Discussion of "Efficient Bailouts?" by Javier Bianchi

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March, 2012

Outline

Overview of the Model

Borrowing constraints or "flight to liquidity"?

Some evidence

Conclusion

Framework

- Standard RBC framework (with bonds)

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- Two features:
  - Collateral constraint κ ($b' \leq \kappa k'$)
  - Lower bound on dividends ($d \geq \underline{d}$)

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- Two features:
  - Collateral constraint κ ($b' \leq \kappa k'$)
  - Lower bound on dividends ($d \geq \underline{d}$)
- "Financial shock": κ drops so that the borrowing constraint of firms is binding.

Result: bailouts are good during crises

- Firms want to borrow
- Households want to invest
- The government can “circumvent” the borrowing constraint and make this happen!

What I like about this paper

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- *Non-productivity* shock
- Useful predictions that can help distinguish between different *kinds* on non-productivity shocks

Alternative theories: "flight to liquidity"

- The shock: an increase in households' preference towards *liquid* assets
  - Panic (Caballero and Simsek, 2009)
  - "Monetary" contraction (disappearance of substitutes for money, e.g. bubbles bursting) (Martin and Ventura, 2011, Holmstrom, 2009)
  - Binding liquidity constraint on the consumer's side
  - Liquidity "hoarding": waiting for fire sales (Shleifer and Vishny, 2010)

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  - Binding liquidity constraint on the consumer's side
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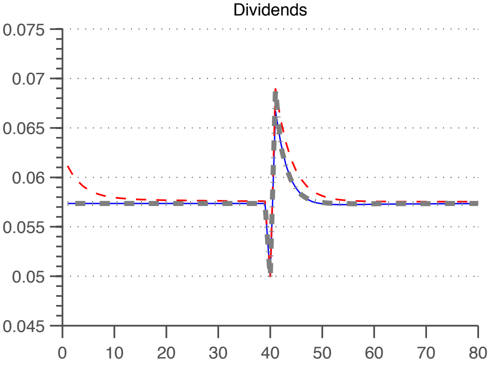
- Important difference:
  - Households do not want to lend
  - The case for a government bailout is less clear

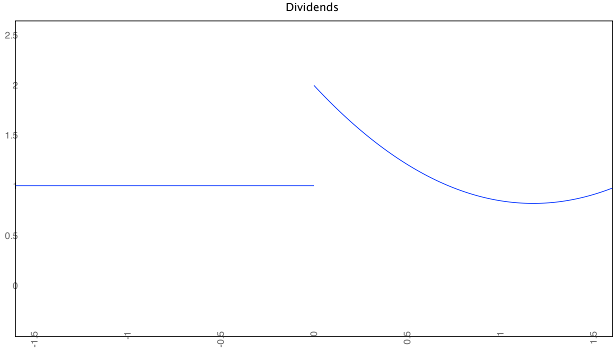
Predictions for dividends and stock prices

- **Binding borrowing constraints (Bianchi):**
  1. Dividends and stock prices drop
  2. As the economy recovers, dividends "overshoot": adjusting the capital stock is costly
  3. Dividends decline as investment returns back to trend



Predictions for dividends and stock prices

- **“Flight to liquidity”:**
  1. Stock prices drop, but dividends may increase; investment falls
  2. Dividends decline:
     - Output declines
     - Households substitute back into investment
  3. Dividends increase as output increases.

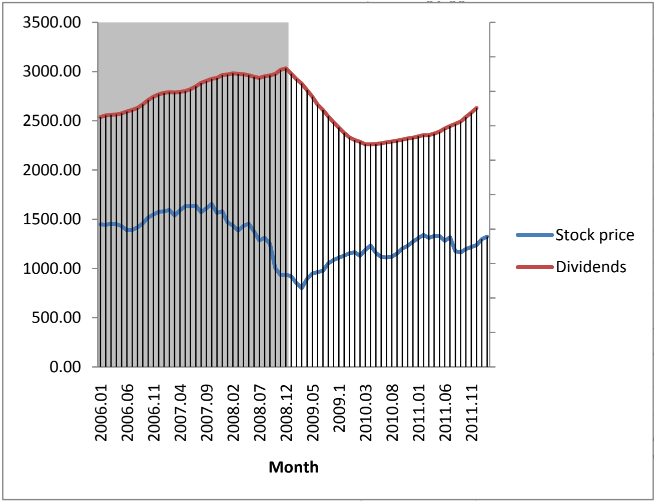


Data

- Robert J. Shiller stock market data
- S&P 500 real price and real dividend series

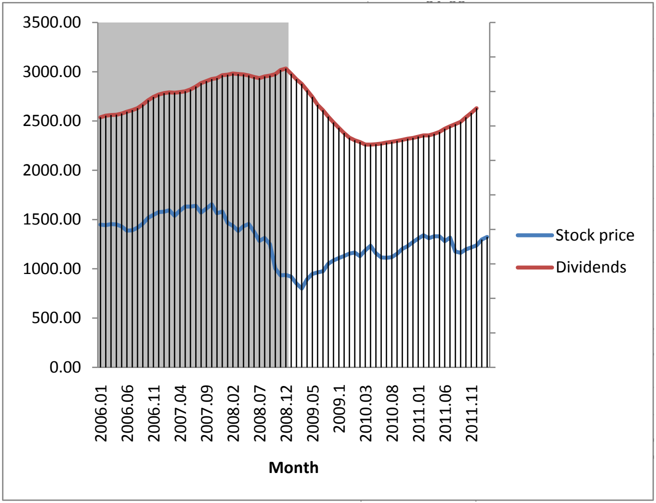
Did the borrowing constraint bind?

- **Bianchi:** stock prices fall, dividends fall
- **"Flight to liquidity":** stock prices fall, dividends increase



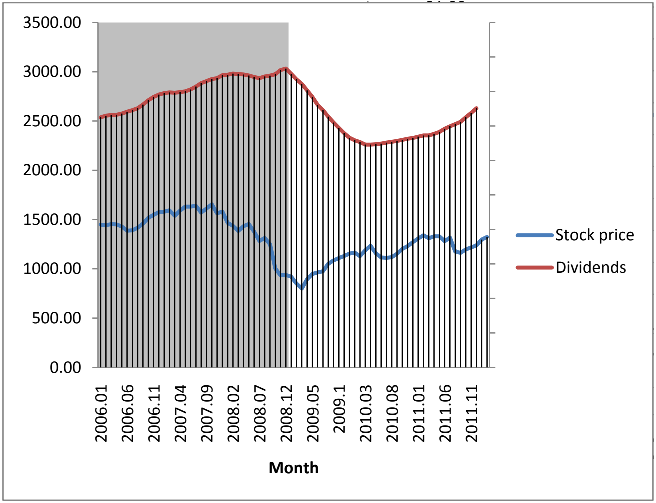
Recovery: did dividends "overshoot" or decline?

- **Bianchi:** overshooting of dividends as economy recovers
- **"Flight to liquidity":** dividends fall as:
  - Output drops
  - Households substitute back into investment



Recovery phase 2: dividends increase or decrease?

- **Bianchi:** dividends decline as they return to trend after overshooting
- **"Flight to liquidity":** dividends increase as output increases



Conclusion

- **Useful insight**: government bailouts may be good when there is a "financial shock"
- **Useful prediction:** shock to firm's borrowing ability leads to an initial decline in dividends
  - Seems to be rejected by the data; crisis more consistent with *flight to liquidity*
  - Bailouts have potentially different normative implications