

Discussion of  
Khwaja, Mian, and Zia  
“Dollars Dollars Everywhere, Not a Dime to  
Lend: Debt Capacity Constraints and Limited  
Absorptive Capacity”

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April 21, 2007

# The Central Idea

- 9/11 was a big and positive liquidity shock for Pakistan
- Should have led to more lending by banks
- But if firms faced binding debt-capacity constraints, lending need not increase
- Evidence seems to support this conjecture

# Empirical Strategy

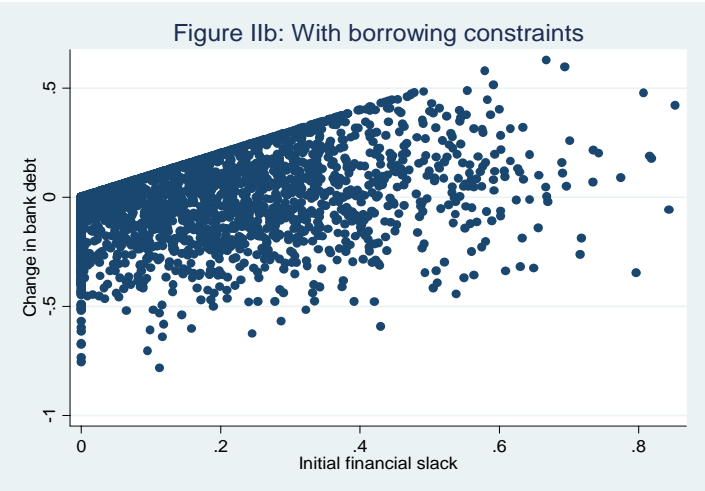
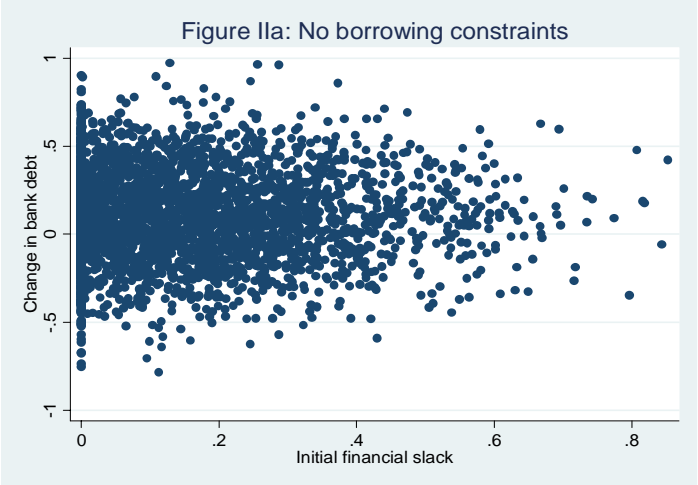
- Large positive shock will push firms with unused debt-capacity to their credit limit
- Firms with larger slack will end up borrowing more
- This implies that:

$$\Delta d_{it} = \alpha + \beta_1 s_{i,t-1} + \epsilon_{it}$$

with  $\beta_1 > 0$

- Figures Ila-b

**Figures IIa-b: Relationship Between Change in Bank Debt and Initial Financial Slack**

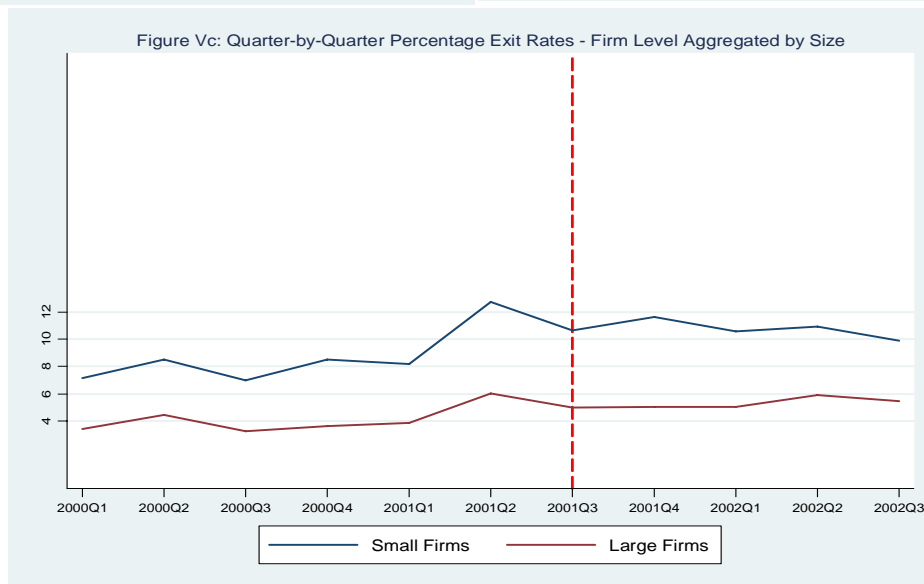
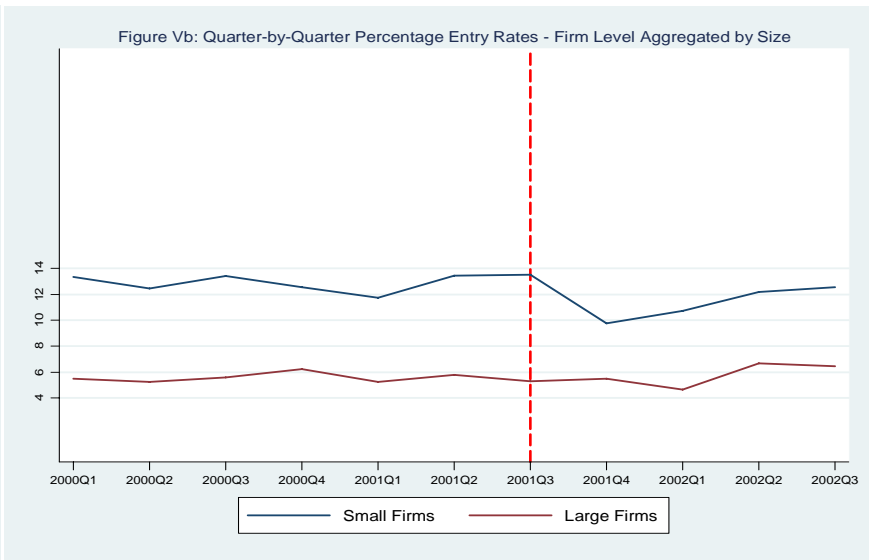
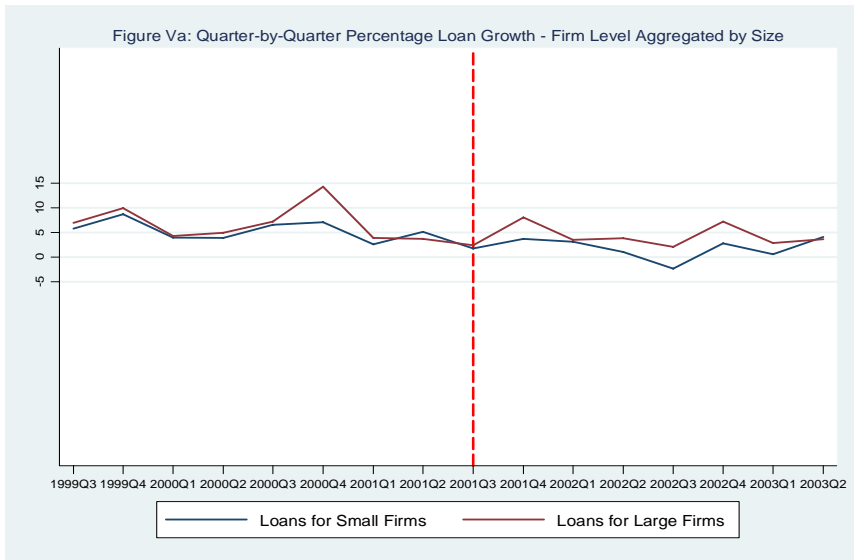


These Figures plot the empirical relationship between change in bank debt and initial financial slack with and without borrowing constraints, based on a simulation exercise. The simulation was conducted using the actual distribution of initial financial slack, and plausible values of demand shocks.

# Lending does not Increase?

- Figures Va-c show that lending did not increase

### Figures Va-c: Changes in Bank Lending

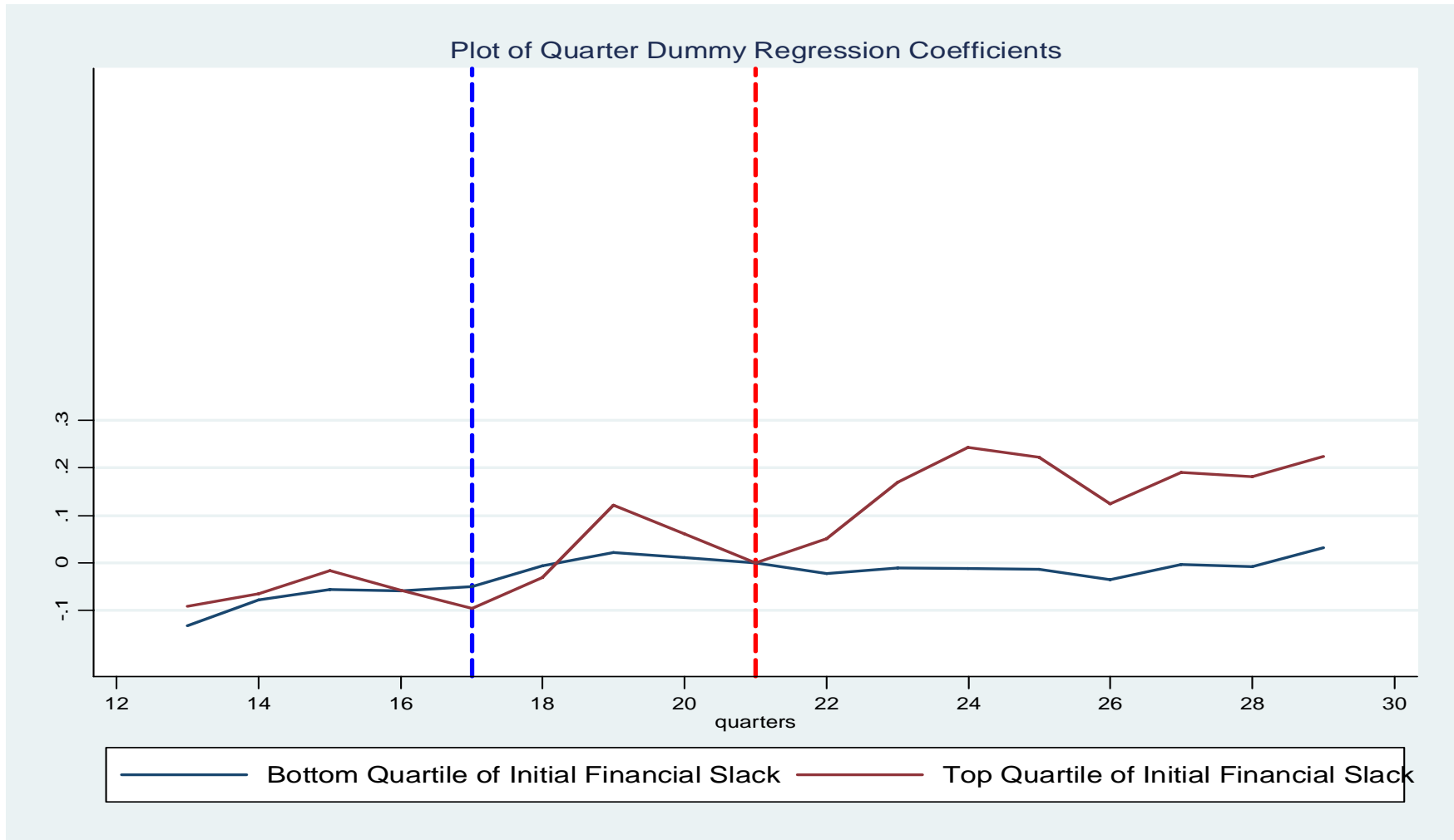


These Figures plot the time-series change in bank lending, both for the intensive margin and the extensive margin. The intensive margin for firms is defined as loan growth for existing customers, whereas the extensive margin for firms is defined as entry into and exit from bank loan relationships. The vertical dashed line represents September 2001.

# Lending Must Increase

- The conclusion that lending does not increase is problematic
- For the empirical strategy to have power, lending must increase
- Intuition: Figure IIb
- Figure VII shows that lending does increase for high slack firms

**Figure VII: Cumulative Loan Growth Regression Coefficients - High vs. Low Slack Firms**

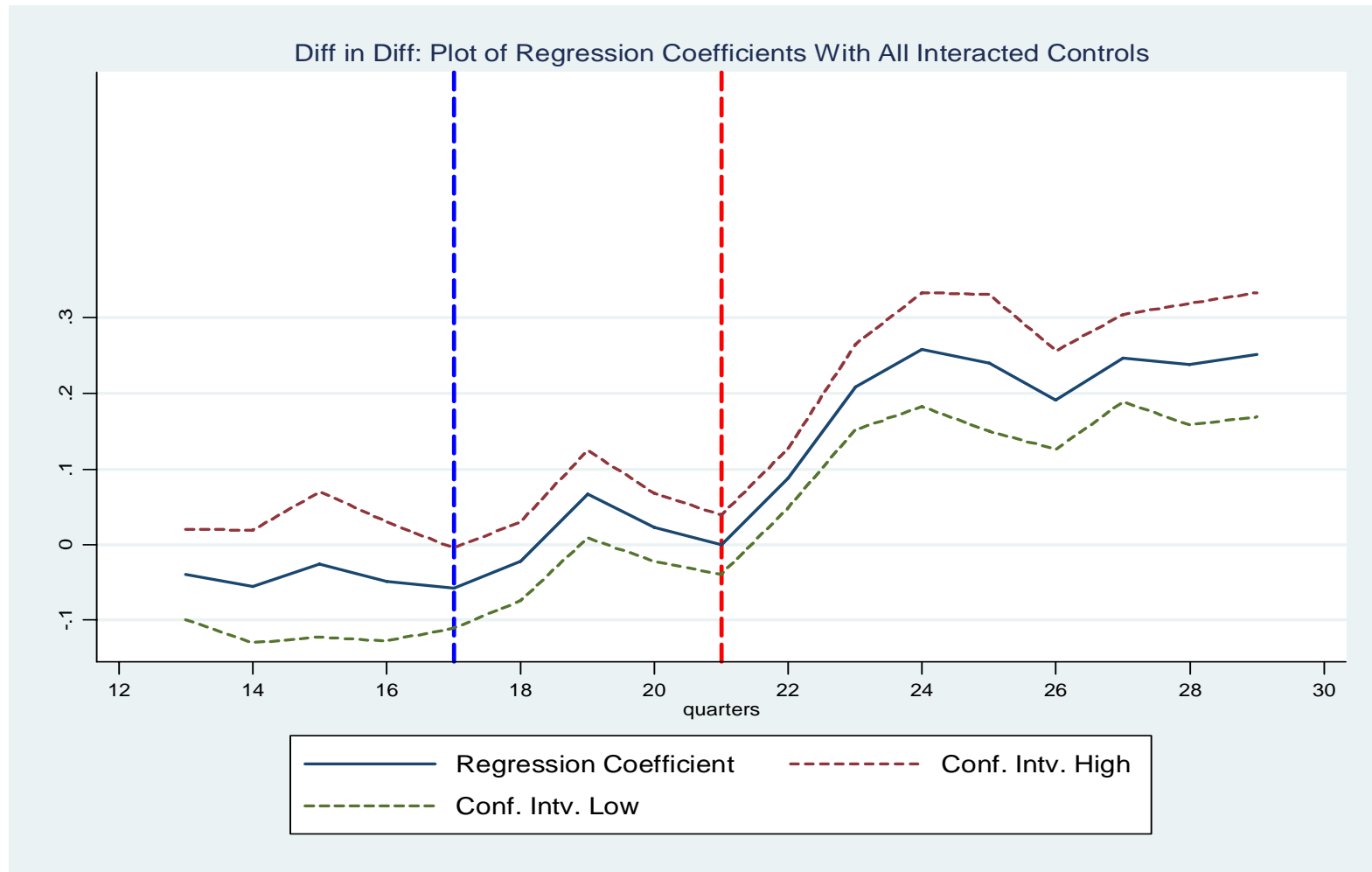


This Figure plots the quarter-by-quarter regression coefficients for all quarter dummies from the regression of cumulative loan growth on quarter dummies, separately for top and bottom quartile firms based on initial financial slack. Cumulative loan growth is the de-meaned value of the log of loans for each firm.

# Is Slack Proxying for Something Else?

- Firm Quality Controls: Are they Adequate?
- Another testable prediction: Up-beta must be positive, Down-beta must be zero
- Need two shocks:
  - Large positive shock: 9/11
  - Large negative shock: Economic sanctions after 1998 nuclear tests
  - Figure VIII

**Figure VIII: Cumulative Loan Growth Regression Coefficients**

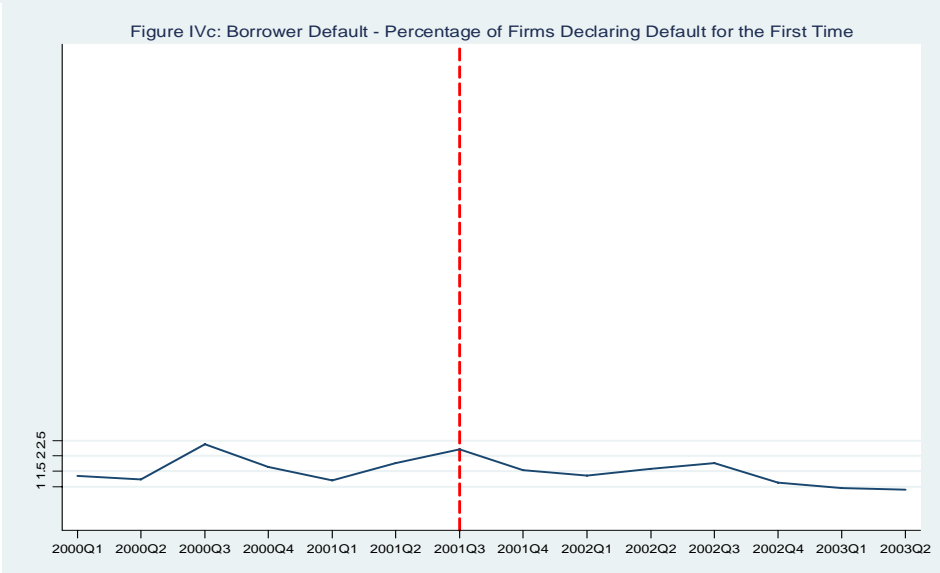
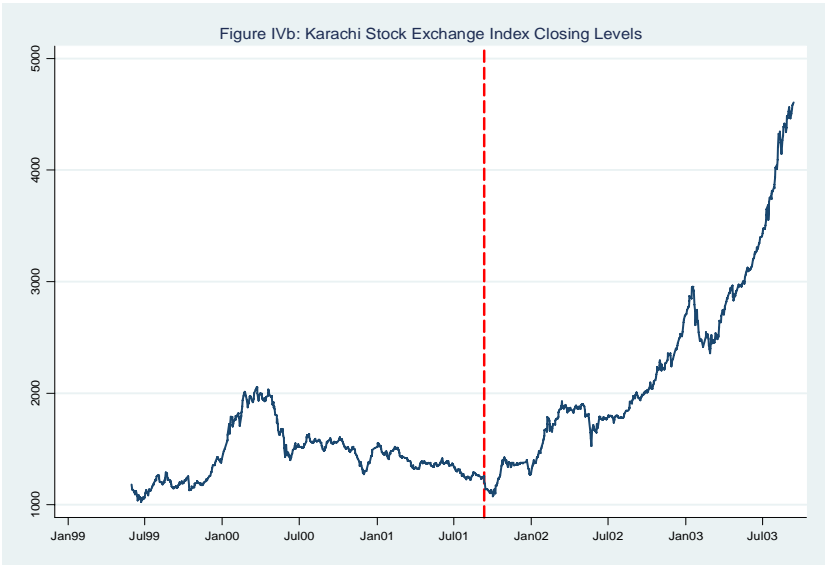
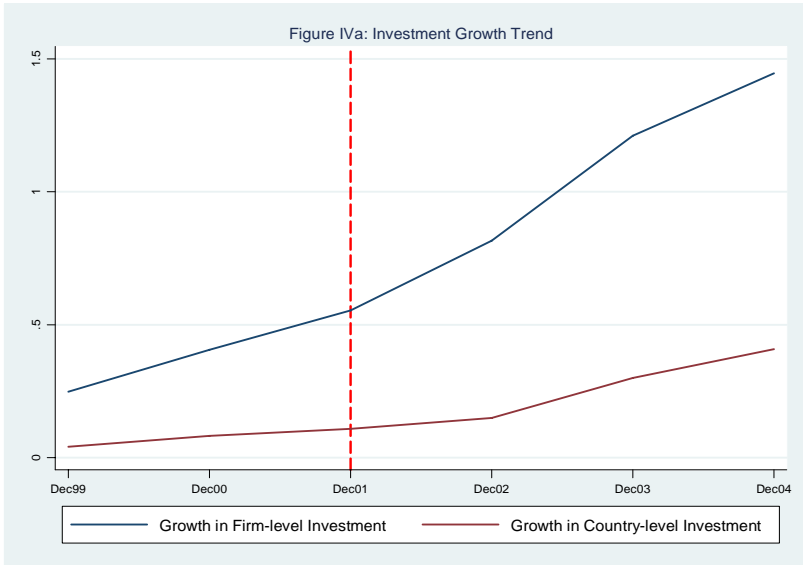


This Figure plot the continuous quarter-by-quarter regression coefficients from the regression of cumulative loan growth on all quarter dummy interactions with initial financial slack. Cumulative loan growth is the de-meaned value of the log of loans for each firm. The coefficients on these interaction terms are then plotted, along with a 95% confidence interval band. The regression also include all quarter dummy interactions with firm level controls such as size, industry, location, and dominant bank.

# Cost of Debt-capacity Constraints: An Overestimate?

- Bank Lending is not the only channel
- Substitution to other forms of capital
- Figures IVa-b show that:
  - Investment goes up
  - Stock prices increase
- What happens to equity issuance? IPOs?

**Figures IVa-c: Establishing Positive Demand Shock After 9/11**



These Figures plot the time-series movements in firm- and country-level investment, the Karachi Stock Exchange index, and percentage of borrower default. The vertical dashed line represents September 2001.

# Theory

- Effect of a fall in risk-free rate on optimal debt-capacity is not satisfactory
  - First, a smaller risk-free rate directly implies that repayment is smaller which should increase debt-capacity
  - Second, moral hazard issues may also be ameliorated (Stiglitz-Weiss)
- Banks may not increase lines of credit formally but may be more lenient about bending rules