

Discussion of Braggion, Manconi, and Zhu

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Does credit contraction lead to increased labor unrest?

- **A new real effect** studied in the fledgling Republic of China
- Depletion of banks' silver reserves as a negative credit-supply shock
- Firms in proximity of banks with larger silver reserves
⇒ labor unrest ↓↓ and Communist Party penetration ↓↓

Three main comments

1. Why?
2. Why not?
3. How?

Three main comments

1. Why?

Bank-level treatment

2. Why not?

Bank-firm relationships and external validity

3. How?

Mechanism linking credit contraction and labor unrest

The treatment

The 1933 U.S. Silver Purchase program

- Cross-border spillover effects of U.S. monetary policy
 - Federal Reserve “in the back seat,” implemented policies dictated by the Roosevelt administration
- Loans have to be matched with silver reserves amounting to at least 60% of their nominal amount
- Authors use banks’ 1931 silver reserves as treatment variable

1. **Partly self-imposed shock:** definition of treatment, and how does it work?
2. Ambiguity of treatment depending on **banks' balance sheets:** all else equal?

Silver-reserve requirement

- Bank-level heterogeneity: silver-to-loans ratio
- **Case 1:** $\text{silver/loans} \leq 60\%$
 - At the margin, no more loans
 - Unless bank acquires additional silver at market price (nearly doubled!)

Silver-reserve requirement

- Bank-level heterogeneity: silver-to-loans ratio
- **Case 1:** $\text{silver/loans} \leq 60\%$
 - At the margin, no more loans
 - Unless bank acquires additional silver at market price (nearly doubled!)
- **Case 2:** $\text{silver/loans} > 60\%$
 - Bank can draw down on its silver reserves to lend until $\text{silver/loans} = 60\%$
 - Or bank stops lending, and sells its silver reserves instead

⇒ Effect on credit supply depends on decision to export silver

Banks' balance sheets

- Monetary policy transmits to the real economy via banks' balance sheets
- Shock to cost of funding (**liability side**) \Rightarrow lending decisions
- **Assumption:** no differential treatment on **asset side** despite differences in structure of liabilities (silver reserves)
- Does this necessarily hold in the setting at hand?

Yuan Shih-kai copper coin



Copper vs. silver

- Exploit parallel circulation of a currency backed by copper
- **Conjecture:** copper and silver reliance are substitutes
 - This could solve the potential endogeneity of silver reserves
- **But** copper-backed money mainly used to clear small transactions \Rightarrow substitution relationship depends on asset structure of the banks

External validity

Two layers of external validity

1. **Across samples:** within firms vs. between firms
2. **Labor unrest as a real effect:** then vs. now

- Regressions at the *bft* level, firm-time FE μ_{ft} to control for demand
- Sample drops only from 306 to 229 \Rightarrow many firms with multiple bank relationships, results virtually unaltered
- **Implications for aggregation?**
 - Real effects (labor unrest) at the *ft* level
 - Lender composition within firms matters for strength of effect
 \Rightarrow lay out summary statistics on bank-firm relationships

Unrest spillover effects across firms

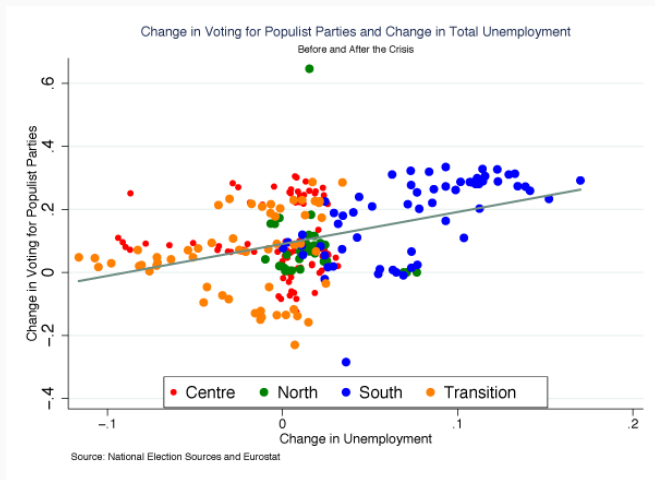
Pool of silver reserves of banks in the firm's proximity				Actual silver reserves of the firm's lenders		
Dep. variable:	$\Delta \log(1 + \text{Number of labor unrest episodes})$			$\Delta \log(1 + \text{Number of labor unrest episodes})$		
Silver pool	-0.246			-0.027		
	(0.065)			(0.014)		
Exc. silver pool	-0.229			-0.024		
	(0.056)			(0.013)		
Exc. res. pool			-0.675			-0.180
			(0.208)			(0.085)
N	1,743	1,743	1,743	60	60	60
R ²	0.12	0.12	0.12	0.09	0.09	0.13

- Mean values of explanatory variables \approx only 3 (and not 10) times as high in the right sample
- Suggests existence of unrest spillover effects: what are they?
 \Rightarrow explore them through interaction effects at the firm level

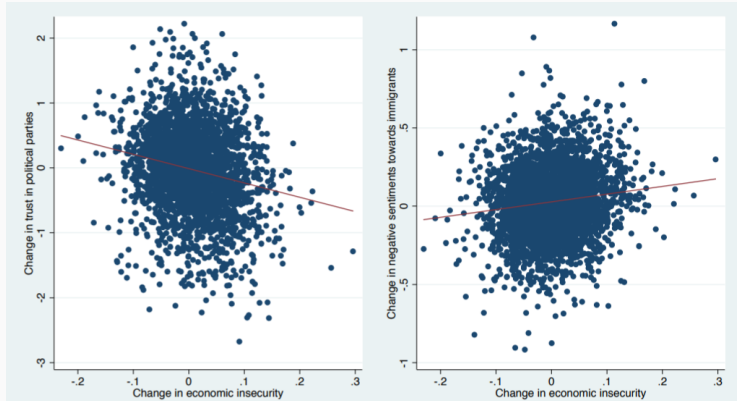
Labor unrest and communist activities

- Real effect of credit contraction due to employment effects
- **Why travel so far back in time?**
 - Severity of employment consequences (can you show more on this?): layoffs and possibility of paycuts
 - No complete absence of, but not yet functional, labor insurance and unemployment benefits (1929 *Labor Code Draft*)
- **Equivalent today:** unemployment increasing in response to credit contraction \Rightarrow support for populist parties?

Unemployment and voting for populist parties (Algan et al. 2017)



Economic insecurity, trust & sentiments (Guiso et al. 2017)



Mechanism

Two big questions

1. How can we make sure that silver outflow has no impact on unrest other than through credit contraction?
2. **How does credit contraction lead to labor unrest?**

How does credit contraction lead to labor unrest?

- Binding credit constraints can lead to:
 - Investment ↓↓
 - Employment ↓↓
 - Wages ↓↓
- If labor unrest only due to employment outcomes, then worthwhile to explore which part of the wage bill is decisive
- Smaller loans vs. fewer loans – may have repercussions for firms' decision to lay off workers vs. pay them less

Conclusion

- *Very* interesting paper on an important topic!
- Fascinating setting, massive data-collection effort, thought-provoking results
- Some suggestions on interpretation and further refinements that could help to shed light on the underlying mechanism