

Financial and informational frictions and the effectiveness of protectionist tariff policy

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24 February

KBTU

Ideal market

• Perfect competition

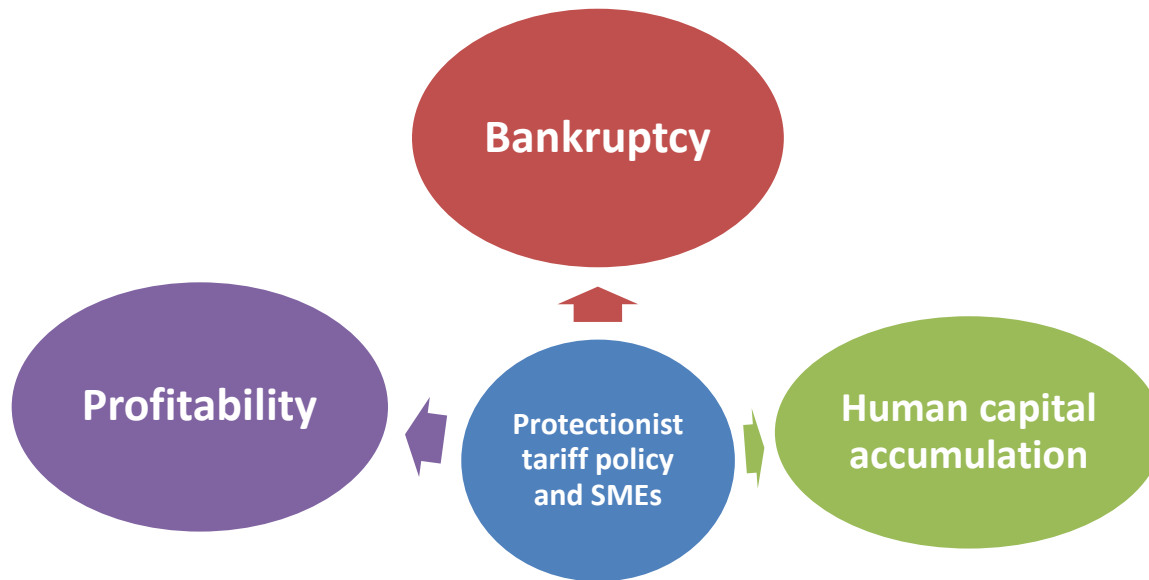
**Monopolistic
competition
P. Crugman**

• No financial frictions

**Financial Friction
Model FFM**

• No informational frictions

**Informational
Frictions Model
IFM**



Compustat yearly database.

- 3000 financial reports of firms working in or closely related to steel industry.
- The time span of the sample is from 1985 till 2012.

- 1) frictions are a more important factor for small firms versus big firms, and, consequently
- 2) small firm performance is more sensitive to the change in protectionist policy by the means of international trade barriers.

**Informational Frictions Model
IFM**

Economic integration:



Output

- An increasing of the protective custom tariff reduces the number of bankruptcies among companies of the industry where the tariff was applied, and the effect is stronger for small firms.

Financial Frictions Model FFM

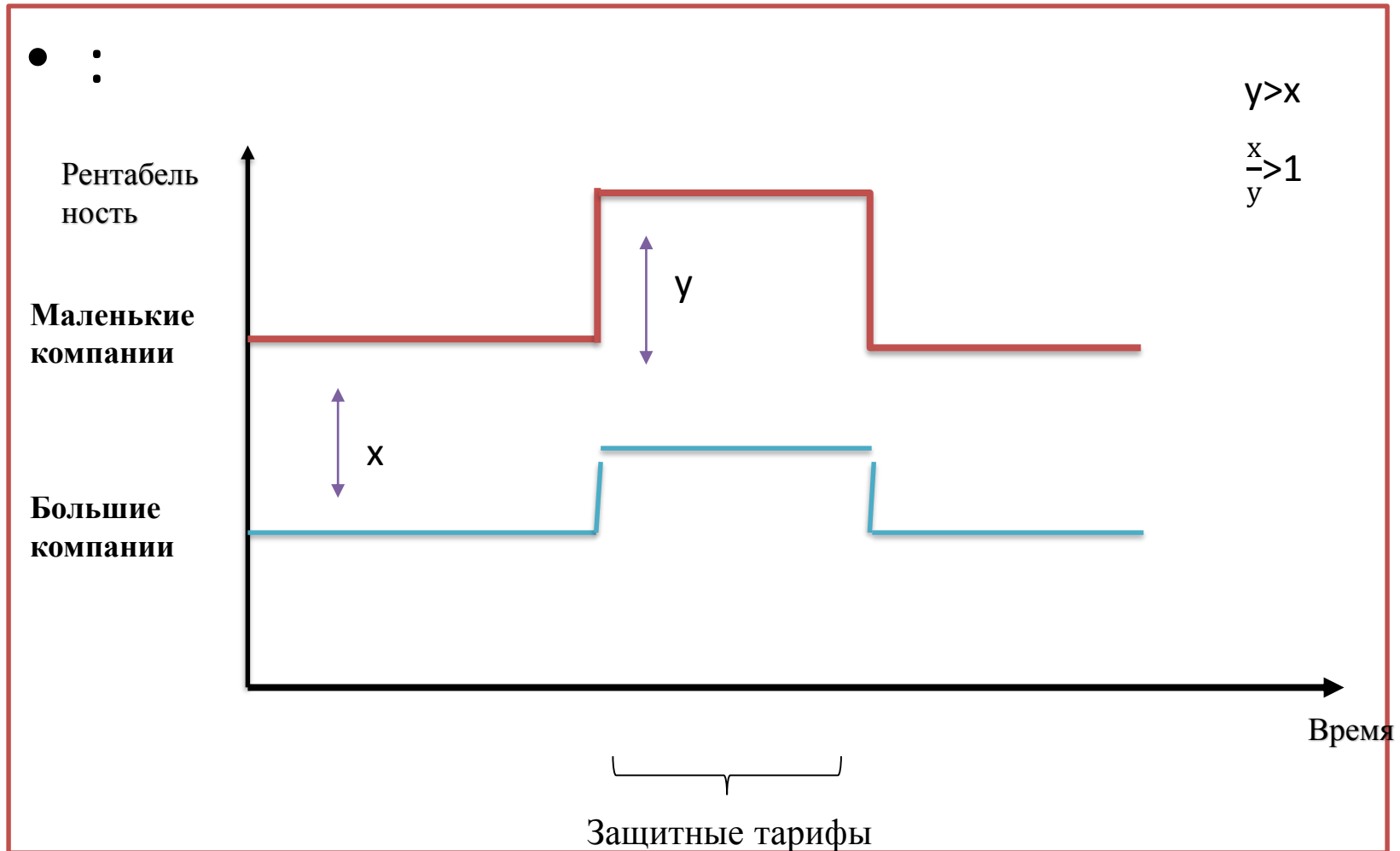
◆ Diamond's delegated monitoring theory (1984)

$$RL = rb + C/I$$

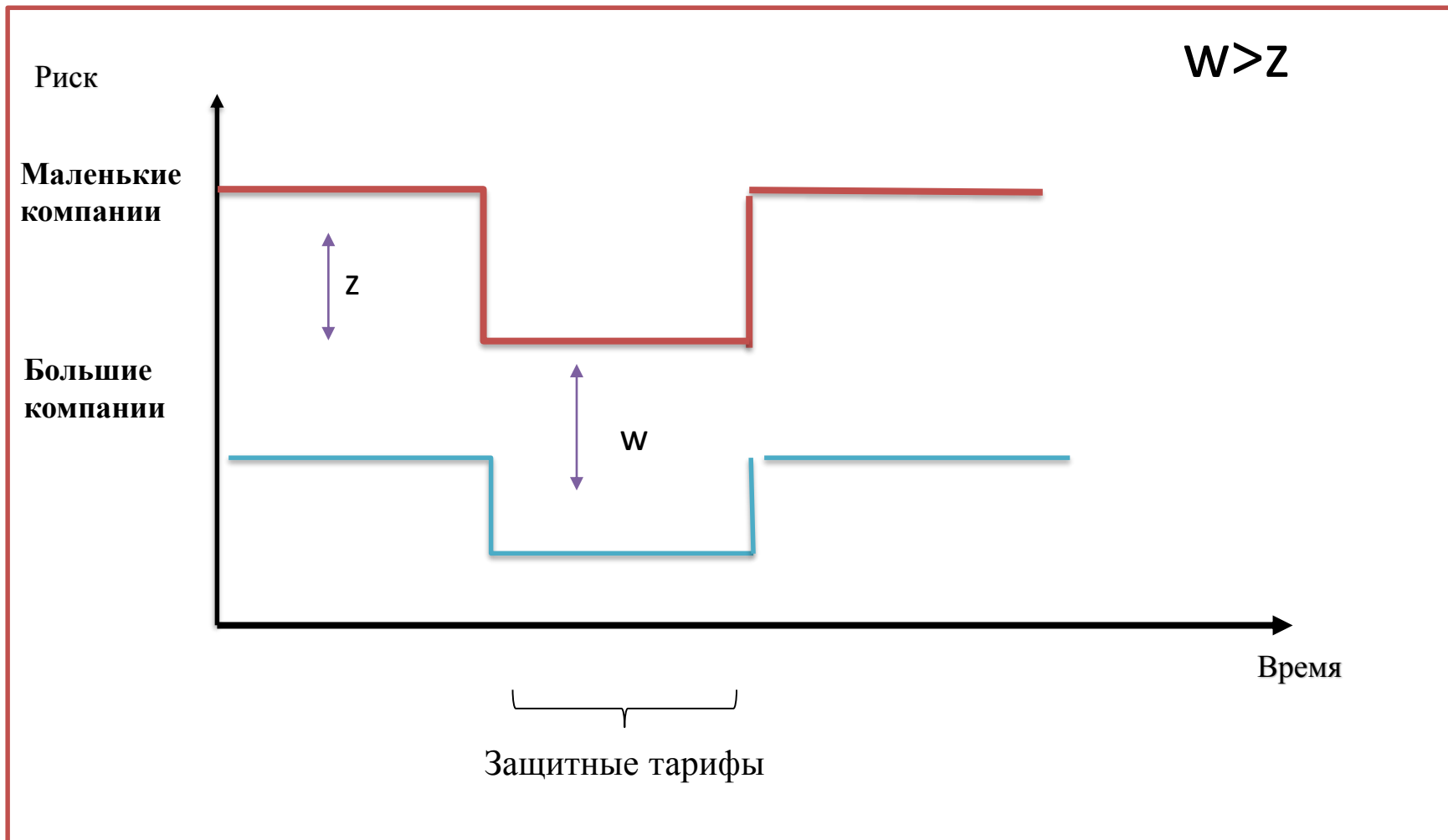
Output

- An increase in the protective tariff increases profitability of companies affected, and the effect is stronger for small firms

Impact of protectionist policy on profitability



Impact of protectionist policy on bankruptcy



Results:

1

- profitability of small firms responded stronger to the protectionist measures than profitability of big firms.

2

frictions are a more important factor for small firms versus big firms

3

small firm performance is more sensitive to the change in protectionist policy by the means of international trade barriers

Recommendation

- Small firms should consider the change of government protectionist policy as a major factor for their choice of strategy.
- Particularly they should
- a) reserve necessary resources to respond to the protectionist policy shock, and
- b) lobby the government protectionist policy (for example through establishing of industrial associations).