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The Impact of Creditor Protection in the Presence of Credit Crunches

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The Impact of Creditor Protection in the Presence of Credit Crunches

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The Basic Idea of the Paper

- Legal regimes across countries vary in terms of <u>creditor rights</u>, or the <u>ability to seize collateral in states of default</u>

- An increase in the ability to seize collateral has two effects stock market

  1. Reduces the probability of a credit crisis
  2. Has an independent effect on stock price not related to the probability of a credit crunch

- The goal is to empirically show the importance of both channels

Empirical Approach

- Appears to be standard two stage least squares set-up:

$$\Pr(CreditCrisis) = X * \beta + IV * \delta + \varepsilon$$

$$Stockmarket = X * \theta + \widehat{\Pr(CreditCrisis)} * \lambda + u$$

- If properly specified, this gives us the causal effect of a credit crisis on the stock market level and volatility

- But here, the authors fully admit that strong creditor rights is not a valid instrument
  - The theory shows that creditor rights has an independent effect → violation of exclusion restriction

Empirical Approach

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- Instead, the authors predict first stage with and without inclusion of creditor rights, and then see whether effect of predicted credit crisis is larger or smaller with inclusion of creditor rights in first stage.

- Creditor rights also in second stage?

Main Comment

- Use of applied microeconomic techniques critical to understand causal mechanism of this very important questions

- But the empirical design is confusing:

  - This empirical approach is not standard and I have no idea whether the properties justify the conclusions
  - The inclusion of creditor rights in both the first and second stage makes it hard to interpret the independent effects
  - Creditor rights is a country-specific time-invariant characteristic, and the authors switch between country and region fixed effects

Main Suggestion

- The effect of creditor rights on credit crises is of first order importance and a really interesting question
- Why not focus uniquely on first stage? And try to get exogenous shocks?
  - Creditor rights is country-specific and time-invariant
  - To identify the effect, it is best to use a global macro-shock, and then see how each country responds
  - Has there ever been a global shock that could be used to address this question? (Irony)