Fioralla De Fiore, Pedro Teles and Oreste Tristani: Monetary Policy and the Financing of Firms

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Overview

- Issue: Our imperfect understanding of the macroeconomic role of financial frictions
- Paper develops and elegant, dynamic stochastic general equilibrium model incorporating financing constraints for firms
- explores implications for policy, notably that it becomes acceptable to have periods of inflation to lower financing burden on firms.
- Sophisticated set up: firms (entrepreneurs), households, banks.
- One of several current models incorporating financial frictions in DSG
- Here, no sluggish price/ wage adjustment

Description

- Households optimize over consumption, leisure (labour supply), money holdings, debt.
- Firms have a linear production technology, but output is constrained by level of net worth
- Firms borrow additional funds from banks, according to standard costly state verification set up
- This implies that borrowing and output is proportional to net worth
- Nominal firm worth is predetermined, before shocks occur and policy responds.
- Monetary policy is characterized by a plan for the price level

Assessment

- Rich model; overcome several technical challenges.
- I am working on related model of money transmission, I know this is hard.
- Skillful and relevant. But there is a lot going on this model.
- So my discussion focusses on assumptions and set up, not conclusions and policy analysis
- I encourage the authors to put in more intuition explaining what underlies their results..

What is money in this model?

- Money is distinct from bank deposits.
- It is the only store of value for firms (where they 'keep' their net worth.
- It is one store of value for households (the others are arrow securities and bank deposits)
- This 'money' is supplied exogenously by the monetary policy maker
- Institutionally hard to understand. Where is broad versus narrow money?

Entrepreneurs versus households

- Model has a marxist flavour: capitalists versus workers!
- Relationship between two might be explored further
- Technical problem with entrepreneurs never consuming. They are myopic. Expect to consume in future, but never do because of lump sum taxes.
- More natural (I think) to have households as shareholders in firms, paying dividends
- With firms managed by professional managers (agents)
- Work on optimal firm dividend policy may be relevant e.g. Milne and Robertson (JEDC 1996)

Is appeal to representative firm valid?

- In this kind of model (see for example Caballero), usually necessary to trace the distribution of net worth amongst firms
- Not necessary here because of the linearity of the production function
- This is a nice technical device, but the long run equilibrium determined by government (otherwise we get unbounded growth)
- Is it realistic? Does it overstate the impact of finance on real output?

Finally: nature of shocks

- A key driver is the assumption that net worth of firms is pre-determined
- Allows a role for aggregate shocks, but not shocks to bank net worth
- One form of shock is increase in monitoring costs, I am not clear how to interpret this
- Overall, very worthwhile paper, elucidates one aspect of a very complex problem. Would be good to have an agenda for further research, in light of this work.

Minor comments

- Do not follow the "implementability conditions" , needs more intuition discussion
- The policy makers objective function could be discussed more clearly and earlier on
- Almost all results derived with utility logarithmic in consumption and linear in leisure (which implies that shocks do not affect labour supply). Why not start with these assumptions from the beginning?