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Household Debt and Income Inequality, 1963–2003

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PDF

Abstract

I construct an economy with heterogeneous agents that mimics the time-series behavior of the earnings distribution in the United States from 1963 to 2003. Agents face aggregate and idiosyncratic shocks and accumulate real and financial assets. I estimate the shocks that drive the model using data on income inequality, aggregate income, and measures of financial liberalization. I show how the model economy can replicate two empirical facts: the trend and cyclical behavior of household debt and the diverging patterns in consumption and wealth inequality over time. While business cycle fluctuations can account for the short-run changes in household debt, its prolonged rise of the 1980s and the 1990s can be quantitatively explained only by the concurrent increase in income inequality.

LITERATURE CITED

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