Abstract*:

We develop a tractable quantitative framework to study the productivity effects of financial crises. The model features endogenous productivity, heterogeneous firm dynamics, and aggregate risk. Selection of the most promising ideas gives rise to a tradeoff between mass (quantity) and composition (quality) in the entrant cohort. Chilean plant-level data from the sudden stop triggered by the Russian sovereign default in 1998 confirm the model's main mechanism, as firms born during the credit shortage are *fewer, but better* in terms of idiosyncratic productivity. The quantitative analysis shows that at the end of the crisis, total output is permanently 0.9% lower.

*: Joint work F. E. Saffie (University of Virginia)