

Discussion of 'Corporate Cash and Employment'

ESSIM 2015

Tomasz Wieladek (BoE and CEPR)

May 26th 2015

This paper

- Documents a new stylised fact about the relationship between corporate cash holdings and employment: It is negative
 - The authors present both aggregate time series and firm-level data evidence
 - The correlation is present in both macro and firm level data and this empirical part is very convincing

This paper (II)

- Develops a theory to explain this negative correlation
- The authors put forward a real model with credit and TFP shocks, as well as intra-period need for liquidity
 - Firms need liquidity to pay wages at the end of the period
 - ➔ A rise in the cost of external liquidity leads to higher cash holdings and lower employment

Some potential issues

- How robust is the stylised fact?
- Is this the right modelling approach?
- Is this a new mechanism or a new shock?

Is the stylised fact robust?

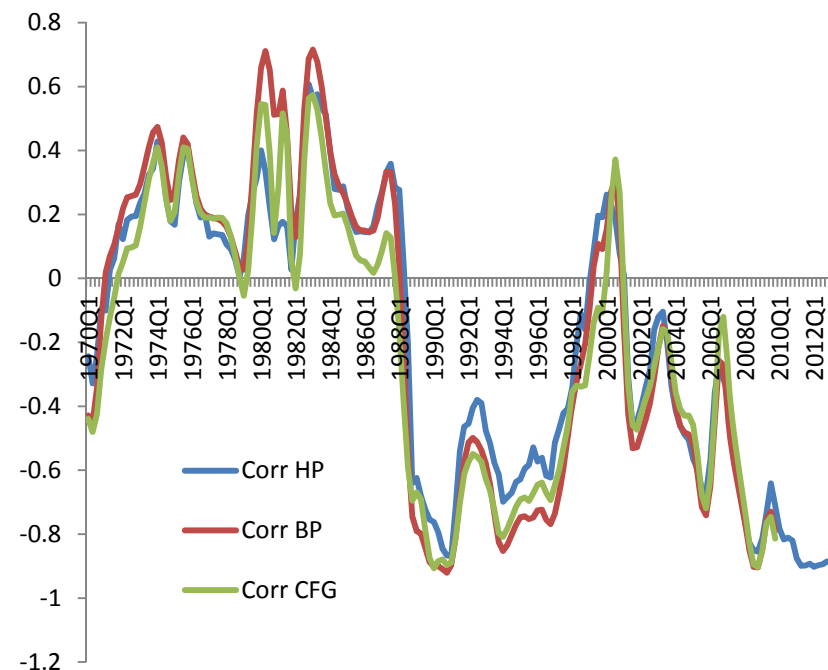
- Authors use the Hodrick-Prescott (1997) filter to document their time-series correlation. But different filters give different answers (Canova, 1993).
- Is their result robust to other time-series filters?

HP	Baxter-King	CFG	Log difference	Det time trend
-0.37	-0.38	-0.40	-0.13	0.38

- That seems to mostly be the case (3 out of 5).

Is the stylised fact robust? (II)

- 5-year rolling correlations suggest substantial time variation
- Sign Change pre/post 1988
- Consistent with liquidity/credit shock story?



Is this the right modelling approach?

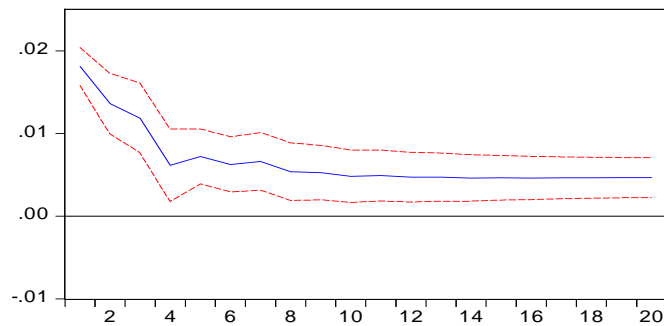
- The theory assumes that liquidity shocks 'cause' low employment and high cash-ratios
 - But firm-specific uncertainty/demand shocks, and hence low employment, may lead pre-cautionary firms to hold high liquidity ratios.
 - Which is supported by the data?
- Estimate VAR to examine this view:

$$Y_{c,t} = \alpha_c + \sum_{k=1}^L A_{c,k} Y_{c,t-k} + e_{c,t}$$

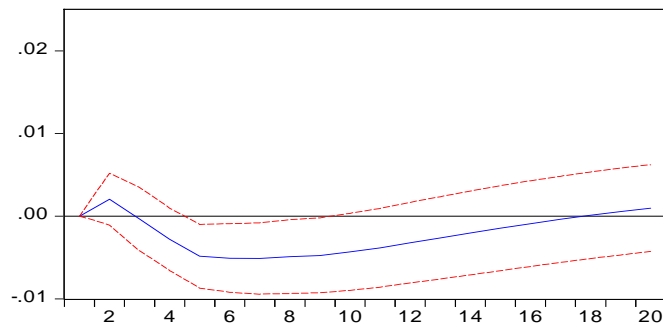
- where $Y_{c,t}$ is: log of employment and liquidity ratio
- Estimate model with both macro and firm level data
- Identify shocks with Choleski

In macro data, cash ratio shocks raise employment independent of ordering

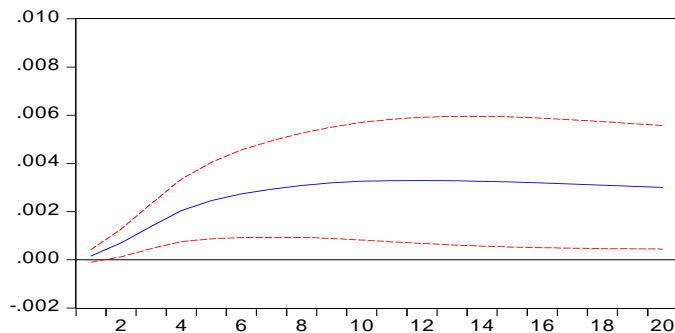
Response of CASHRATIO to CASHRATIO



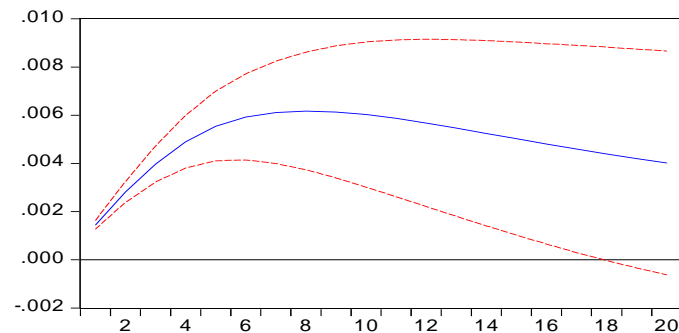
Response of CASHRATIO to EMPLOYMENT



Response of EMPLOYMENT to CASHRATIO

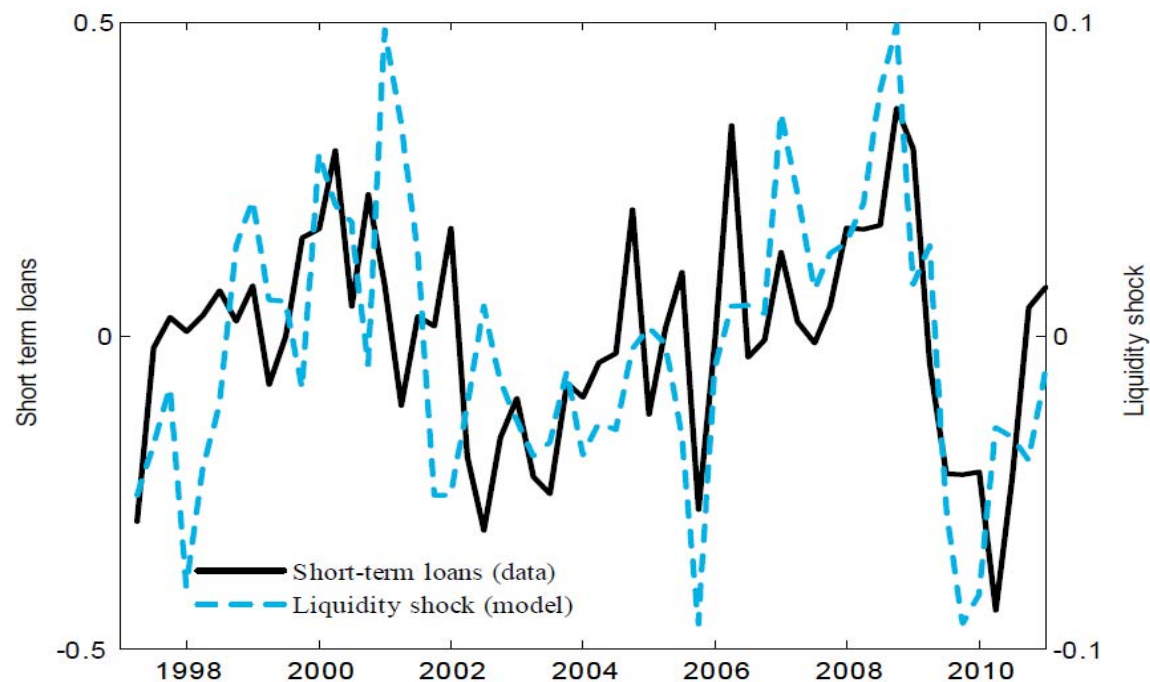


Response of EMPLOYMENT to EMPLOYMENT

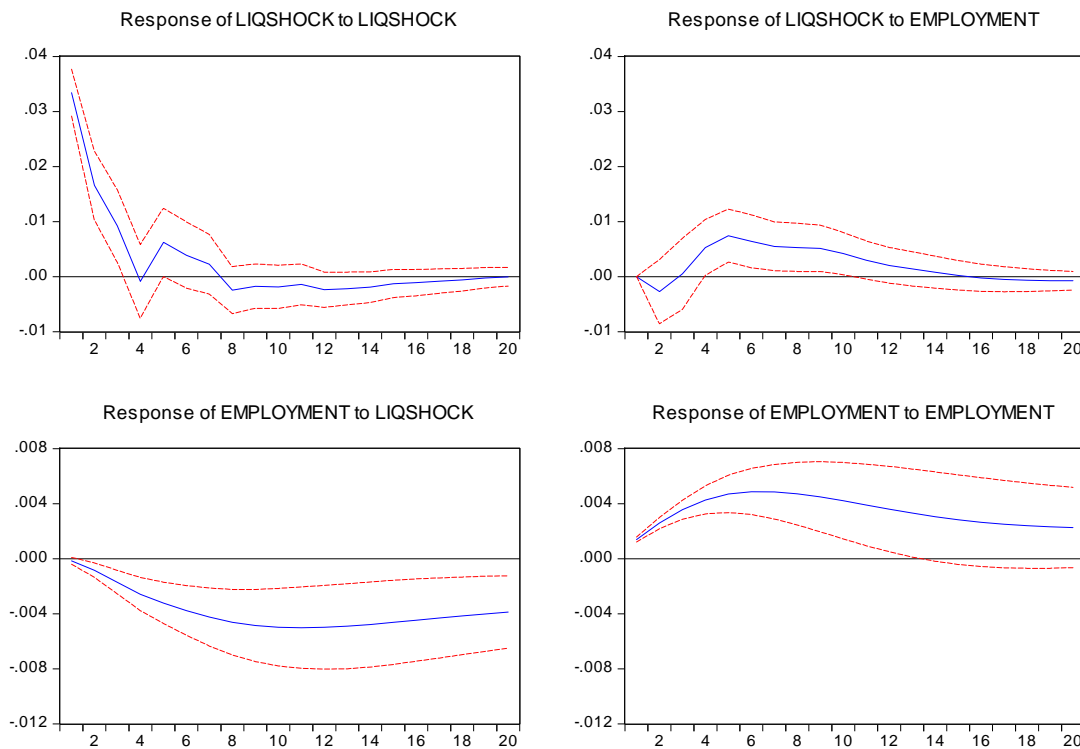


But when I use their liq shock series...

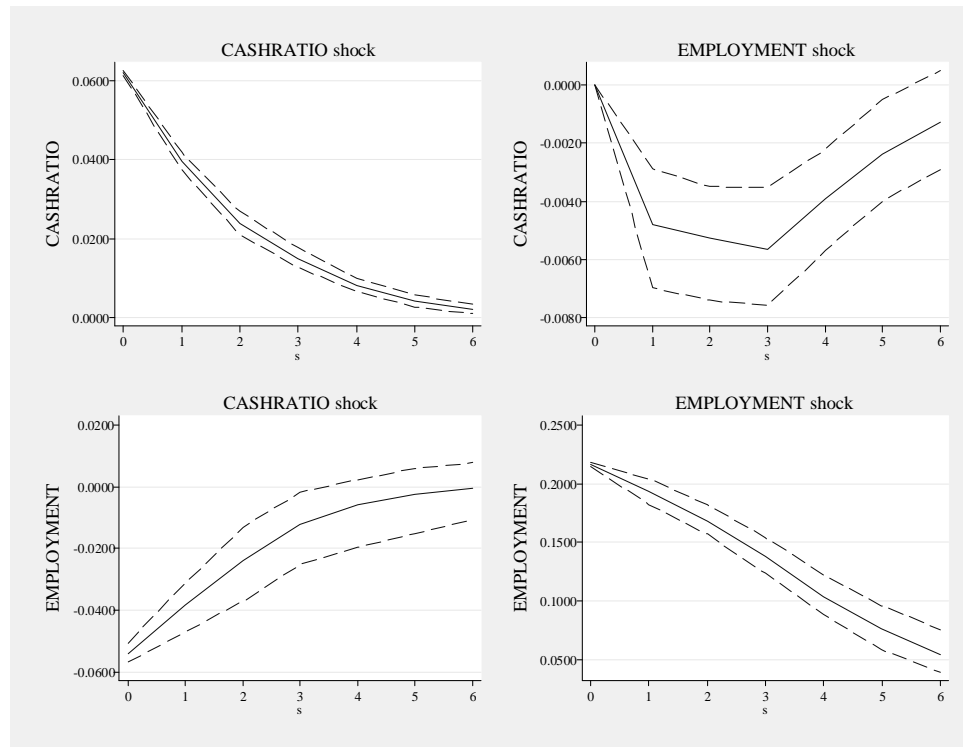
Figure 4: Model-based liquidity shock and short-term loans.



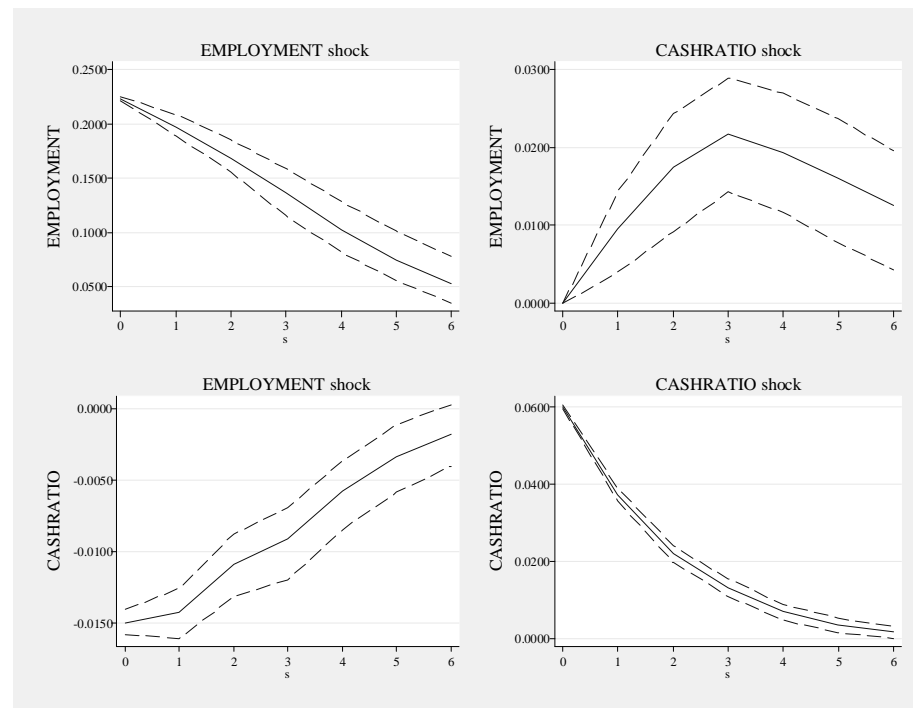
... I get a negative employment impact.



With firm-level data...



... the results depend on ordering.



New shock or mechanism?

- The liquidity shock proposed by the authors affects availability of external liquidity (commitments and credit lines).
- The credit shock affects long-term debt.
- But are these really two different things?

New Shock or mechanism? (II)

- Cornett, McNutt, Strahan and Tehranian (2011, JFE) examine the impact of a TED (LIBOR-OIS) spread shock on US bank lending.
- They find: Banks tend to cut back commitments (credit lines) significantly more than lending
- ➔ That is consistent with **one credit shock**, but **different transmission mechanisms** to liquidity/ long-term debt

Conclusion

- Well executed paper.
- Very credible documentation of a negative correlation between employment and liquidity
- But not clear if:
 - The data is consistent with the theory.
 - This paper is about a new shock or new mechanism?