Discussion of "Liquidity Traps and Monetary Policy: Managing a Credit Crunch"

by J.P. Nicolini and F. Buera

Pedro Silos
Federal Reserve Bank of Atlanta

Advances in Economic Theory and Measurement, CIGS,
June 2013

The Paper

- Alternative to NK models for analyzing policy at ZLB.
    - Heterogeneity introduced in fairly tractable way.
    - Role for expansion of stock of nominal government liabilities in response to "credit crunch".

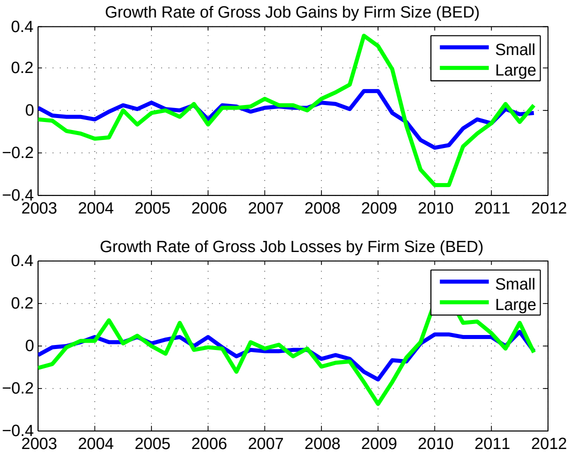
My Discussion

- The "Credit Crunch"
  - Evidence on reallocation and productivity.
  - Alternative view of credit crunch.
- A model for analyzing QE?
  - The zero lower bound.
  - Fiscal vs. monetary policy

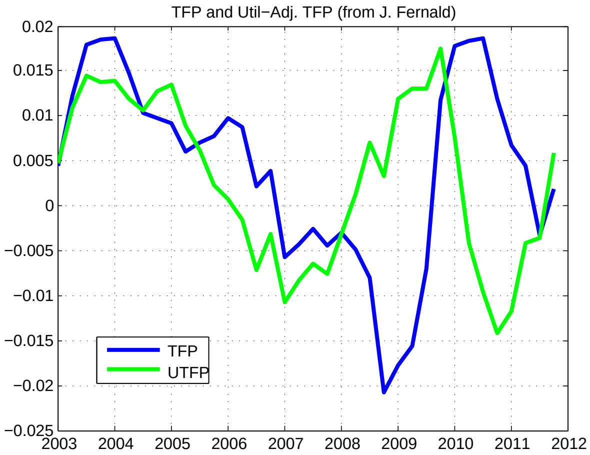
A Credit Crisis

- Sudden tightening of BC: entrepreneurs using capital can't roll over existing stock of debt.
- Capital reallocation: Only available place is to less productive entrepreneurs.
- TFP and output fall.
- Marginal entrepreneur faces lower rate of return: equilibrium real rate falls.

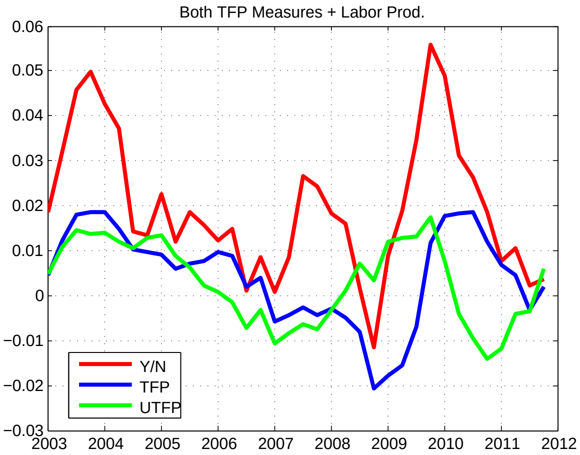
Job Gains and Losses By Firm Size



Productivity (I)



Productivity (II)



Evidence Mixed

- Larger firms lost more jobs relative to small.
- But observed drop in Solow residual due to idle resources.
- Adjustment mainly in employment, not capital.
- Destruction of least productive matches; low skilled - low productivity jobs disappear.

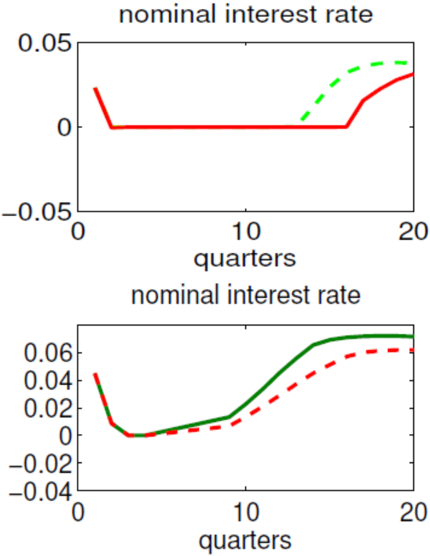
Another View of Credit Crunch

- N. Petrosky-Nadeau's JET paper (2013) "TFP During a Credit Crunch".
- Frictions in credit and labor markets.
- Credit Crunch = Increase in screening costs by lenders.
- Entrepreneurs operating technologies with different productivities.
- Increase in (active) marginal entrepreneur's productivity $\hat{z}$ increases after a credit crunch.
- Range of productivity values inside which entrepreneur is currently idle, expands in recessions.
- TFP falls but utilization adjusted TFP rises.

The Money Side

- Main result: an inflation target dampens negative shocks but delays full recovery (relative to constant money).
    - Prevents a large price level drop $\rightarrow$ real interest rate higher, drop in TFP and output not as large.
    - Increase in government liabilities crowds out private investment.

Liquidity Effect?



Fiscal vs. Monetary Policy

- Distinction between fiscal and monetary policy.
- QE targeted directly at relaxing the borrowing constraint.
  - Tax low productivity entrepreneurs give to high productivity entrepreneurs.