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

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

- \(Y_{i,t}\) - Gini index (market/net income).
- Dummy \(h_{i,t}\) 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).

Rationalizing the results - channels

- Earnings heterogeneity
- Income composition
- Savings redistribution

Main results

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

Conclusion

- Fiscal consolidations...
  1) increase inequality when private debt is high.
  2) 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.