FINANCIAL CONSTRAINTS AND EXPORTS: AN ANALYSIS OF PORTUGUESE FIRMS DURING THE EUROPEAN MONETARY INTEGRATION

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INPUT-OUTPUT MODELLING BASED ON TOTAL-USE RECTANGULAR TABLES: IS THIS A BETTER WAY?

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1848: A PRIMEIRA CRISE DA TEORIA ECONÔMICA
Financial constraints are a key determinant that hinders firms' ability to export. This paper analyses the nexus between these constraints and firms' engagement in international trade, as well as it explores the impact of the European monetary integration process upon firms' financial constraints. Therefore, we estimate cash to cash-flow sensitivities for different periods (1996-2000 and 2001-2004) and different groups of firms, according to their exporting and importing activity. Our results indicate that, depending on their international openness, the European monetary integration seems to have generally helped reducing the degree of financial constraints faced by Portuguese firms. Additionally, our findings suggest that rather than unconstrained firms self-selecting into exporting firms' constraints were reduced after they started exporting.

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The causality between financial constraints and openness to foreign markets is rather unclear. On the one hand, open firms may have access to foreign finance and, especially if they are strong exporters, see their domestic credit conditions improve. On the other, these firms may only export because they were able to overcome the financial constraint barriers. Effectively, there are additional costs to explore foreign markets and the required investment may be financially constrained. As a result, only firms that are not financially constrained are able to export.

This paper explores how financial constraints relate to the openness of firms to foreign markets, in particular to their exporting and importing activities. Additionally, it evaluates the changes in firms’ levels of constraints driven by a monetary integration process (the European Common Currency). While we find an inverse relationship between export intensity and financial constraints, we cast some doubts on the argument stating that only unconstrained firms self-select into export behaviour. In fact, a priori constrained firms are also able to export and there are significant improvements in firms’ ability to raise external funds once they start exporting. Furthermore, we argue that while in general the monetary integration reduced the constraints faced by Portuguese firms, these were affected differently depending on their importing and exporting activities.

After the accession to the European Economic Communities (now the European Union, EU) in 1986, Portugal experienced not only the creation of the Common Market in 1992, but most of all the introduction of the Common Currency in 2001. The monetary integration that culminated in the Euro brought several changes, of which we should point out the reduction of interest rates (annualised benchmark interest rate fell from 7.2% in 1996 to 2.1% in 2004)¹ and the promotion of deeper integration of financial markets within the Euro area. Not only could economic agents obtain finance in the Euro area cheaper and in an easier manner, but also the adoption of a stronger currency has eased the access of Portuguese firms to foreign finance.

This paper is the first, to our knowledge, to analyse the effects of the European Monetary Integration on firms’ ability to raise external funds. Additionally, along with the recent text of Silva (2011b), it is the first to analyse the relationship between openness to foreign markets, exports and firms’ constraints for Portugal. Furthermore the relatively large time span of our unique dataset (see Silva and Carreira, 2010) allows us to compare two distinct periods (before and after monetary integration), which, as far as we know, is novel in the analysis of financial constraints at the firm level².

The importance of this paper with respect to policy making seems also worthwhile mentioning. On the one hand, it provides insights on the effects that monetary integrations have upon firms financial constraints, which is relevant not only to understand the subsequent behaviour of Portuguese firms after the introduction of the Euro, but also for policymakers in countries now joining the Common Currency. On the other, the clarification of the relationship between constraints, degree of openness and, most importantly, export activity, provides further evidence that is crucial to devise the adequate incentives to alleviate constraints and ultimately foster exports.

The paper is organized as follows. Section 2 makes a brief discussion of the literature on financial constraints, firms’ exports and monetary integration. In Section 3 we discuss the dataset. Section 4 describes our empirical methodology, while Section 5 presents the main results. Finally, Section 6 pulls the pieces together and concludes.

¹ Annualised Euribor and Lisbor at 3 months with adjusted Lisbor by the mean difference in common years (see Appendix for details).
² Focusing on firm size issues and using different datasets, Cabral and Mata (2003) and Oliveira and Fortunato (2006) have also analyzed the role of financial constraints. The former use entrepreneurs’ age as a proxy for wealth (ultimately for financial constraints) to analyse the evolution of firm size distribution; the latter estimate the impact of cash-flow upon firm employment growth (significant cash-flow coefficients are usually regarded as indicating the presence of financial constraints).