Finance and Income Inequality - panel BMA approach*

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November 29, 2019

Abstract

Using a global sample, this paper investigates the determinants of wealth inequality capturing various economic, financial, political, institutional, and geographical indicators. Using instrumental variable Bayesian model averaging, it reveals that only a handful of indicators robustly matters and finance plays a key role. It reports that while financial depth increases wealth inequality, efficiency and access to finance reduce inequality. In addition, redistribution and education are associated with lower inequality whereas wars and openness to international trade contribute to greater wealth inequality.

Keywords: Income inequality, finance, Bayesian model averaging

JEL Codes: D31, E21

*We thank two anonymous referees, ...

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1 Introduction

2 Related literature

Piketty and Zucman (2014) Van der Weide and Milanovic (2018) provide evidence that income inequality in the United States (US) has different implications for the future income growth of the rich and the poor. High inequality seems to hurt the prospects of the poor while the top for the distribution is unaffected. The rich thus disproportianately benefit from higher inequality as their subsequent income exhibit faster growth. The authors attribute this effect to the political channel the rich use to lobby for implementation for the policies which back their economic interests. Preferences of the rich are ultimately more likely to determine public policy than the preferences of the majority (Gilens and Page, 2014). High inequality together with a credit constraint and rich driving the political process results in low government spending and lasting high inequality.

Marrero and Rodríguez (2013) introduce two types of inequality - inequality of oppportunity and inequality of effort/luck. Applying this to the EU countries and US states, they show that inequality of opportunity (driven by race and parental education ...) is negatively related to growth while the residual ”good” inequality is growth inducing.

Income inequality and growth may intersect through varying channels. Accumulation of savings, unobservable effort, and investment project size favour the prediction on growth inducing inequality. Negative impact of inequality on human capital accumulation, entrepreneurial activity, and hence growth provides argument for the opposing view.

3 Data

4 Methodology

5 Results

References

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A Appendix