

Research Seminar "Quantitative Economics"

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Abstract

Debt, Drought, and Mobility: How Bankruptcy Institutions Shape Adjustment to Economic Shocks

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Abstract

Understanding how economies adjust to negative shocks is a central question in economics. This paper provides causal evidence on how indebtedness affects occupational and geographic mobility after a shock. We focus on 19th-century U.S. agriculture and exploit repeated introductions and repeals of federal bankruptcy law, variation in drought exposure, and rich county- and individual-level data. We find that bankruptcy protection, which reduces indebtedness, facilitates reallocation: farmers affected by drought are more likely to exit agriculture and migrate to manufacturing jobs in urban counties. In contrast, in the absence of bankruptcy protection, farmers remain in agriculture and sell portions of their farms to other locals. These effects are reinforced by homestead exemptions, which protect local assets; bankruptcy law transforms these from illiquid to liquid assets. Our findings underscore the role of institutions in enabling individual mobility and structural change following adverse economic shocks.