Discussion of “Economic Crises and the Lender of Last Resort: Evidence from 19th Century France”

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Overview

Comments
How discounting works
The amazing effect of monetary policy in 19th century France
The role of central bank presence
Additional issues

Conclusion

This paper is *not*...

- ... on the *lender of last resort*
- ... on the *broadening of eligibility criteria* in central bank transactions
- ... on how to deal with *liquidity shocks* at financial institutions

Instead this paper is ...

- ... on the effect of *monetary expansion* in times of real economic crises
- ... on the importance of *central bank presence* for the effectiveness of monetary policy in 19th century France
- ... on how to deal with *real economic shocks* in an important subsector of the economy

Overview of the paper

- Paper analyzes the effects of *shocks in the agricultural sector* on the *default rates in the non-agricultural sector*
- Idea: Shocks *spill over* to other sectors due to demand effects
- A central bank may mitigate shocks by discounting bills of exchange (and thereby raising money supply)
- Presumption: A prerequisite for discounting is *physical presence* of the central bank in a given district
- Note:
  - This has nothing to do with crisis lending of central banks in order to mitigate liquidity problems of banks
  - Instead it is a reaction of monetary policy to a real shock in the economy

Identification

- Paper exploits that both the agricultural shock and central bank presence *varied across time and across districts*
- Identifying assumptions: Agricultural shocks and central bank presence are not driven by default rates in the non-agricultural sector and are not correlated with other (omitted) factors that may explain default rates
- *Difference-in-differences setup* with *varying treatment intensity* (depending on the size of the shock)

Main results

- An agricultural shock *raises default rates* in the non-agricultural sector in the absence of a central bank
- A higher presence of the central bank *mitigates the effect of the shock* on default rates
- Result is *robust* to the use of different measures of shocks and central bank presence, to varying sets of controls, and to controlling for spatial autocorrelation

Overall Assessment

- Historical research on central bank lending is very welcome
- The (true) question of the paper is interesting although not quite as topical as the alleged question
- Identification is innovative and convincing
- Nice data
- Issues to discuss:
    1. How discounting works
    2. The amazing effect of monetary policy in 19th century France
    3. The role of central bank presence
    4. Additional issues

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How discounting works

- In a system where monetary policy works through the discounting of bills, the central bank can influence money supply mainly through the *discount rate*
- Everything else is *demand-driven*: Every firm that has an eligible bill can discount this bill at a bank or central bank
- Money expansion is automatically linked to economic activity as long as bills are based on trading transactions
- In such a setup central banks do not actively stabilize shocks (in the absence of discount rate changes)

The amazing effect of monetary policy in 19th century France

- Estimated effect of a one-unit shock on default rates depending on central bank presence (Table 1, column 1):
  - 0 central bank branches: $+0.69$
  - 1 branch: $+0.23$
  - 2 branches: -0.23
  - ...
  - 8 branches: -2.99
- In districts with more than one branch, the presence of central banks strongly overcompensates the initial shocks
  $\Rightarrow$ Default rates drop sharply in response to a shock (plausible?)

The role of central bank presence

- Presumption: Lower central bank presence restricts discounting activity.
- But: Firms without a nearby central bank branch most likely would use a *financial intermediary* to get access to credit
- If this had caused prohibitively high transaction costs and had severely restricted access to credit, firms would have moved to an area with better central bank access
- Solutions:
  - Provide anecdotal evidence that central bank presence is important for discounting activity of firms
  - Show that economic activity is more volatile in regions without central bank presence
  - Repeat the analysis explaining the *amount of discount loans* in different districts

The role of central bank presence

- Districts with higher central bank presence are likely to differ from other districts in *many other respects*
- For example, they may be able to *better cope with shocks* in a subsector of the economy
  - This would be consistent with the regression results
- Solutions: Include broader set of controls (e. g. urban vs. rural, industrial structure) and interact all controls with *shock*

Additional issues

- Role of the *exchange rate regime*
  - France had a gold or bimetallic standard throughout the period
  - Scope for an independent monetary policy is limited
- Extremely long time series is likely to be subject to *structural breaks*
- Can we really exclude *fiscal stimuli* at the district level?

Additional issues

- No descriptive statistics
- No assessment of economic significance of the coefficients
- Notation of district-specific trend not correct
- Do default rates include financial firms?
- Branch density better suited than number of branches (does not control for district size)

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- Interesting paper with fascinating dataset
- Innovative identification procedure exploiting historical institutional arrangements
- Avoid over-selling/mis-selling
- Reconsider implausible negative effects
- Strengthen the argument on the importance of central bank presence by additional analyses