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Financial Openness and Inequality

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Although there is a large body of literature on the link between trade openness and inequality, there is little empirical research on the relationship between external financial openness and inequality. In this paper, we attempt to fill this gap in the literature by conducting an empirical examination of the link between Gini-based inequality measures and key measures of financial openness for a sample of 47 countries between 1991 and 2010. We find that in emerging market economies the impact of external financial openness on inequality varies considerably over time. An increase in a country's external liabilities is associated with an initial rise and a subsequent fall in inequality. The main driver of this pattern appears to be foreign direct investment, whose estimated impact exhibits a very similar dynamics, in line with existing theoretical predictions. Meanwhile, the estimated impact of external financial openness on inequality in advanced economies tends to be considerably smaller than in emerging market economies.