

# Leverage, Labor Market Size, and Employee Pay

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Discussion by:

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# Paper Summary

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- Research Problem: Identify causal impact of leverage on employee wages
- Hypothesis: Increase in leverage leads to increase in wages; leverage commands a wage premium as compensation for unemployment risk due to financial distress
- Empirical Approach:
  - Regress individual wages (Y) on labor market size of employees across establishments (X1) interacted with firm leverage (X2)
  - Key Assumption: Smaller local labor market -> Costlier Unemployment
- Findings: Positive regression coefficient
- Conclusion: Firms pay higher wages to employees in smaller labor markets after increases in leverage; argue for support of hypothesis

# Assessment

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- Question is interesting and important
- Difficult to address: Data and Identification limitations
- Room for improvement: close the gap between statistical findings and theoretical conclusions
- Main Suggestions:
  - Measurement of Theoretical Quantities
  - Theory -> Empirical Predictions
  - Alternative Interpretations of Findings

# Measurement of Theoretical Quantities

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$$\text{Wage} = \beta (\text{Distress Risk} \times \text{Exp. Costs Unemployment})$$

## 1. Labor market size a proxy for expected unemployment costs?

There are several theoretical costs: size of lost wages, reduction in consumption, probability of unemployment, probability of reemployment, search costs

Suggestion: Show the link between labor market size and expected costs of unemployment. Perhaps present estimates of each of the components above and correlate with labor market size.

- likely will facilitate additional tests

## 2. What is driving the variation in distress risk?

Suggestion: Need more clarity on definitions. Market or book leverage? Net of cash?

## 3. What component of employee compensation responds to leverage?

Suggestion: Discuss wage compensation vs. changes in severance pay. Show large sample or case study evidence to justify focus on wages.

# Theory-> Empirical Predictions

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1. When a firm increases leverage, if the firm goes into financial distress, how important are layoffs as a source of restructuring?
2. Is the risk of layoff similar for workers in small vs. large labor markets?
3. What determines choice of establishment location? Why aren't more establishments located in large markets?
4. Regression coefficient driven by + and – changes in leverage and wages? Or just + changes?

**Suggestions:** Present data in a more systematic progression  
Show raw data not just regression output  
Exploit variation driven by “sticky” factors

# Alternative Interpretations of Findings

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1. Omitted Variable: Changes in unobservable investment opportunities
2. Financial distress or economic distress?
3. Are we learning about costs of unemployment or labor market size?

## Suggestions:

Could expend effort into looking into data in more detail and looking for convincing sources of variation.

Likely more productive approach: shift focus by starting with the data and broadening set of potential questions you might be answering.

# Additional Research Ideas

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- Great data... likely many other avenues of research
- Leverage, wages, productivity shocks
  - Explain time series and cross-sectional variation in wages within and across firms?
- Leverage and career paths / wage profiles
- Leverage and Employment Policies
  - Hiring vs. firing margin?