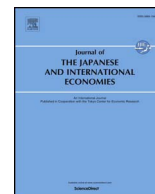




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## International evidence on firm level decisions in response to the crisis: Shareholders vs. other stakeholders<sup>☆</sup>

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### ABSTRACT

The relationship between changes in GDP and unemployment during the 2008 financial crisis differed significantly from previous experiences and across countries. We study firm-level decisions in France, Germany, Japan, the UK, and the US. We find significant differences between the response of US and non-US firms. US firms significantly decreased their production costs relative to firms in other countries. They have also reduced debt, reduced dividend payout, and increased their cash holdings compared to firms in other countries. The differences are, in general, explained by differences in financial leverage. However, financial leverage does not explain differences between production decisions in German and U.S. firms and between Japanese and US firms. We argue that differences in firm governance between US firms and firms in Germany and Japan drive these responses. US firms are more prone to cut labor costs and reduce leverage compared to German firms and Japanese firms in order to achieve larger profits and a larger cash-cushion in the short-run.

### 1. Introduction

One of the interesting features of the 2008 financial crisis is the wide range of relationships between changes in a country's output and changes in unemployment as shown in Fig. 1. Spain and Ireland had very large increases in unemployment despite quite different falls in output. This is perhaps not very surprising because both had significant construction industries that were devastated by the bursting of the property bubbles in both countries. More surprising is the fact that countries like Germany and Japan had much larger drops in output than the US but the effect on their unemployment rates was small. Germany actually had a decrease in unemployment.

Fig. 2 shows the path of gross domestic product (GDP) for the G5 countries, France, Germany, Japan, the US and UK. It can be seen that Japan had a 10% drop in GDP between quarter 1, 2008 and quarter 1, 2009. Germany's GDP dropped more than 6%, for the UK and US it was about 5%, and for France under 4%. Fig. 3 shows a dramatically different situation for unemployment. Japan's unemployment increases a small amount, while Germany's falls most of the time. France and the UK rise somewhat but by far the largest change is the US, which more

than doubles from just under 5% to 10%.

Using data from quarter 2, 1947 until quarter 4, 1960, Okun (1962) found that a 3% change in GDP was associated with a change in unemployment of about 1%. This relationship became known as Okun's law. Although it was recognized that Okun's law varied across countries and time (e.g., Lee, 2000, and Knotek, 2007), the breakdown of the relationship during the crisis was of a different order of magnitude than what was previously observed.

There has been extensive discussion of why this change has occurred. One important point that is frequently made is that Okun's law is a statistical relationship. It is not based on a theoretical framework. There is no particular reason why the relationship should be expected to be stable. The examples of Ireland and Spain suggest that the importance of the construction industry in employment when there is a real estate bubble that bursts is a key factor. Much of the discussion has been focused on differences in labor markets. In particular, there are significant differences in employment protection law, the share of temporary workers not protected from dismissal and the generosity of unemployment insurance (see, e.g., IMF, 2010, Chapter 3). There is no consensus on the importance of these factors. Cazes and Verick (2011),

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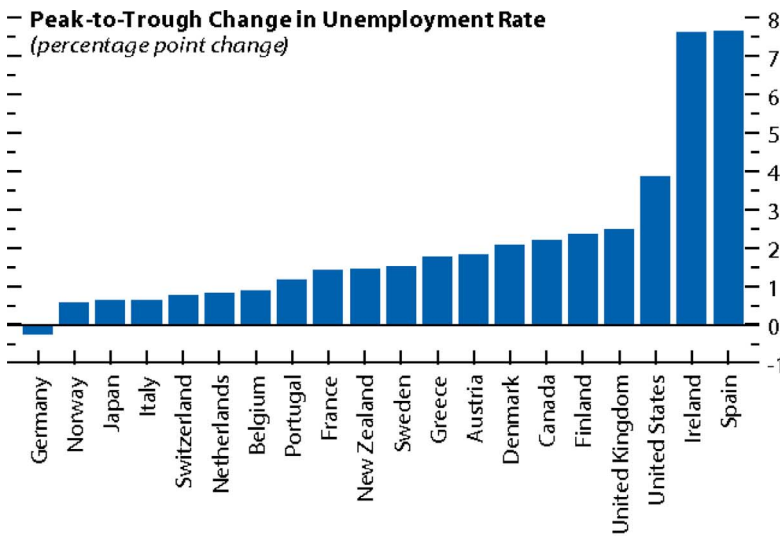


Fig. 1. Based on Fig. 3.1 on p. 70 of IMF (2010).

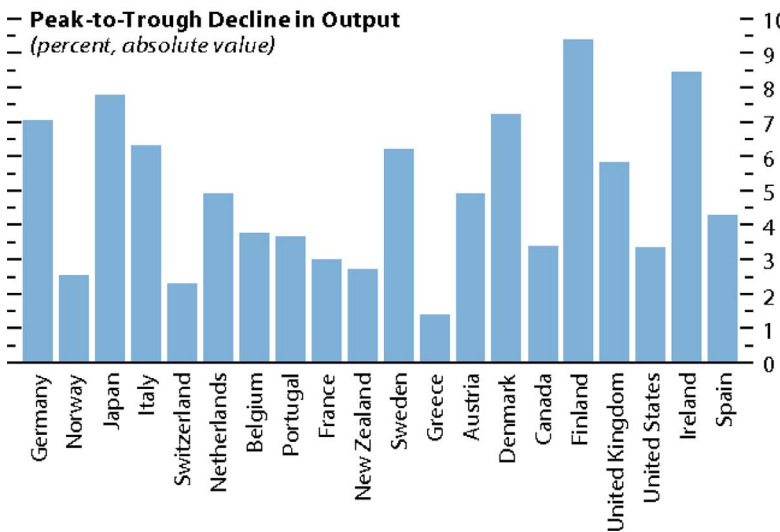
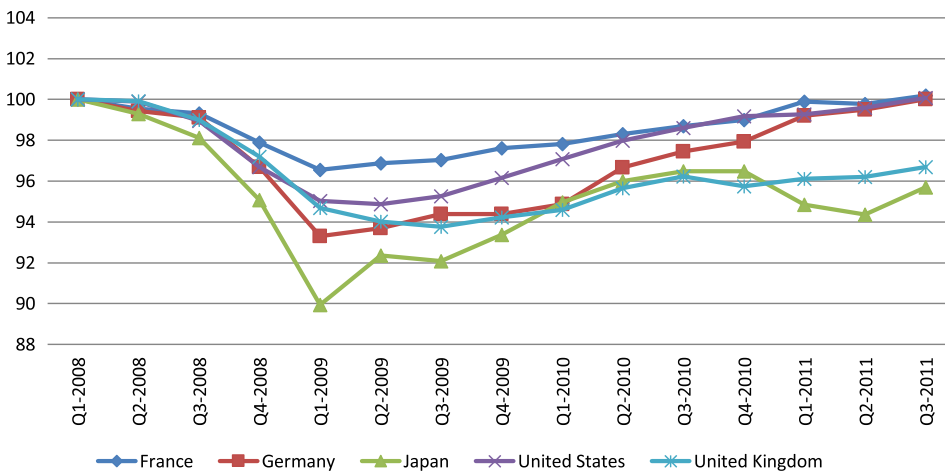


Fig. 2. GDP, constant price, rebased. OECD.



for example, conclude that it is difficult to identify a robust relationship between cross-country estimates of Okun's coefficient and labor market institutions.

One important institutional difference between the countries that has not been considered in the previous literature concerns corporate

governance. In the UK and US it is quite clear that shareholders own the firm and managers have a fiduciary (i.e., very strong) duty to act in their interests. In contrast, in Germany there is co-determination. In large corporations employees and shareholders have an equal number of seats on the supervisory board of the company (see Allen and

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