The inequality-credit nexus

Fischer, Ronald

Huerta, Diego

Valenzuela, Patricio

This paper explores the inequality-credit nexus from both a theoretical and an empirical perspective. The paper develops an overlapping generation model in which the effect of income inequality on private credit depends on the countries? per capita income and on the quality of laws protecting creditor rights. The model predicts that greater inequality leads to higher levels of private credit in countries with low per capita incomes and weak legal rights, while this effect is ambiguous or negative in economies with higher aggregate income and stronger credit protection. Using a panel dataset of 155 countries over the 1982?2015 period, the paper shows empirical evidence that is robust and consistent with the model's predictions. The paper's major finding suggests a credit channel through which inequality may affect economic outcomes.