Financial Structure and Income Inequality

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Summary

- This paper studies the empirical relationship between financial development and income inequality.
- The sample includes 97 economies over the period 1989–2012 (condensed into non-overlapping 5-year averages).
- Financial development is further disaggregated into bank credit versus market capitalization (relative to GDP).
- The paper identified a beneficial-to-detrimental pattern (where further FD increases income inequality).
- The pattern was found to be more pronounced and regular for market-based financing.

Comments

1. Provide more documentations on the use of system GMM estimator:

   - Are FD variables and/or any other RHS variables allowed to be endogenous in estimations? Or are they assumed to be exogenous?
   - What are the choice of the lags in instrumental matrix?

     the default of lag 1 (and earlier) of the instrumenting variable in levels for the differenced equation and lag 0 of the instrumenting variable in differences for the level equation? Or other lag specifications?
   - Are the instrument matrix collapsed (across t for each instrument) or otherwise (with one moment condition for each t)?
   - It is good practice to report the instrument count and test the robustness of results with different lag limit specifications.

Comments

2. Include time dummies to remove universal time-related shocks from the errors:

- The system GMM estimator assumes that the idiosyncratic errors are uncorrelated across i (countries in the current context).
- This may not be valid if the income inequality increases/decreases across the board because of a global shock

  such as skill-biased technology shock, trade shock, financial crisis, correlation in stock markets across countries?

Comments

3. Verify the mechanisms?

   - Regress top 10 percentile income on bank-based and market-based FD: Are the effects of market-based FD stronger than bank-based FD?

     assuming that the richest derive proportionally more of their income from equities/bonds than bank deposits

   - Construct Gini coefficient based on the sample below 90 percentile (and increasingly lower percentiles), to verify whether the market-based financial development index still has a beneficial-to-detrimental effect

   - Similarly, use the income of the lowest quintile, to verify whether the market-based financial development indicator has any effect

   - Regress past income inequality (before 1990) on future financial development (after 1990), to reduce the concern of unobserved long-run common causal factors $\rightarrow$ falsification tests

Comments

4. Motivate the robustness checks?

    - Why is the beneficial-to-detrimental pattern only present for market-based FD in countries of high economic freedom?

      high economic freedom $\rightarrow$ more transparent banking system?

    - Why is the beneficial-to-detrimental pattern stronger in countries that made more use of macroprudential policies?

      use of macroprudential policies is a response to more aggressive rent-seeking financial sectors? endogeneity issue?

Comments

5. To differentiate the current paper's contribution to the literature from works that use similar estimation specifications

- in terms of findings and implications (rather than in terms of sample size or the set of controls)?
- Seven and Coskun (2016)
- Tan and Law (2012)