

## **Financial Development, Firm Growth, and Aggregate Productivity Divergence in Europe**

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### **Abstract**

Since the information and communications technology (ICT) revolution, productivity growth in Southern European countries has been substantially lower than in developed European countries. I use firm-level data for Spain and Germany to document that Spanish firms have lower productivity growth, lower intangible capital growth, lower leverage, smaller firm size, and lower firm growth than German firms. The disparity is larger among smaller firms. To rationalize these findings, I build a model featuring endogenous firm productivity growth and size-dependent financial frictions. Financial frictions affect productivity through two channels: innovation investment and misallocation. Quantitatively, I illustrate how differences in financial frictions interact with the ICT revolution, leading to differential transitional growth. The model finds that financial frictions account for 11% of the aggregate TFP growth difference in the data.

**Keywords:** D24, E22, O16, O30, O40.

**JEL Codes:** Productivity growth, collateral constraint, innovation investment, misallocation, transition dynamics.