

# Debtor Protection, Credit Redistribution and Income Inequality

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# Debtor Protection and Income Inequality

## Main Result:

**Increases in the amount of debtor protection (exemption) are associated with higher level of state income inequality**

**Heterogeneity:** the effect is stronger in:

- Areas with higher % single state banks
- Mitigated in areas with higher % local branches
- Industries with higher financial dependence and startup capital

Driving by growing income gap between unskilled and skilled workers

# Main Comments

1. Are changes in debtor protection (exemptions) exogenous?
2. How debtor protection changes affect income inequality? (channel)

## Comments: Endogeneity of Exemptions

The empirical specification is the following

$$y_{st} = \alpha_s + \alpha_t + \beta \text{Exemption}_{st} + \delta \text{Controls}_{st} + \varepsilon_{st}$$

### Identification assumption:

State that change their level of debtor protection did it for reason unrelated to income inequality

**Currently:** check for pre-trends and reverse causality

**However:** time varying unobservables correlated with exemptions are still a problem.

For example, local economic conditions

# Comments: Endogeneity of Exemptions

## **Heterogeneity of the effect**

It is interesting but does not alleviate endogeneity concerns.

## **Financial Dependence and High Start up Capital**

Include state-year fixed effect

It only identify a differential effect between industries

**Concern:** Chetverikov et al (2015) show that imports from China within the same time period have similar differential effect on wages of skilled and non-skilled workers for manufacturing firms.

This could be a problem if results are driven by manufacturing sector

# Suggestions: Endogeneity of Exemptions

## 1. Include standard tests for difference in difference

- Use only states that eventually change exemptions
- Focus on only big changes

## 2. Check that results are robust to exclude industries affected by China import shocks

## 3. Control for unobservable time varying omitted variables.

Use county pairs across state borders to control for local unobservables economic conditions

$$y_{s,i,t} = \alpha_i + \alpha_t + \alpha_{b,t} + \beta Exemption_{st} + \delta Controls_{s,i,t} + \varepsilon_{s,i,t}$$

Where b is a economic unit of bordering counties in different states.  
Requires county level data

## Comments: How exemptions affect inequality

It seems that the authors prefer channel is

*Exemptions*  $\xrightarrow{a}$  *Credit*  $\xrightarrow{b}$  *Entrepreneurship*  $\xrightarrow{c}$  *Income inequality*

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a. Cerqueiro and Penas (2014) exemptions reduce the available credit to poor entrepreneurs

How are the two sample related

Increases on exemptions not always lead to lower credit holdings



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$$\textit{Exemptions} \xrightarrow{a} \textit{Credit} \xrightarrow{b} \textit{Entrepreneurship} \xrightarrow{c} \textit{Income inequality}$$

b. Financial constraints, access to credit and entrepreneurship

Kerr and Nanda (2009), etc

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*Exemptions*  $\xrightarrow{a}$  *Credit*  $\xrightarrow{b}$  *Entrepreneurship*  $\xrightarrow{c}$  *Income inequality*

c. Poor entrepreneurs and income (wage) inequality

Are poor entrepreneurs important enough to change state level inequality?

Important to provide evidence to make the magnitudes and effect plausible

## Suggestion: Explore within state variation

Looking at state level variation:

- Does not recognize within state variation of the effect of exemptions
- Make the interpretation of the results harder

## Suggestion: Explore within state variation

Exemptions increase credit card holding and decrease inequality:

Consistent with:

- Poor entrepreneurs using credit card to finance their business
- Good economic conditions reducing inequality and increasing consumption (credit card use)

## Minor comments

1. Are results robust to excluding DC, change to unlimited during the sample period.
2. BACPA in 2005 increase the cost of bankruptcy, are the results robust to exclude 2006 post BACPA?

# Conclusion

Very interesting paper that documents a relationship between debtor protection and income inequality

Need to do more to sharpen the contribution

- Asses even more endogeneity of the changes in exemptions
- Clear exposition and direct evidence of the proposed channel

Looking forward to read the new version.

Thank you!