Marcello Messori (LUISS-SEP)

ITALY’S FIRM AND HOUSEHOLD INVESTMENT: A COMMENT

How financial systems work: Evidence from financial accounts

Bank of Italy
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General statement

- Several reasons to enjoy the paper of Giordano, Marinucci, and Silvestrini.
- **Subject:**
  Low level of investment (*I*) rate in Italy ➔ analysis of gross fixed capital formation = crucial topic.
- Analytical and econometric **setting**:
  - Reference to institutional sector national accounts (→ non-financial firms, households);
  - Models able to disentangle the impact of long- and short-run independent variables on *I*;
  - Role attributed to financial constraints (flow-of-funds data allow a measure of leverage);
  - Robustness of econometric results.

Outline of my specific comment

- A few specific comments:
(1) an ‘external’ remark;
(2) a remark due to the use of the neoclassical accelerator model in the Italian case;
(3) an ‘internal’ remark relating to the short-term non-financial factors;
(4) an ‘internal’ remark relating to the short-term financial factors.

1. Public investment

- The authors state:
  “an advantage” of our setting is that “we can abstract from public investment, which is often counter-cyclical and driven by different factors to private investment.”
- However, implicit assumption:
  public *I* = no impact on private *I*.
  This assumption = ill theoretical foundations:
  (i) ‘crowding out’ approach;
  (ii) ‘fly-wheel’ approach.
- 2007-’09 and 2010-’13 crises ←→ (ii).
  Authors’ selection of *I* short-term determinants (uncertainty and economic climate) ←→ (ii).

2. Long-run determinants of *I*

- The reference to the acceleration model implies that in the long-run:
  - firms' *I* 🡐 by real value added and real user cost of capital (with time lags);
  - households' *I* 🡐 by real disposable income of households and real user cost of capital (with time lags).
- This approach overlooks:
  - specificity of innovative *I* (firms' case);
  - role of financial wealth (households' case).

  Both these factors matter a lot in the Italian case.

3. Short-term non-financial variables

- By referring to the ‘real options’ theory of Dixit-Pindyck (1994), the authors introduce a short-term independent variable: uncertainty.
- Their definition of uncertainty is:
  “the cross-sectional dispersion in the subjective expectations of manufacturing firms” and “a similar indicator…referring to expectations on consumers’ personal situation.”
- This indicator is not an appropriate measure of macro-uncertainty.
  Clue: the authors refer to an additional measure = ‘economic climate’.
  Possible implication: uncontrolled interactions between these two variables.

4. Financing constraints

- According to the authors, high-leveraged firms face high financing constraints since they are concerned about defaults risks.
  Authors’ explanation: default events ➔ that *I* benefits entirely accrue to creditors.
- However, Standard Debt Contract {*L*, *r*, *C*} ➔ borrowers’ limited liability.
- Hence, it will become unclear if the high-leverage constraint is a demand or a supply constraint.

4. Financing constraints

- The authors maintain that the high-leverage constraint is characterized by another limit:
  "it does not take into account possible frictions in the credit market…"
  Hence, for the non-financial firms case, they refer to the BoI survey on credit availability →
  "firms are 'financially constrained' when either their loan request is (partially or totally) refused by the bank or the loan conditions are deemed to be excessive by the firm."
- New indicator strengthens previous ambiguities in terms of demand or supply constraints.

Conclusions

- Hence, my remark on financing constraints is similar to my previous remark on short-term non-financial variables: uncontrolled or ill-specified interactions between the two financial variables. Overall, these interactions =
  possible consequences on the construction of the econometric model.
- My comments on these four short-term variables suggest different specifications of:
  - uncertainty = more emphasis on related risks;
  - financing constraints = reference to supply side.