ISSN 2545-806X

4° JORNADA DE INVESTIGACIÓN EN CIENCIAS ECONÓMICAS

FACULTAD DE CIENCIAS ECONÓMICAS
UNIVERSIDAD NACIONAL DE LA PLATA
SECRETARÍA DE INVESTIGACIÓN Y TRANSFERENCIA

ECONOMÍA

Does inequality affect investment in a nonlinear way? A Cross-Country Analysis

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Proyecto I+D 11/E167 Tetra anual 2018
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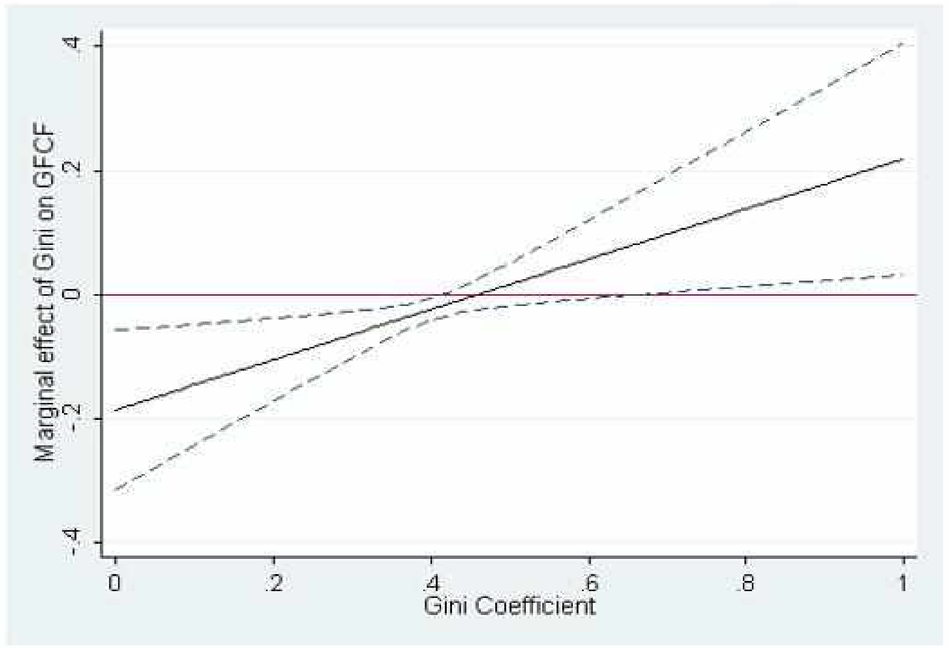
- This paper explores the relationship between inequality and investment based on a panel of 95 countries.
- This work contributes to the investment determinants literature because (i) it controls by a wide set of variables contrasting different theoretical approaches; (ii) it tests for a possible nonlinear relationship; and (iii) the sample includes advanced and developing countries.
- We find a "U-shape" relationship between inequality and investment. At low levels of initial inequality, an increase in inequality is associated with a lower investment; but at high levels of initial inequality, the relationship is positive.
- Given the high correlation between the wage share and income dispersion, policies of wage restriction increase inequality, thus generating lower investment and growth in countries with low or middle levels of initial inequality.
- With high levels of initial inequality, the result is the opposite, so it is possible, if such countries are open economies (i.e. “export-led”), that they can fall into a trap of high growth with high inequality, where only government policy can push the country to the other side of the “U.”

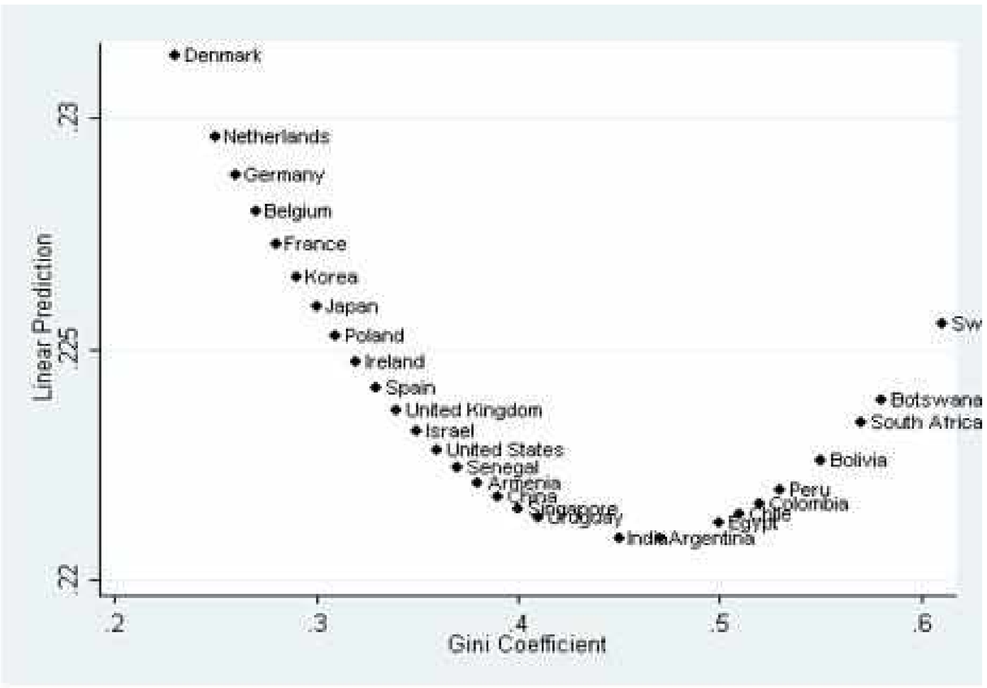
The baseline specification is:

$$y_{i,t} = \gamma y_{i,t-1} + \beta_1 gini_{i,t} + \beta_2 gini^2{}_{i,t} + x'_{i,t}\delta + \eta_i + \mu_t + \varepsilon_{it} \qquad (1)$$

where: y(i,t) is the gross fixed capital formation (% GDP)
***h(Gini)* is an unknown function**
η_i is a fixed effect per country; μ_t is a time fixed effect; and ε(i,t) the unobservable error term.
x(i,t) is a vector of control variables



Conditional Marg. Effect of Gini (90 percent CIs)



Prediction of GFCF (for values of gini in 2000)