Dual Credit Markets

RCFS Discussion

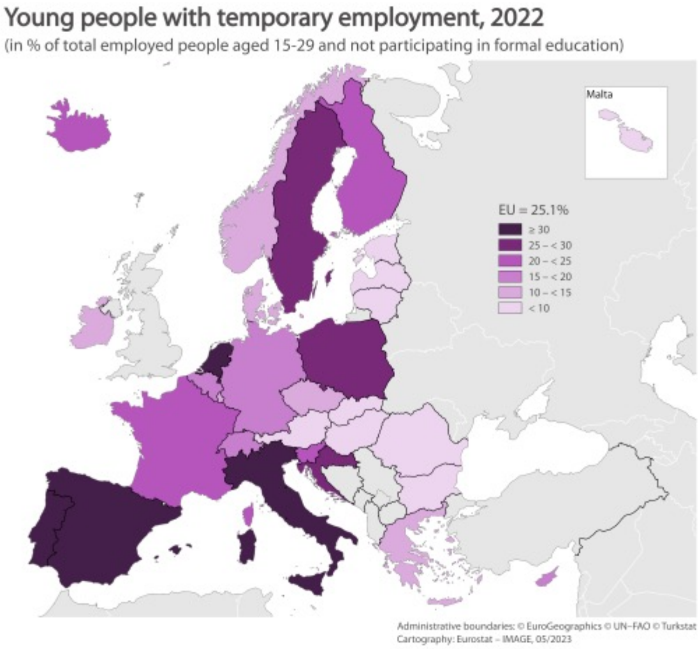
Constantine Yannelis

Income Risk and Credit

- Income is typically uncertain early in the life-cycle.

Income Risk and Credit

- Income is typically uncertain early in the life-cycle.



Income Risk and Credit

- Income is typically uncertain early in the life-cycle.
- Income risk impedes consumption at precisely when agents are building wealth.
- Temporary workers see more credit denials
  - Leads to less credit and homeownership.
- Labor laws raising job security shift more workers into temporary work.
  - Raises income risk and has knock-on effects on credit and homeownership.

Main Empirical Concern

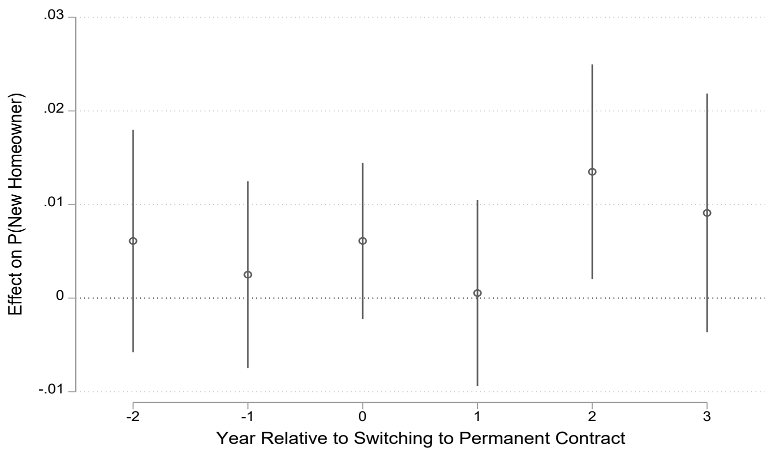
- Temporary workers differ from contract workers.
- Cross sectional results may be driven by unobserved differences between permanent and temporary workers.

Main Empirical Concern

- Temporary workers differ from contract workers.
- Cross sectional results may be driven by unobserved differences between permanent and temporary workers.
- Authors are very aware of this concern, so rely on within person variation and industry risk.
- Suggestion: Use changes try to use changes in labor laws which shift the security of workers. For example, Greece changed contract durations following IMF memorandum.
- Could also use other protections like UI and social transfers.

Main Empirical Concern

Figure 7. Transition to Permanent Contract and Becoming Homeowner



- More event studies would be helpful.
- Although this is an imperfect measure since switching

to a permanent contract may be correlated with other life events.

Is Lack of Credit Provision Inefficient?

- In a frictionless world, probably not. But we probably don't live in a frictionless world. Should these temporary workers be getting credit? Should the state be providing more insurance to workers?

- Information asymmetry: individuals on temporary contracts with lower earnings trajectories, and higher risk, may borrow more.

- Will lead to inefficient credit provision a la Stiglitz Weiss (1981).

- Do we have evidence of information asymmetry? Unclear, but likely.

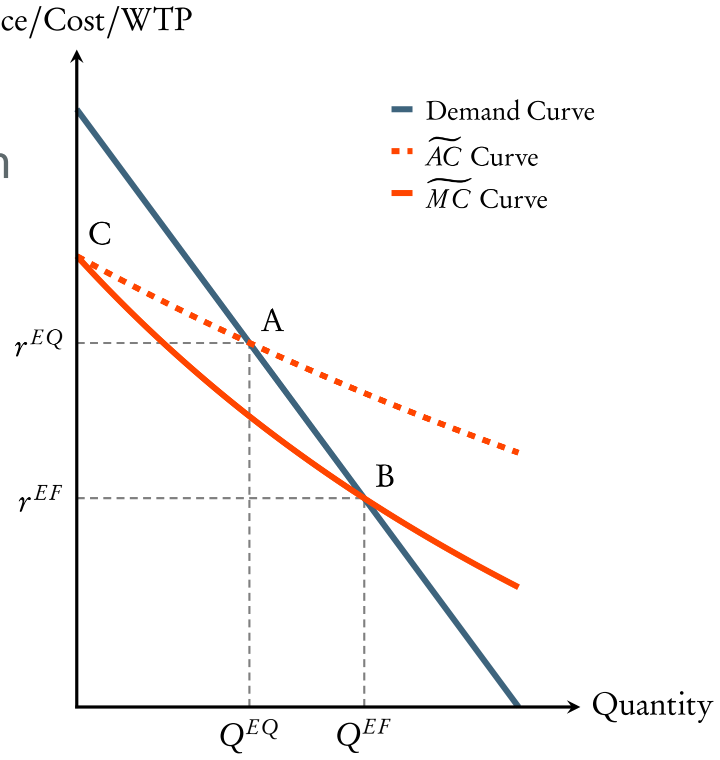
Is this Inefficient?

- Can test for positive correlation between loan balances and loan default.
  - Similar to Chiappori and Salanie (2000) test.

- If positive correlation between balances and default evidence of either:
  - Adverse Selection
  - Moral Hazard

Is this Inefficient?

- In a world with adverse selection, interest rates may be inefficiently high and loan provision inefficiently low.
- Authors can incorporate and formalize test for adverse selection.



Panel A. Equilibrium and Efficient Allocations

Policy Solutions

- Credit subsidies like:

(i) Loan guarantees and

(ii) Interest rate subsides

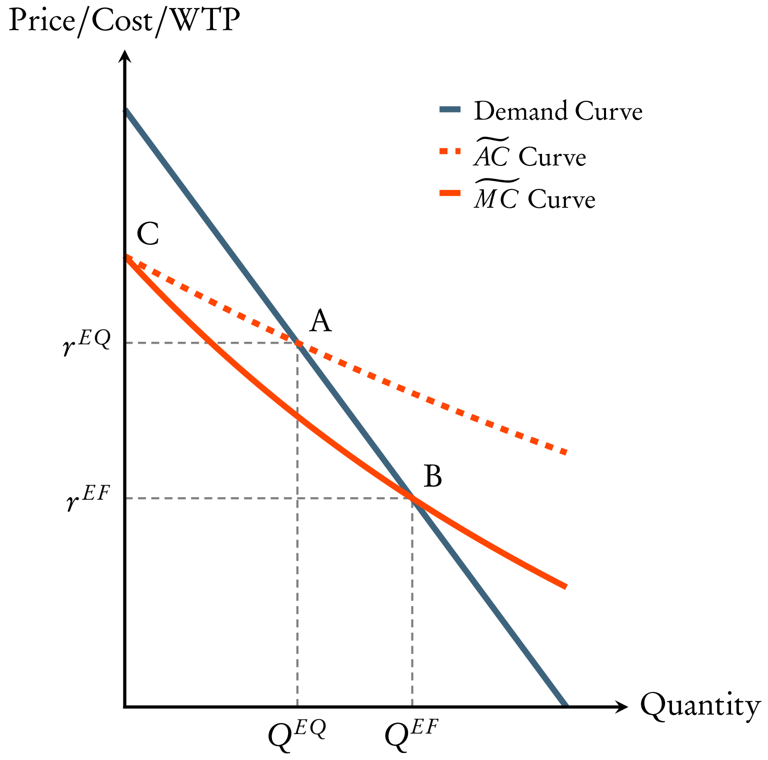
Policy Solutions

- Credit subsidies like:

(i) Loan guarantees and

(ii) Interest rate subsides

- Can help bring borrowing back up the the efficient level as in Stiglitz Weiss (1981)



Panel A. Equilibrium and Efficient Allocations

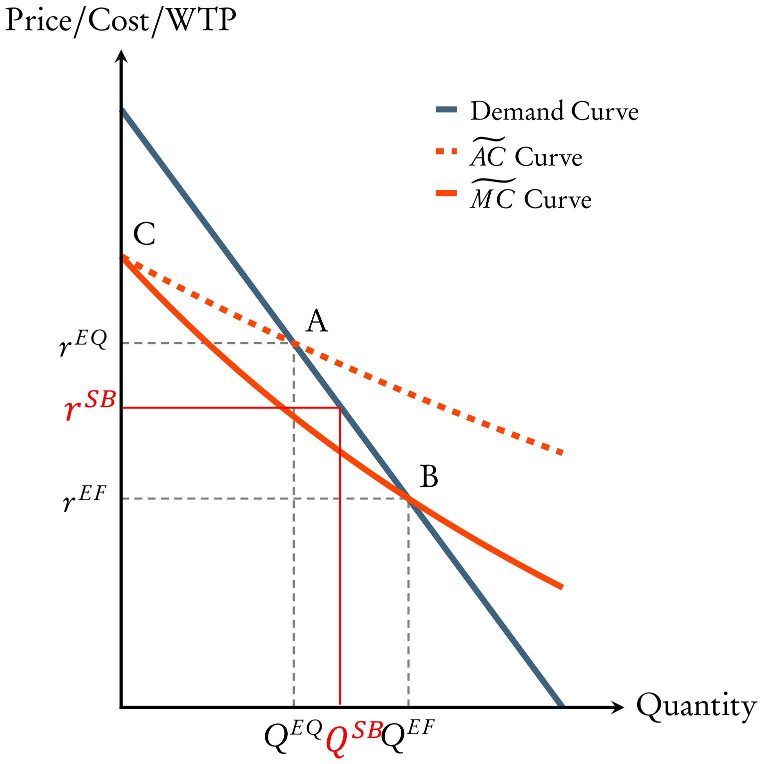
Policy Solutions

- Credit subsidies like:

(i) Loan guarantees and

(ii) Interest rate subsides

- Can help bring borrowing back up the the efficient level as in Stiglitz Weiss (1981)



Panel A. Equilibrium and Efficient Allocations

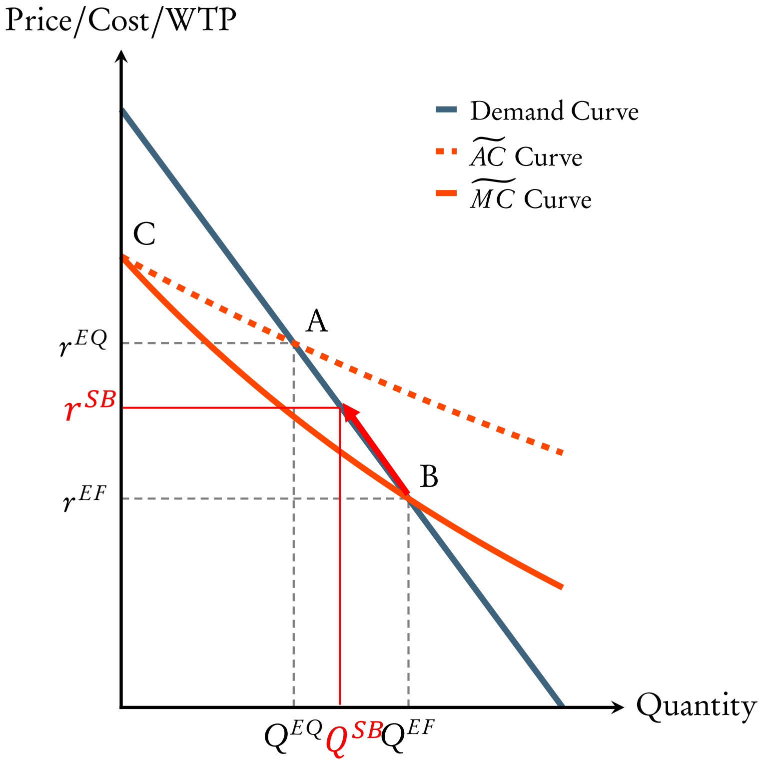
Policy Solutions

- Credit subsidies like:

(i) Loan guarantees and

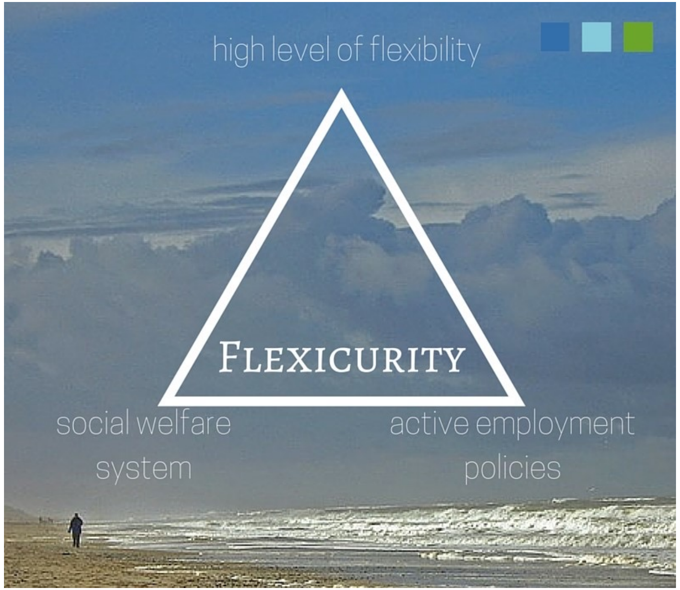
(ii) Interest rate subsides

- Can help bring borrowing back up the the efficient level as in Stiglitz Weiss (1981)



Panel A. Equilibrium and Efficient Allocations

Policy Solutions



- Flexicurity: directly insure workers through the state and provide greater benefits early in the lifecycle.
- Advantages: eliminates risk for workers, allows agents to build wealth.
- Disadvantages: possible moral hazard, may be greater early in the life-cycle if agents acquire skills and/or human capital depreciates.
- Standard trade-off between moral hazard and insurance.
- Likely also more difficult to balance than credit market interventions.

Concluding Remarks

- Very important and interesting new cost identified of stringent European labor market protections which encourage temporary work.

- Paper can strengthen identification.
  - Show trends!
  - Thank about using policy changes for variation.

- Discuss (but perhaps not come down too strongly) on a more normative framework, links to theory, tradeoffs and policy implications.