Discussion of “Efficient Bailouts?” by Javier Bianchi

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Outline

Overview of the Model

Borrowing constraints or “flight to liquidity”?

Some evidence

Conclusion
Framework

- Standard RBC framework (with bonds)

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

- "Financial shock": $\kappa$ drops so that the borrowing constraint of firms is binding.
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- Two features:
  - Collateral constraint $\kappa \left( b' \leq \kappa k' \right)$
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- “Financial shock”: $\kappa$ 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

▶ Non-productivity shock
What I like about this paper

- *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)

- Important difference:
  - Households do not want to lend
  - The case for a government bailout is less clear
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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

![Figure 2: Non-linear Impulse Responses](image-url)
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

![Graph showing stock price and dividends over time.](image-url)
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