

Austerity, Inequality, and Private Debt Overhang

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In a nutshell

- Does austerity increase inequality?
- It depends on how much debt firms and households have.
 - Private debt high: inequality increases strongly.
 - Private debt low: no effect on inequality.
- ⇒ Policy makers should implement austerity when private debt is low.



Motivation, research question

- Austerity affects economic stability, but also social equity.
- Private debt shapes macroeconomic fragility and crisis risk (Schularick, Taylor 2012; Mian et al. 2013).

⇒ **What are the distributional consequences of austerity**

- Understanding how policy interventions affect inequality helps...
 - (1) to identify winners and losers (public support).
 - (2) to better understand underlying transmission mechanism.
 - (3) to differentiate between competing model classes.



Estimation approach: State-dependent local projections

$$Y_{i,t+k} - Y_{i,t-1} = \alpha_{i,k} + \eta_{t,k} + I_{i,t-1} [\phi_{H,k} X_{i,t-1} + \psi_{H,k} \text{shock}_{i,t}] + (1 - I_{i,t-1}) [\phi_{L,k} X_{i,t-1} + \psi_{L,k} \text{shock}_{i,t}] + \epsilon_{i,t+k}$$

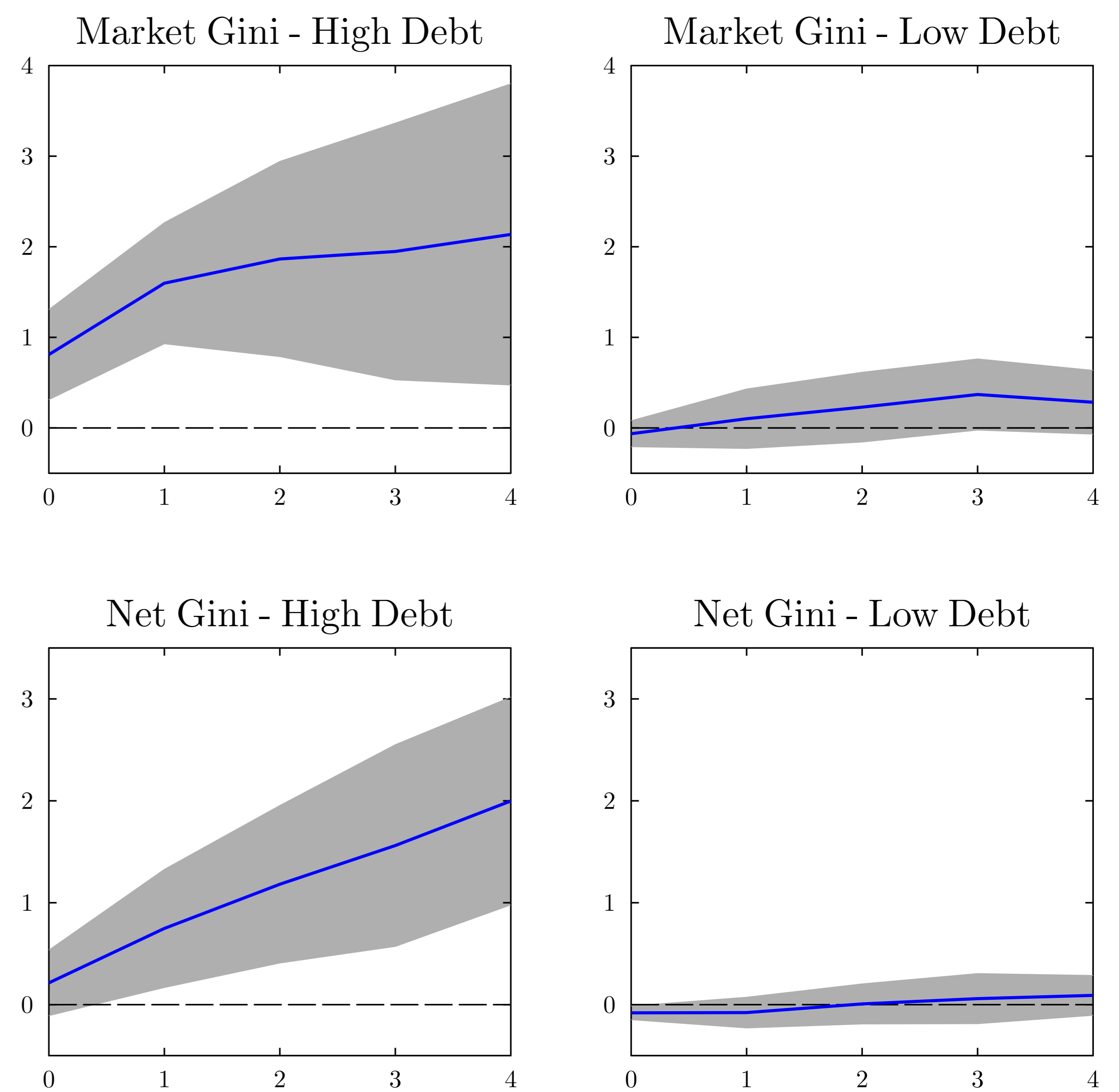
- $Y_{i,t}$ - Gini index (market/net income).
- Dummy $I_{i,t}$ indicates state $\{H, L\}$ of the economy.
- $\psi_{H,k}, \psi_{L,k}$ provide state-dependent response of $Y_{i,t+k} - Y_{i,t-1}$.



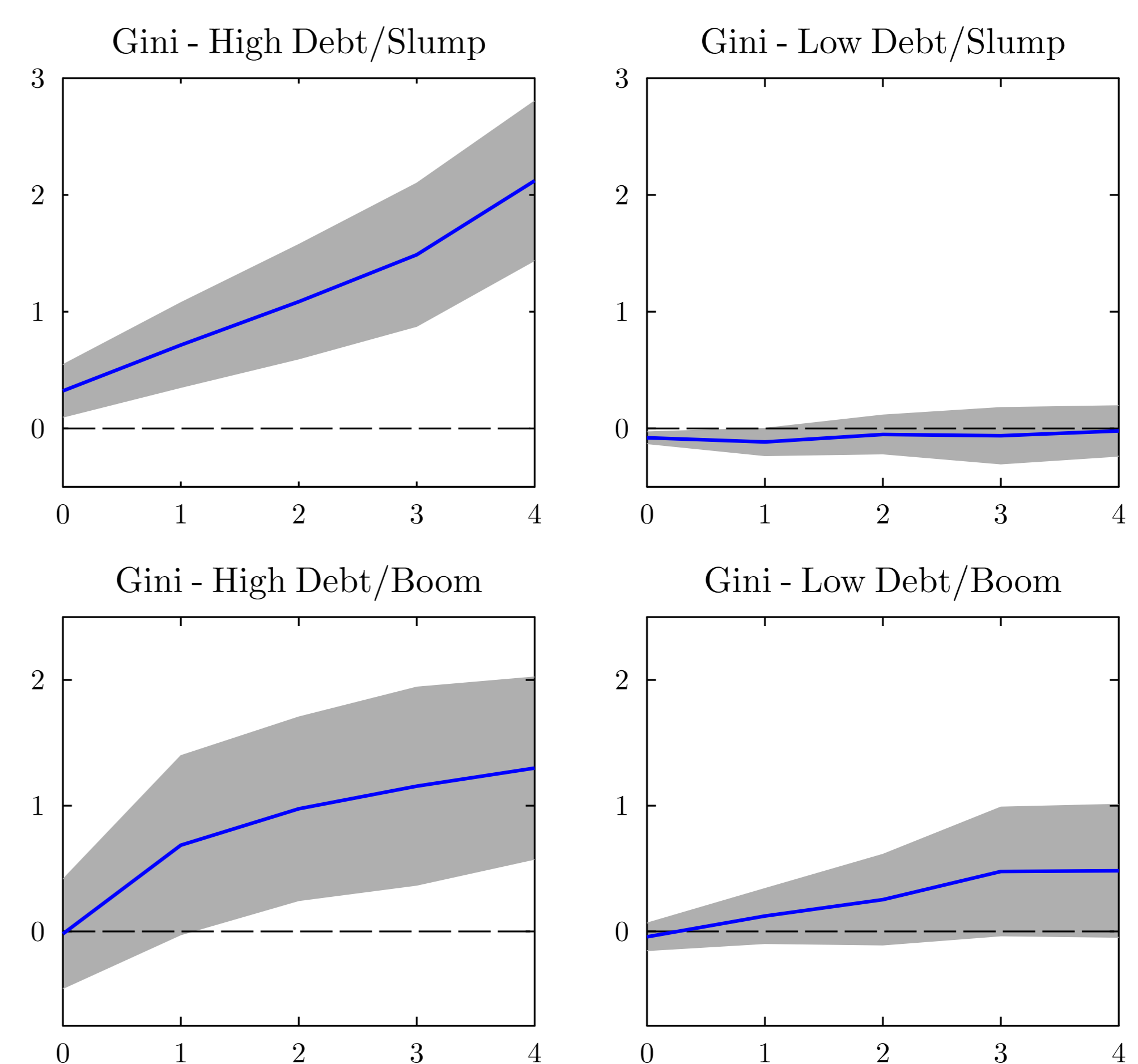
Data, states, and identification

- Yearly panel (1980-2011) of 17 OECD countries.
- Debt states: Deviations from debt-to-GDP trends (HP, $\lambda = 100$).
- Fiscal consolidation shock: Narrative measure (Devries et al. 2011).

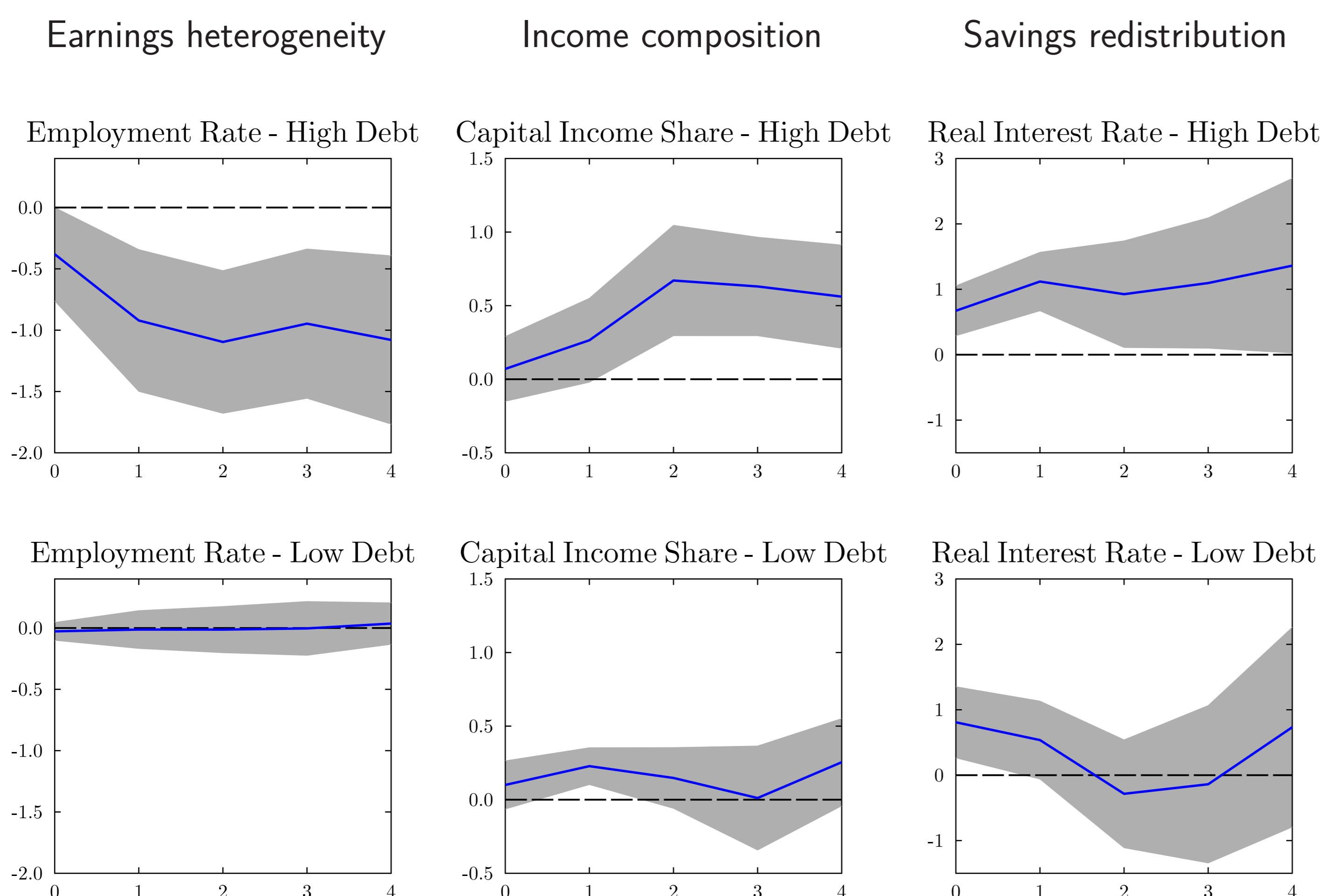
Main results



- Findings robust to...
 - alternative identification.
 - alternative debt states definitions.
 - controlling for composition (tax versus spending based).
 - changes in the sample.
- controlling for state of the business cycle.



Rationalizing the results - channels



Conclusion

- Fiscal consolidations
 - ... increase inequality when private debt is high.
 - ... have no significant effects in low private debt states.
- Possible explanation: earnings heterogeneity, income composition, savings redistribution channel.
- Time is right for austerity when private debt is low.

