# *Discussant Comments*
# *Trade Credit and International Stock Comovement*


***Michael G. Plummer,***
**Head, Development Division**
**OECD**


*Presented to the*:

**7th Research Meeting of the NIPFP DEA Research Program**

31 August-1 September, 2010

New Dehli, India

# *Introductory Comments*

- Why is it that local shocks, as in the case of the Asian Crisis or the current on, are associated with a greater co-movement across stock markets?
- The literature suggests that transmission can be due to a variety of possible factors, originating in the real-sector (e.g., “real contagion”) or via direct and indirect financial channels.
- The policy relevance of this line of research is obvious:  to avoid transmission of such shocks that are external in origin, countries have embraced a variety of measures, from various forms of capital controls to even changes in exchange rate regimes.
- Understanding the transmission mechanism is, therefore, of the essence.

# *The need to understand contagion*

- So a salient question emerges: why exactly is it that local shocks, as in the case of the Asian Crisis or the crisis that began in 2008, are associated with a greater co-movement across stock markets?
- The literature looks extensively at a variety of possible factors, originating in trade or via the actions of financial intermediaries.
- The policy relevance of this line of research is obvious:  to avoid such transmission of such shocks that are external in origin, countries have embraced a variety of measures, from various forms of capital controls to even changes in exchange rate regimes.  Easy to make mistakes!
- Understanding the transmission mechanism is, therefore, of the essence.

## *Trade credit links: an important part of the puzzle?*

- Thus, the topic of this paper is extremely relevant and, I think, an important step in the direction of understanding the origins of transmission from a microeconomic perspective.
- As noted in the presentation, the authors do this via a model that focuses on trade credit links that exist across firms and countries.
- This approach allows the authors to capture a good deal that is missed when exploring transmission via arms-length finance, including changes in trade finance that was identified as source of transmission in the current crisis.
- Focusing on trade credit links across consumers and suppliers seems to be the right way to go.

# *Comments on the model*

- There does exist some literature on this topic, and I must confess that I was not aware of it. But the extension of the analysis to focus on asset-price implications of trade credit across firms in different countries appears to be a logical extension of this literature, and I am optimistic that the paper will ultimately be a useful contribution to the literature.
- The theoretical model developed in this paper is clear and elegant. The authors note the “main limitation” of the model being a failure to include the origin of a supplier to concede trade credit, but frankly this does not seem to be a major problem, in my view.

# Comments on Empirics

- My few comments relate to the empirical side of the paper.
- The selection of countries follows the literature, in which producer countries is defined to have exports greater than 20% of GDP and their consumers are those that consume 5% or more of the producers exports.
- For producer-suppliers, producers are defined to be those countries with at least 20% of GDP in imports and suppliers supply 5% of or more of these imports.
- The paper does not include any analysis at this point regarding how reasonable these definitions are at the aggregate level.  Why are 20%/5% the magic numbers? At present they seem to be somewhat arbitrary.
- And, perhaps, problematic:  cut-off excludes US and Japan (as well as Brazil and India) as producer countries…(and yet US is included in Table 2 summary statistics for producers).

# *Sectoral Analysis?*

- Second, given the set-up of the model and the fact that the authors (admirably) are using firm-level data, could the authors undertake analysis at the sectoral level?
- I understand that the model itself is geared to an economy-wide approach, but it is not unreasonable to assume that the importance of trade credit varies across sectors, and therefore we would get different effects.
- The authors do robustness checks for firm size; perhaps sectors might be another consideration.
- Third, why terciles, outside of consistency with the literature? It is not that I believe that using terciles is unreasonable; it's just that there is no justification for it. My guess is that it might be useful to do some sensitivity analysis here.

# *Developed/Emerging/Developing*

- Third, it was not clear to me how the empirical part of the paper deals with the fact that producer/consumer/supplier relationships between developed countries, developed-emerging economies, emerging-developing, etc., would affect the empirical results.
- We would expect that trade credit arrangements would be different in these contexts.  Perhaps more discussion about how allowing such diversity would impact the results would be interesting.

# *Policy Conclusions*

- Finally, I believe that the authors could take a little more time in developing the policy implications of their research. Their primary “market” may not be policymakers, but the implications are so interesting—and the policy conclusions so easy to draw—that I believe it would strengthen the paper.