Aiginger, K., Guger, A., "Stylized Facts on the Interaction between Income Distribution and the Great Recession" No. 2013-25, March 22, 2013

Reaction to Anonymous - Referee Report 3 (29.5.2013 09:06)

The two statistically significant correlations may depend on ***outliers*** *like the three Baltic countries*

We presented graphs exactly for the purpose to allow the reader to judge themselves, whether the results may depend on specific countries, as to allow the generation of new stories and a more profound understanding.

If we delete the three Baltic countries (as suggested by the report) the correlation coefficient for the Gini changes from -0.6 to - 0.1, but on the other hand if we delete Poland and Ireland (which are outliers in the other direction) it increases to -0.4 and is significant again. If - instead of deleting countries which are unfavourable for the hypothesis and then those which are favourable – we use the more professional technique of robust regression the t-value diminishes relative to the non-robust regression, but stays significant. Applying the same procedure for wage shares, leads to a breakdown of the significance. We will add these tests and thank for the critique.

However, it is not our main point to claim that the two plain vanilla correlations are significant, our purpose is to provide for those who are disappointed by the general result – no connection between crisis and income distribution – the possibility to build new hypotheses about some connections not developed up to now.

Other explanatory variables*: first there are others "good practices" than those used in the paper to prove the robustness of the results, and secondly if there are any suspects, they should be used from the beginning.*

First there are to our knowledge not many other robust explanations (see our survey in Review of Economics and Finance, No.4 /2011). We ourselves did not succeed to prove country regulation to be connected with the in-depth performance and we could not prove that public budgets (be it flows or stocks, levels or changes) were significantly related with the country performance in the crisis.

Let us remind where we started. There is a strong presumption among many economists that distribution mattered for the crisis. To say it more bluntly, 80% of the audiences we speak to (students, media) start from the presumption that inequality and rising polarization or decreasing wage shares mattered. We investigated this in the most explorative way (i) with a composite indicator; one for levels, one for changes, and we failed. Then (ii) we screened whether adding the usual suspects would help (which is necessary from sound econometrics anyway) and we failed. Finally (iii) we looked whether individual indicators might do the job, and we present that there is some hope.

We do not claim that we "proved" anything beyond doubt; our principal result is that there is no straightforward relation between distribution and cross country differences in performance in the crisis. Being cautious also for this negative, tentative result, we find that there is some hope for those wanting to continue in this research (what we find very useful); therefore the probability for rejecting a hypothesis in our sample – while it is true in real world or in a world of much better data on distribution- should be lowered. This may also explain why we did not stress from the beginning that all data could be flawed. This would have discouraged empirical investigations into the distribution-crisis-connection at all. We want the research to continue, because we believe some relation might exist not yet detected due to incomplete theories, imprecise channels, and bad data.

Minor points:

Studies on how labour market worked in the crisis as well as Bordo - Messner (2011) will be cited, too. Thanks!