

“The Paradox of Transfers: Distribution and the Dutch Disease” (With Richard Chisik) (Job Market Paper)

In this paper we analyze the effect of within-country income inequality on economic outcomes. In particular, we develop a new model of international trade with non-homothetic preferences whereby within-country income distribution affects the pattern of trade and economic growth. Alternative forms of foreign transfers, such as foreign aid and remittances, interact with the income distribution in dissimilar manners, which in turn generates differences in spending patterns, the real exchange rate, production patterns, and the pattern of international trade. In a three sector model with international trade and production we show that while remittances can foster economic growth, foreign aid can cause economic stagnation. An appreciation of the real exchange rate inducing a production shift to the sector with less long-run growth potential is known as the Dutch disease and in our model the disease is triggered by within-country income differences and the form of the foreign transfer. We empirically verify these hypotheses with data from a panel covering the years 1991-2009 while controlling for the issues of omitted variable bias and the possible endogeneity of foreign aid and remittances.

“Does Inequality Drive the Dutch Disease: Theory and Evidence” (With Richard Chisik, Harun Onder and Bill Battaile) (Published in the *Journal of International Economics*)

In this paper we show that the Dutch disease can arise solely from inequality in the distribution of natural resource rents. Given two otherwise identical countries that differ only in the ownership shares of the natural resource rents, the country with the less equal distribution will have less production of manufacturing goods and less development of learning-by-doing in this sector. As opposed to conventional models, where income distribution has no effect on economic outcomes, an unequal distribution of the resource wealth can generate the Dutch disease dynamics even in countries with an initial comparative advantage in manufacturing. We also provide a range of empirical tests of our model, including both difference and system GMM estimators in a dynamic panel. To disentangle the effects of inequality and institutional quality we purge our inequality measure of any linear or higher order correlations with institutional quality and repeat our system and difference GMM estimations. Our empirical analysis supports the hypothesis that inequality indeed plays a significant role in whether being resource-rich is a blessing or a curse for a country. The more unequal is the distribution of natural resource rents, the stronger is the disease.

“Dutch Disease and the Manufacturing Firms” (Work in progress)

Understanding the supply side of the Dutch disease requires a deeper examination of the windfall’s effect on the firms. In a two-country three-sector monopolistically competitive framework with costly international trade, I explain firms’ behaviour following the receipt of a windfall. I show that in the monopolistically-competitive manufacturing sector, the number of domestic firms and their market share increases with the size of the domestic windfall, but decreases with greater inequality of its distribution. In order to draw empirical conclusions using a panel of industries and countries for 1991-2009, I utilize a sensitivity measure and differentiate industries in terms of their response to the real exchange rate appreciation. In addition, in order to address the lack of a natural resource specific measure of inequality, I construct a natural resource Gini coefficient and use it as the preferred measure of resource rent distribution. I find empirical evidence that a more equal distribution of natural resource rents can boost the growth of value added in industries that are more sensitive to the real exchange rate appreciation. In contrast, an unequal distribution of the resource rents retards growth by a greater amount in these more exportable industries.