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The Labor Market Consequences of Adverse Financial Shocks

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Comments on *The Labor Market Consequences of Adverse Financial Shocks*

Tito Boeri, Pietro Garibaldi and Espen Moen

Discussant: Amartya Lahiri

Jacques Polak Conference 2012, IMF

November 2012

Introduction

- The Great Recession of 2008-09 started with a financial crisis
- Existing macro models were found lacking
- An army of people went to work

Some issues surrounding the financial crisis

- What caused the financial fragility?
- What is the transmission mechanism from financial shocks to the real side?
- Was the crisis related to the pre-crisis boom?

Standard approach to financial frictions

- Finance flows from households to firms through intermediaries
- Pre-Great Recession
  - focus on agency problems between intermediaries and firms
  - Bernanke-Gertler-Gilchrist, Kiyotaki-Moore, Carlstrom-Fuerst and others
- Post-Great Recession
  - focus on agency issues between households and intermediaries
  - response to the nature of the crisis
  - Adrian-Shin, Gertler-Kiyotaki, Beaudry-Lahiri and others

Standard approach (cont.)

- Common feature: formalizing the nature of the key friction
- Agency cost important for some factor
  - cost of capital (e.g., Bernanke-Gertler-Gilchrist)
  - cost of hiring labor (Jermann-Quadrini, Beaudry-Lahiri)
- Transmission of financial shocks
  - employment of factor subject to agency cost
  - all complementary factors also affected

This paper

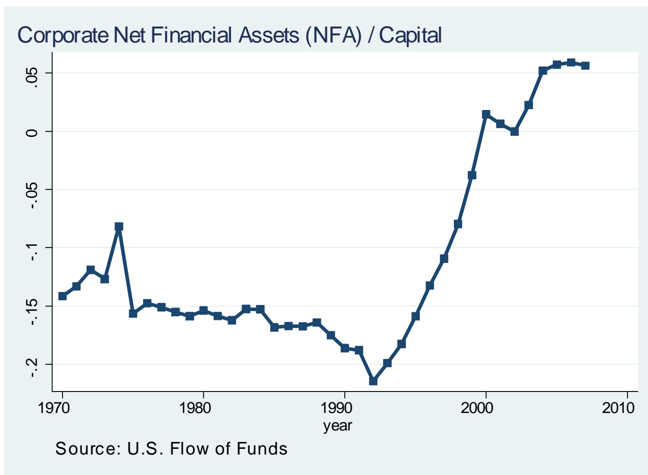
- Focus on finance and labor markets
- Story it wants to tell:
  - deep financial markets lead to more leverage and less buffer stock savings by firms
  - financial shocks in these markets lead to deep employment cuts by firms
- Markets with less developed financial markets
  - less leverage of firms
  - more buffer stock saving
  - financial shocks have smaller employment effects

Evidence on basic idea

- Is there evidence supporting the basic idea?
- Are firms very liquidity constrained?
- How large are firm savings?
- Is there a difference in corporate savings between US-UK and others?

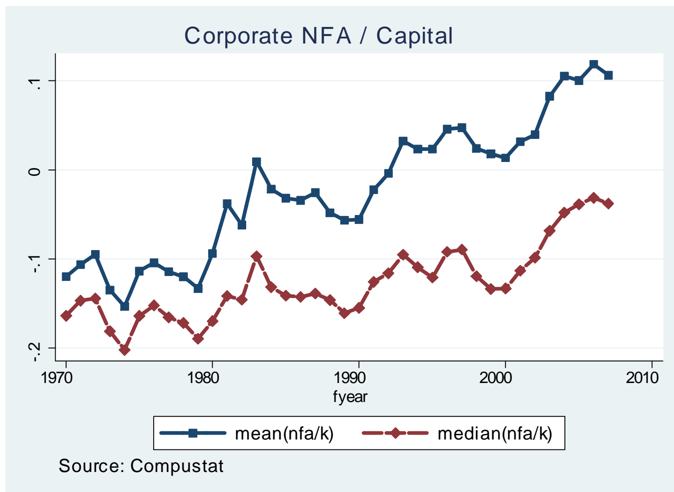
Susceptibility to liquidity shocks

Corporate savings: US flow of funds (Armenter-Hnatkovska 2012)



Firm level savings

Compustat data (Armenter-Hnatkovska 2012)



Implications of this evidence

- Rising corporate saving over the past 30 years is a global trend
  - Karabarbounis-Neiman (2012) show it for a sample of 44 countries
- Raises question regarding how important liquidity shocks are
  - corporate sector appear to have been self-insuring in the 2000s
- Maybe small private companies hold less cash
- Variation in employment changes by size distribution of firms?

What does the paper do

- Labor search model of matching
- Firm matches with one worker and borrows to produce output

$$y = \Delta + l^{\alpha} \qquad \text{(normal times)}$$

- Liquidity crisis occur with probability λ_0

$$y = \Delta \qquad \text{(liquidity crisis)}$$

- Finance is productive by assumption

Quick comment

- *Leverage* here is just a label
  - who produces finance and why is it productive?
  - what friction is it reflecting?
- Could re-label leverage as *Energy*
  - could be any productive input complementary with labor

Results

- Two equilibria
  - High credit: borrowing independent of crisis probability
  - Low credit: borrowing function of crisis probability
- High credit equilibrium: always destroy jobs during crisis
  - crisis probability affects both job creation and destruction rates
- Low credit equilibrium: keep jobs open during crisis
  - crisis probability affects only job creation rate
- Additional job destruction margin in high credit zone: bigger effects

Data corroboration 1

- Cross-Europe firm-level data during the Great Recession
  - greater leverage was associated with more downsizing
  - conclude that effect through job destruction
- Tenuous mapping of data to the model
  - is leverage important for downsizing firms in normal recessions?
  - is there variation in responses by country level of financial deepening?
- Is Europe high or low credit?
  - implicit idea: US high credit and Europe low credit

Data corroboration 2

- Cross-country, quarterly, sectoral data from the IMF
- Some evidence that financial recessions negatively impact sectoral employment growth
- Effect of financial crisis on sectoral employment growth not dependent on sectoral leverage
- Tenuous mapping of this to model
  - Is there a distinction between high and low credit countries?

Overall

- Important question about finance and employment decisions
- Needs to take a stance on what friction makes external finance important for firms
- Needs better mapping of model to the data
- Model contrasts high and low credit economies
  - The data used cannot find evidence of this
- What is a normal recession in the model?
  - I response to TFP shock in general equilibrium?