Discussion: The Impact of Securities Regulation on New Keynesian Firms

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- Testing model predictions on real and financial outcomes: stickier firms increase leverage, have more volatile equity return, are more sensitive to MP shocks (in investment and stock price) after SOX

Comments

- Clarify the punchline
- Commets on the empirical evidence
  - The underlying mechanism
  - The response of other firm outcome variables, help connect to the model
- Comments on the model
  - Modeling the information friction more formally
  - The purpose of the model: connecting to empirics
  - Exogenous credit spread and result robustness
  - Countercyclical credit spread

The Punchline

1. Price stickiness makes financial frictions severe through misreporting
   - The SOX is interpreted as a economywide financial friction shock (reduced misreporting), and the empirical results show stiky price firms are affected more
   - The role of the model: highlight the channel of "misreporting", and how that is interacted with price stickiness, but the current model seems to "assume" the channel

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2. Impact of security regulation on firms of different price rigidities
   - Compare to the security regulation literature, especially its real impact
   - The role of the model: quantitatively match the DID effect and use the model to infer aggregate effects

SOX on Firms: The Mechanism Underlying DID

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- While the mechanism is straightforward and plausible, it will be nice to provide direct evidence on this exact mechanism
  - Evidence of overstatement is very helpful, but are they linked to financial frictions?
  - The authors rule out alternative explanations of more risk taking, but how about due to reduced cash flow volatility (Augustin et al, 2021) - the authors' mechanism also leads to lower cash flow volatility
  - More work or direct evidence on the information mechanism will be useful

- The authors test the responses of other firm-level variables using the same DID design

The Response of Other Firm-level Variables

- The authors test the responses of other firm-level variables using the same DID design
  - These results are presented after the model as model implications. In my opinion, these results are equally important as the loan spread and collateral result, as they measure the real impact of security regulation
  - The variables the authors look at: leverage, equity return volatility, investment and stock price sensitivity to monetary policy shocks
  - Other useful variables to check: dividend vol, investment vol
  - Why specifically focusing on MP shock? How about other shocks?

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- The model assumes sticky firms face higher spread than flexible firms, and the difference is reduced after the regulation
- Why sticky firms' behavior less likely to be verified? Shocks are economywide, price stickiness is persistent and close to predetermined
    - If keeping prices staggered can hide information that insiders do not share, why not for flexible price firms?
- Helpful to clarify the source of information friction more formally

Why Model? Connecting to Empirical Evidence

- Currently the model is to illustrate the differential response of sticky and flexible firms through IRFs, and derive implications to be tested
- The model can do more
    - Quantitatively match the aggregate moments and the DID evidence (both before and after, loan spread, collateral, real and financial impact)
    - How much aggregate volatilities are reduced? Is there any change in variance decomposition, i.e., contribution of MP shock and TFP shock
    - Any general equilibrium of the size change of sticky vs. flexible sectors

Exogenous Credit Spread and Result Robustness

- The authors specify a borrowing constraint for sticky and flexible firms

$$b_{jt}(i) \leq \mu_j E_t[K_{jt}(i)\Pi_{t+1}/R_{jt}^B]$$

  - The authors assume $\mu_1 = \mu_2 = \mu$ and $R_{2t}^B = \tau R_{1t}^B$ ($\tau > 1$)
  - The loan rate is endogenously solved in a standard model, which is the sum of risk-free rate and the shadow cost of constraint. Why can the authors specify loan spread exogenously? More elaboration is helpful
  - The authors try an alternative setting, $R_{1t}^B = R_{2t}^B$ and $\mu_1 > \mu_2$, equity return volatility is reversed

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  - The authors try an alternative setting, $R_{1t}^B = R_{2t}^B$ and $\mu_1 > \mu_2$, equity return volatility is reversed
  - Standard model logic: if a firm faces more stringent constraint, the cost of debt is higher, which should have similar effects as loan rate different - why does the result reverse?
  - More discussion on result robustness will be helpful

Countercyclical Credit Spread

- One key mechanism of the model is countercyclical credit spread

- The countercyclical of credit spread is plausible and common in typical models of financial frictions. In bad times, constraints tighten and the shadow cost of debt rises, loan spread increases

- The logic in this paper is different: in bad times, expected consumption growth is high and interest rate is high, which drives higher loan spread

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  - Since loan spread is specified, the mechanism of endogenous shadow cost of debt is not present

  - More discussion on the comparison of these two mechanisms will be helpful for understanding the model

Conclusion

- A great paper on a very interesting topic, recommend to everyone
- Clean empirical results, quantitative model plus additional predictions
- My comments
  - Make the punchline clearer
  - More formally elaborate the source of information friction
  - Connect the model more to empirics, quantitatively fit aggregate moments and DID evidence, conduct variance decomposition can be an insightful exercise
  - A bit more elaboration on the driver of loan spread can be helpful