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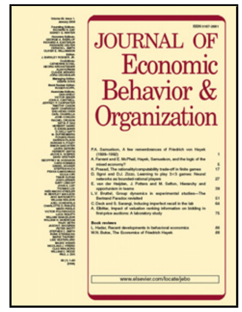

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Trickle-Down Consumption, Financial Deregulation, Inequality, and Indebtedness

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Abstract

Over the last thirty years the U.S. experienced a surge in income inequality coupled with increasing levels of borrowing. We model an OLG economy populated by two types of household that care about how their consumption compares to that of their peers. In this framework individual debt-to-income ratios decrease with income, increases in consumption of rich households lead to increases in consumption of the rest, and aggregate borrowing increases with income inequality. We calibrate our model to evaluate the welfare implications of the process of financial liberalization that began in the 1980s. Our analysis suggests that some of the financial developments that lead to the recent expansion of credit may have decreased, rather than increased, welfare.

JEL Classification:

Key words: relative consumption; indebtness; inequality; credit constraints.

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