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Wealth Inequality and Democracy

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The relationship between wealth inequality and democracy has become increasingly important in the minds of voters, politicians, and academics. Despite this importance, research on wealth inequality and democracy has not reached a consensus partly because the measures of inequality used vary, and few measures capture wealth inequality given the lack of data on that front. Our work develops the existing research by using billionaire wealth as a percentage of gross domestic product (GDP) as a proxy measure of wealth inequality.

This measure has three advantages. First, billionaire wealth is a comprehensive gauge of wealth that captures many asset classes. Second, it represents an extreme version of wealth inequality by measuring what those at the very top of the wealth distribution own. To the extent that models of democratization emphasize the role of elites (or the lack thereof), our measure of wealth inequality is likely to better capture the influence of those elites than a measure like the Gini index, which captures inequality over the entire distribution. Third, because we classify each billionaire in our sample as self-made or inherited and also as politically connected or unconnected, we can disaggregate wealth inequality and comment on the effects of certain types of wealth inequality on democracy. By contrast, aggregate measures of inequality, such as the Gini index, whether of income or wealth do not permit classifying economic elites, and previous research has shown that differences in the source of economic inequality can matter for economic growth.

The ability to look at differences between economic elites is important because the expected impact of wealth inequality on democracy is theoretically ambiguous. On the one hand, economic elites may believe that voters will vote to redistribute wealth, and therefore, elites may oppose democracy to avoid bearing redistributive taxes. On the other hand, recent work suggests that elites are not a monolithic group and may not share identical views on the desirability of democratization.

For instance, politically connected billionaires who owe their fortunes to the current regime may prefer the

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continuation of that regime, as any replacement of the existing political regime or incumbent politicians may lead to the elimination of their advantages in the economic sphere, such as monopoly rights or exclusive licenses. However, because authoritarian governments can more easily expropriate the wealth of individuals who are politically unconnected, unconnected elites may prefer democracy if they view the protection of property rights and rule of law as more credible under a democracy than an autocracy.

To make progress on the question of the relationship between wealth inequality and democracy, we constructed a panel data set of 149 countries for the period from 1987 to 2017 and examined the impact of our measure of wealth inequality using measures of democracy from Polity, the Varieties of Democracy (V-Dem) project, and the continuous Machine Learning Democracy Index. Although these measures each define democracy slightly differently, they share the minimum criteria that in a democracy, citizens must be able to elect their leaders through free and fair elections that provide meaningful choices.

Moreover, democracies must permit political competition by allowing candidates and citizens to freely assemble and associate. Extending our analysis through 2017 enabled us to examine the rise of populist regimes among several existing democracies and the beginning of a so-called democratic recession. Because it takes time for large, structural political changes to occur, we studied the effect of changes in the democratic status of a nation five years after changes to its level of wealth inequality.

We found no relationship between inherited wealth inequality and democracy and weak evidence of a negative relationship between overall wealth inequality and democracy. However, we found robust evidence of a negative relationship between politically connected wealth inequality and levels of democracy across the globe and in a subsample of countries that are already democratic.

We also found strong evidence that the vulnerability of assets to confiscation is what makes inequality harmful for democracy. If politically connected elites oppose democracy, then high capital mobility should moderate the negative influence of such inequality on democracy, as elites could more easily avoid an expropriation of their assets. Indeed, we found that higher capital mobility weakens the negative relationship between politically connected wealth inequality and democracy. Our results suggest that an increase of one standard deviation in politically connected wealth inequality (2.3 percent of GDP) lowers V-Dem electoral democracy scores by 0.009 points holding all else equal for a country with no capital mobility.

Comparing the United States and Indonesia proves useful in establishing our claim that differences in the source of inequality matter. Although billionaire wealth is high in the United States, having risen to 10 percent of GDP by 2012, politically connected wealth inequality in the United States never rises above 0.15 percent of GDP. The lack of politically connected wealth, as classified by us, perhaps explains why despite relatively high levels of wealth inequality compared with, for example, continental Europe, scores on democracy indices for the United States are comparable to (or higher than) those in continental Europe.

In contrast to the United States, politically connected individuals dominated the *Forbes* billionaire list for Indonesia in the 1980s and 1990s, with politically connected wealth inequality peaking at over 7 percent of GDP in 1996 on the eve of the Asian financial crisis. The crisis and the subsequent ousting of President Suharto in 1998 reset the scene both politically and economically. The individuals we classify as politically connected dropped out of the *Forbes* billionaire list for 2002 and 2007 altogether.

Although there was a partial reversal in their fortunes and some of them reemerged in 2012, even then politically connected wealth inequality clocks in at less than a tenth of what it had been just 15 years earlier.

In line with our thesis, we note that Indonesia's V-Dem scores were about 0.05 until 1996 and then increased until reaching about 0.5 in 2002 and then remain relatively stable during the rest of our sample period until 2017. Our interpretation of these events is that as the previous economic elites connected to Suharto were displaced by outsider economic elites, Indonesia democratized and did not revert to autocracy.

In closing, our research sheds new light on a topic that has long fascinated social scientists and citizens at large: the relationship between inequality and democracy. By exploiting a novel measure of wealth inequality and by classifying billionaires into distinct categories based on the presence (or absence) of political ties and on the origins

of their wealth, we find that while wealth inequality has at best a tenuous relationship with democracy, politically connected inequality exerts a negative influence on democracy when capital is not freely mobile.

NOTE

This research brief is based on Sutirtha Bagchi and Matthew J. Fagerstrom, "Wealth Inequality and Democracy," *Public Choice* 197, no. 1-2 (October 2023): 89–136.

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