaction technological gap with labour market regulation		-0.004 (0.48)	-0.007 (0.47)	-0.005 (0.81)	0.001 (0.16)
Interaction technological gap with financial market regulation		-0.009 (0.34)	-0.014 (0.97)	0.016** (2.34)	0.007* (1.89)
N. obs.	6340	6340	2929	2048	2271
R ²	0.13	0.14	0.18	0.11	0.22

The EU Economy 2007 Review:

- TFP growth at the frontier spills over to TFP growth elsewhere,
- spill-over effect becomes weaker if financial markets are more tightly regulated,
- Authors could test this for financial market openness, as follows:

$$\Delta y = \delta \Delta y_{frontier} + \varepsilon FO_t \cdot \Delta y_{frontier} + \dots$$

The EU Economy 2007 Review

Main effect confirms spillover from frontier

Interaction effect suggests tighter regulation reduces the spillover

Table 2.4.3
The role of regulations

	All industries	Only manufacturing sector	Only private services sector	Only ICT-related sectors
TFP growth at the frontier	0.171** (3.39)	0.175** (5.82)	0.368** (4.02)	0.138** (3.97)
Technological gap	-0.049** (5.09)	-0.047** (5.20)	-0.042* (2.28)	-0.026** (5.13)
Product market regulation	-0.002 (0.96)	-0.000 (0.01)	0.126** (3.41)	-0.008 (1.65)
Labour market regulation	0.008 (1.45)	-0.004 (0.79)	-0.009 (1.46)	0.002 (0.36)
Financial market regulation	0.005 (1.31)	-0.007 (1.43)	-0.004 (0.98)	0.009 (1.73)
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Interaction technological gap with financial market regulation		-0.009 (0.34)	-0.014 (0.97)	0.016** (2.34)
N. obs.	6340	6340	2929	2043
R ²	0.13	0.14	0.18	0.11

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- Product and labour market regulation matter both for the speed of convergence to the frontier and the rate of spill-over from the frontier
 - This is implicit in this paper (assumption that financial openness prompts better regulation in financial, product and labour markets,)
 - Could be tested explicitly by including product and labour market regulation gauges in the regressions