Reply to Referee 2 on “Inequality in Latina America: The Role of the Nature of Trade and Partners”

We would like to thank you for your comments. In general, we think that most of your doubts about the study come from the fact that the focus of our study was not enough clear in the previous document and leads you to the conclusion that we were attempting to explain the level of inequality why we focus on variations of inequality.

In what follows, we address your specific comments, so that we hope to allay any doubts you may have concerning our research.

1. This paper studies empirically the relationship between trade openness and inequality in 11 Latin American countries using dynamic panel data techniques. However, what the paper really does is to estimate a Kuznets curve, where trade is just one control. Surprisingly, the paper is silent about this, and the Kuznets’ paper is not even cited in the text and in the references, in spite of the large number of empirical paper estimating similar models in the literature, also for Latin America countries. This is sad. I recommend to the authors to review this vast empirical literature, especially those papers focusing in Latin America countries and say what they are really doing.

First, we agree with the referee that Kuznets (1955) is a fundamental reference. We would like to draw the attention to the fact that we actually did cite Kuznets’ paper in the version provided to the referee on page 14, and included it in the reference list on page 22.

Second, we would like to argue why we consider that our work does not consist in estimating a Kuznets’s curve. In this sense, we have added a paragraph in the methodology section to clarify this issue.

Another important consideration to discuss is the one of Kuznets (1955) who emphasizes that income inequality steeply augments at the early stages of development, reaches a peak, and then supposedly commences to decrease, as the economy gets through an industrialization process. Then, Kuznets’s prediction concerns long-term change in inequality that are already controlled for by our dynamic approach. However, Latin America is a region that suffers from an inadequate development of the manufacturing sector (except Mexico) and where natural resource-based commodities are still dominant in its production and export basket. Hence, there are doubts whether Kuznets curve holds for Latin America. Nevertheless, a correct validation of the Kuznets’s hypothesis would require a large sample of countries at different stages of the development process or to focus on one country that went through an industrialization process as proposed by Barro (2000, 2008). Then, our study aims at examining the role played by trade in the year-to-year changes in income inequality within countries.

2. However, my main concern refers to the estimation results. The authors estimate a negative relationship with per capita GDP, and a positive relationship with the square of per capita GDP, for some specifications. This is against existing empirical evidence, and against the data. Inequality for Latin America countries (proxied by the Gini coefficient) has decline in most of the
countries in the last years (see Figure 1 in page 11), in a period with significant growth. This is true at last for Argentina, Bolivia, Brazil, Chile, Ecuador, Peru, Uruguay, and Venezuela. Estimation results are not consistent with this piece of empirical evidence.

We have carefully checked these statements and do not clearly understand what looks incoherent to the referee. We have added in the results section the following paragraph to make clear the interpretation of our results:

Our models point out a U-shaped relationship between inequality and the logarithm of per capita GDP. The minimum of this curve for all the models is approximately 10. For our sample, the logarithm of per capita GDP ranges from 7.18 to 9.61. This means that the GDP of the countries in the sample are situated in the decreasing part of the curve. During the last years, inequality has declined in most of the countries of our sample in a period of significant growth. This empirical evidence is coherent with the negative sign obtained for GDP per capita when explaining income inequality. As argued in the Methodology section, our sample do not allow us to perform a test of Kuznets curve hypothesis (1955). Nonetheless, our results would be compatible with a situation where LA countries are situated in the second part of the inverted U shape Kuznets’s curve, where the increase in income per capita translates into a decrease in the income dispersion. These results are consistent with the findings of Meschi and Vivarelli (2009) and Dreher and Gaston (2008).

3. Furthermore, estimations predict the existence of a U-shaped relationship between inequality and per capita GDP. Even, in some specifications, the coefficient for the square root of per capita GDP is not significant, predicting that as per capita GDP increases, also inequality increases for these countries. Empirical evidence indicates the opposite.

To test whether there is a quadratic effect, a joint test of the linear and quadratic coefficients should be performed. In all our models, the joint tests are significant. As we have commented before, given the behavior of the countries considered (log (GDP) between 7 and 9), our results indicate a decreasing and no linear relationship between inequality and per capita GDP. Note that this would not be incompatible with a situation of countries standing in the decreasing part of the Kuznets’s curve, but as explained before, we do not consider that our sample and period allows us to consider our study as a valid test of this hypothesis.

4. More control variables should be included in the econometric model to check for robustness beyond FDI net inflow. Inequality is a serious issue, and it should be treated seriously.

Thank you for drawing our attention to this fact. We fully agree with the referee that inequality should be treated seriously. By including the level of income inequality in the previous year, we already account for all the factors explaining this previous level, even if we are not able to precise which factors there are. As explained in the response to referee 1, we propose to include additional control variables that influence middle and short term trends in income inequality. We have added a discussion of this in the Methodology section.
5. I do not understand the meaning of the data in Table 1. What is the Min (-12.31) or the Max (18.28) of GDP growth?

Min indicates the minimum value of GDP growth rate, while Max indicates the maximum value of GDP growth rate.

References


