Discussion

What Hinders Investment in the Aftermath of Financial Crises: Insolvent Firms or Illiquid Banks

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Questions

Big issue

- How do financial crises affect firms' investment?

In particular

- Currency crises may improve exporters' profitability, increasing their desired investment
- Blalock, Gertler and Levine (2008) find that foreign-owned exporters invest more relative to domestic exporters after currency depreciations (Desai, Foley and Forbes (2008) find the same for all firms)
- **What hinders exporters' investment in the aftermath of currency crises? Is it lack of collateral (balance sheet effect decreases demand for credit) or illiquid/insolvent banks (banks decrease supply of credit) also play a role?**

The Paper

The paper analyzes empirically the importance of the “banks’ illiquidity channel”

Empirical strategy in a nutshell

- Compare investment of two groups of exporters (foreign and domestic owned) controlling for balance sheet in the aftermath of two types of financial crises (currency crisis and twin crisis (currency crisis + banking crisis))
- Maintained hypothesis
  - If we observe that both groups of exporters invest similarly after a currency crisis,…
  - …but foreign-owned exporters invest more after a twin crisis,…
  - …conclude that banks' illiquidity is a relevant channel
- Additional implication: foreign-owned exporters are more able to find alternative financing and overcome banks' illiquidity

Main results

- There is no difference in the investment behavior of foreign-owned exporters relative to domestic exporters under a currency crisis
  - Both groups utilize their investment opportunity even after taking into account the balance sheet effect

- Under a twin crisis foreign-owned exporters increase investment (ratios) by 5% while domestic exporters decrease it by 13% (even after controlling for balance sheet effect)

Data

- Micro data from publicly-traded firms in 6 Latin American countries for the period 1990 to 2005
  - Panel database has information on firms' investment, ownership, sales (domestic and exports), assets
  - 4 of these countries (Argentina, Brazil and Mexico) suffered financial crises in the period
    - Argentina (2002) and Mexico (1995) currency and banking crisis
    - Brazil (1999 and 2002) currency crisis only

Comments

1. Very interesting paper
   - Very important question
   - Understanding the mechanics of the effect of financial crises crucial for policy recommendations
   - Micro data to address macro question!!

2. Is it really banks' illiquidity?

   a. Currency crises versus twin crises

   b. Differential effects of twin crises

   c. Some puzzling results

3. Other thoughts

Currency crises vs. twin crises

- Remember: Maintained hypothesis
  - If we observe that both groups of exporters invest similarly after a currency crisis,…
  - …but foreign-owned exporters invest more after a twin crisis,…
  - …conclude that banks' illiquidity is a relevant channel
- Financial crises that involve only a currency crisis can be very different from those that involve currency crisis + banking crisis
- The only difference might not be what happens to banks

An analogy

Car accident

Car accident + fire

- You want to compare how different types of accidents affect the health of the driver
- Accidents with fire hurt drivers more
- The “Fire effect”? No, accidents with fire are more violent.
- It might be the violence of the accident, not the fire!

Currency crises vs. twin crises (cont.)

- Financial crises that involve only a currency crisis can be very different from those that involve currency crisis + banking crisis

- The only difference might not be what happened to banks

- The paper argues (in robustness checks) that by comparing twin and currency crises with similar origin (Kaminsky classification) they control for this

- That is not right. One might look only at accidents between cars and buses, but still intensity is key

Differential effects of twin crises

- Paper interprets differential effect of twin crises on foreign owned exporters as evidence of banks' illiquidity story

- However, it could be that twin crises have differential effect on domestic exporters through their balance sheet or other channel

- So, we would not be separating the two effects

- Or, it might be that the difference in impact is due to other differences in domestic vs. multinational: size, do they belong to vertical chain, sectors?

Some puzzling results

- Exporters with more cash invest significantly less in the aftermath of twin crises (Table 9: Robustness checks)
    - It does not seem consistent with the liquidity story
    - Paper says it does not matter. Why?

- Exporters with more dollar assets invest significantly less in aftermath of twin crises (Table 9: Robustness checks)
    - It does not seem very consistent with balance sheet story
    - Is the control for the balance sheet story correct?

Other thoughts

- Findings are related to exporters. The paper both in the Abstract and Conclusions extrapolates to all firms ("The results suggest a key role for illiquidity in hindering investment in the aftermath of crises"). This might not be right
- Beware of too much discrecionality in defining variables (continuous foreign: less than 50% =0, more than 50% the actual value). Why not make it really continuous?
- The relevant issue is whether Beta1 is positive or negative, not whether it is larger than Beta4
- Exporters with more bank debt invest more in the aftermath of twin crises a crisis (Table 9: Robustness: Additional Controls). Why? Does it diminish balance sheet effect?
- Foreign exporters in twin versus currency?