

DIW Applied Micro Seminar

Bailouts and austerity

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Abstract:

This paper studies with disaggregated budget data how expenditures, revenues, and borrowing evolve in municipalities that receive bailouts. It asks whether higher-level governments enforce austerity measures after bailing out indebted municipalities. The sample consists of 421 municipalities in the German federal state of Hesse over the 1997-2010 period. The results indicate that municipalities cut personnel, construction, and social expenditures, increase tax revenues and property tax rates, and reduce deficits after they receive a bailout from the state government. The state government appears to be both able and willing to enforce austerity after granting a bailout.