Democratic Institutions and Economic Inequality: An Exploratory Study

Sarthak Singhal
Researcher
PERLab
sarthak.singhal@kearney.com

Abstract

This paper explores the causal relationship between the state and extent of democracy with economic inequality, with an attempt to explore proxies for the robustness of democratic institutions. While the large proportion of literature on this relationship has attempted to explore how economic inequality relates to and shapes the democratic strength of a country, the reverse relationship of how democracy affects inequality has received scarce attention. This paper aims to contribute to the literature by examining whether the empirical patterns support the hypothesized reverse relationship, using multiple proxies to measure democratic strength, and situating modern democracies in the paradigm of neoliberal capitalism. While the paper conducts an exploratory empirical analysis, it explicitly acknowledges methodological limitations that prevent strong causal claims. After establishing a set of measures that could be identified as proxies to measure the extent and robustness of democracy, the paper then attempts to study the relationship of these proxies with the Gini coefficient, a statistical measure of income or wealth inequality within a population. The empirical analysis reveals a consistent negative correlation in the 2024-2025 data, indicating that countries with stronger democratic freedom display lower levels of economic disparity. These findings are interpreted as exploratory associations rather than causal evidence. However, the paper also critically examines the flaws in the methodological construction of causal relationships between complex social phenomena like democracy which is a dynamic process and context specific, and income inequality. The paper also highlights the reductiveness of voting rights as sole bargaining power with the citizens, and the intertwined relationship of democracies with systems of neo-liberal capitalism. Drawing from theoretical frameworks of Sen's impossibility theorem and Graeber's conception of democracy as a core-periphery negotiation process, the study argues that modern democracies have deviated from the original principles of public participation and engagement. The study suggests that strengthening democratic institutions and addressing information asymmetry when accompanied by active policy efforts to reduce income and wealth disparities could result in improved outcomes for reducing inequalities.

Keywords: Democracy, Economic Inequality, Gini Coefficient, Political Economy, Institutions

1. Introduction

The idea of democracy is not a static one. Not only has the popular understanding of the term changed over time, but its dynamic nature comes from the multiplicity of ways in which individuals and groups experience it and perceive it. Its metamorphosis over time comes from the historical evolution of the idea of democracy. The roots of the word 'democracy' can be traced back to the Ancient Greek civilisation of the 5th century B.C. Cleisthenes, the leader of the city of Athens, was the first to use the word 'demokratia' to denote the system of political rule prevailing in Athens. Demokratia is a combination of 'demos', meaning people, and 'kratos', meaning rule. Democracy, therefore, in its first ever conceptualisation meant the rule of people. The principal tenet of this concept was the idea of 'participation'. This meaning of democracy, however, has undergone changes, both in epistemology and in practice, with the evolution of different forms of political organisation and governance, and in the context of modern nation states. The second aspect of democracy's dynamic nature, which is also the subject matter of this paper, is the prevalence of inequality, of several natures and of varying magnitudes. While the idea of democracy was founded on the principle of equality, of people having equal rights and freedom, of them being equal citizens in front of the law, even a cursory glance at the newspaper is enough to inform us that how 'democracy' interacts with people depends on their relative social position and is exacerbated by inequalities. Some people have more rights than others, and some are not even allowed a chance to take part in the functioning of democracy. The purpose of this paper is therefore not only to study this association between democracy and inequality, and how one affects the other, but also to question the idea of democracy itself, the manner of its manifestation in modern nation states, and to investigate whether a possibility exists for democracy to ever achieve equality.

This study makes three contributions to the scholarship on democracy and inequality. First, it revisits the often-assumed direction of association by empirically examining whether greater levels of democracy are associated with reductions in economic inequality, rather than the reverse relationship that dominates existing research. Second, it employs multiple proxies of democracy, including political rights, institutional quality, media freedom, and internet accessibility to capture the multidimensional character of democratization. This approach allows for a more nuanced understanding of how different facets of democracy interact with distributive outcomes. Third, the paper situates the empirical findings within a broader conceptual critique of modern democracy's entanglement with neoliberal capitalism, thereby connecting quantitative trends with structural explanations. By bridging empirical investigation with theoretical reflection, the study extends debates in comparative politics and political economy and underscores the importance of reassessing assumptions about democracy's equalizing potential.

2. Literature Review

The relationship between democracy and inequality, given the severity of impact it has on the material conditions of people's lives, has been of interest to scholars across the world. The direction of this relationship that has received the maximum attention has been on how the presence of inequality affects the practice of democracy. Boix (2003), whose work on this subject is one of the most widely cited and read, in his quest to understand how stable democracies are achieved, argues that democratisation is more probable in societies where the level of inequality is low. Acemoglu and Robinson (2001, 2006), another group of scholars who've done the most pioneering work on this relationship, predict that inequality and democracy have an inverted U-shaped relationship where the level of democratization is highest at middling levels of inequality. A common assumption in both these studies is that democratization is a function of the social elite's fear of revolution and unrest and hence they tend to introduce democracy in a country when the levels of inequality are highest.

Along the same lines, Levin-Waldman (2016) studies income inequality in the United States and concludes that rising income inequality poses serious threats to the functioning of a democracy and undermines it. Muller (1988) finds a two-way relationship between the two, arguing that a longer stable democracy reduces the prevalence of inequality, whereas high inequality, especially in relatively newly transitioned democracies, pose threat to its credibility and stability.

Democracy functions and is practised via its allied institutions and this crucial role of institutions is highlighted in the work of Besley and Burgess (2002). They posit that a democracy with credible institutions, a critical mass media, and symmetric information across its polity increases the propensity of government responsiveness to crisis situations and thereby establish that equality, not only in material distribution, but also in the spread of information, helps in ensuring the practice of democracy. Burgess et al. (2015), in a study on road building in Kenya, established the value of democracy in ensuring equality and found that in the absence of democracy, ethnic favoritism prevails and resources for building roads are distributed unequally among the Kenyan citizens.

While attempts have been made to establish this negative correlation between inequality and democracy, there have been scarce studies contrarian to this hypothesis as well. Ansell and Samuel (2009) study the likelihood of democratisation in relation with land and income inequalities and find that autocracies with high income inequalities are more likely to democratise. Krauss (2015) has highlighted the limitations in studying this relationship and reaching generalisable conclusions with regards to the impact of one on the other, more of which will be highlighted in a later section. In reviewing the literature on democracy and inequality, we find that this has been a topic of concern for many scholars, and rightly so, given the harsh consequences of both less democratic regimes and high inequality. However, there continues to be a dearth of work studying the other direction of this relationship: how does the presence of democracy and democratic institutions affect the level of inequality in a country, and this paper is an attempt to address this question.

3. How to Measure the Extent of Democracy?

As mentioned above, democracy is not an entity that remains static in a particular timeframe. It's a constantly evolving complex social phenomenon, transforming its meaning and the way in which it manifests, and therefore measuring the extent of democracy is itself a difficult task. While some would argue that the existence of an established democratic constitution in a nation that promises equal rights and freedoms to its people can be regarded as a democracy, I argue that democracy is not merely a set of principles but rather a process, one which takes place through the interaction between the citizens and the institutions of a country. In continuation with this and to make the work simpler, while keeping in mind the limitations that accrue to such a reduction, there are four proxies that I consider here to measure the extent of democracy. I will attempt to explain how these proxies are calculated and the rationale behind selecting them. The two sources I draw these proxies from are the indexes constructed by '*Freedom house*' and '*Reporter's without Borders*'.

<u>Global Freedom Index</u> - This index rates countries on the basis of people's access to political rights and civil liberties. Countries are given a score out of 100, where 40 points is for political rights and 60 for the extent of civil liberties, the sum total of which is the country's overall score. Rights and liberties are the two foundational aspects of a democratic setup and hence we choose this index to approximate the level of democracy.

<u>Democracy Score</u> - This score is calculated for 29 Central European and Asian countries, rating countries based on national and local governance, electoral

process, independent media, civil society, judicial framework and independence, and corruption, where countries are given a score out of 7 based on the level of criteria. We use this index because the credibility of institutions is of utmost importance in establishing a democratic regime.

<u>Internet Freedom Score</u> - The symmetry in and ease of information dissemination is an important estimator of modern democracy, since it is one of the ways to hold governments accountable for faltering from democratic principles. The three components of this index are a) obstacles to access, b) limits on content, and c) violation of user rights, with 25, 35, and 40 points respectively.

<u>Press Freedom Index</u> - The press and mass media, institutions which are otherwise referred to as 'fourth pillar of democracy', are extremely crucial to the functioning of a democracy, given that they hold governments accountable directly and indirectly by informing citizens, and therefore the freedom of these institutions is of utmost importance. Countries are given a score out of 100, with the lowest scores given to countries with the highest freedom of press.

The first three indexes are calculated by Freedom house, the last one is done by Reporters without borders. While this is not an exhaustive list of proxies that could measure the extent of democratisation in a country, we will try to ascertain if there is a link between democracy and income inequality, which is measured by the Gini coefficient, which we take from the *'World Inequality Database'*. Gini coefficient is a statistical measure of dispersion in income/wealth in a country, thereby representing the extent of inequality present in that country. The range of the coefficient is between 0 to 1, with 0 indicating perfect equality and 1 representing a state of absolute inequality.

4. An Empirical Attempt to Measure the Extent of Democracy

In an attempt to find a relationship between democracy and inequality, I plot the Gini coefficients against the indices (in increasing order) to see whether an increase in the extent of democracy (measured by these indices) leads to a decrease in income inequality.

Sample Selection Rationale:

The selection of countries for this analysis was guided by three criteria:

1. Data Availability: Countries were included only if complete data was available for all four democracy indices and the Gini coefficient for 2024-2025.

2. Geographic and Regime Diversity: We deliberately selected countries spanning different geographic regions and regimes (autocracies, transitional democracies, and established democracies) to examine whether the hypothesized relationship holds across diverse political contexts.

3. Time Period Selection: The year 2024-2025 was chosen because:
   - It represents a recent snapshot of democracy-inequality relationships
   - Complete comparable data was available across all indices
   - The cross-sectional nature of this analysis acknowledges that 2024-2025 data provides correlational evidence only, not longitudinal causal evidence

Limitations: The non-random, availability-driven sample selection limits generalization. Different country samples might yield different patterns. Future work should employ panel data spanning multiple years to address causal identification.

5. Global Freedom Index

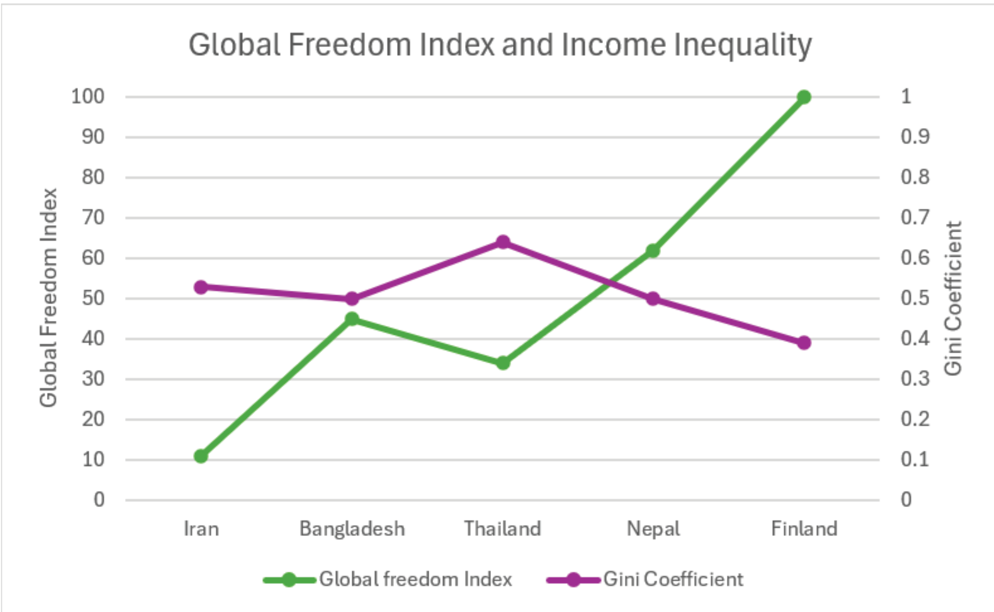

Figure-1, Global Freedom Index Score against respective Gini coefficient, 2024-2025

Source: Based on Data from Freedom House & World Inequality Database

We plot the Global Freedom Scores of five countries: Iran, Thailand, Bangladesh, Nepal and Finland, in an increasing order, with their respective Gini coefficients and observe a downward trend in income inequality as the extent of political rights and civil liberties in the country increases.

6. Democracy Score

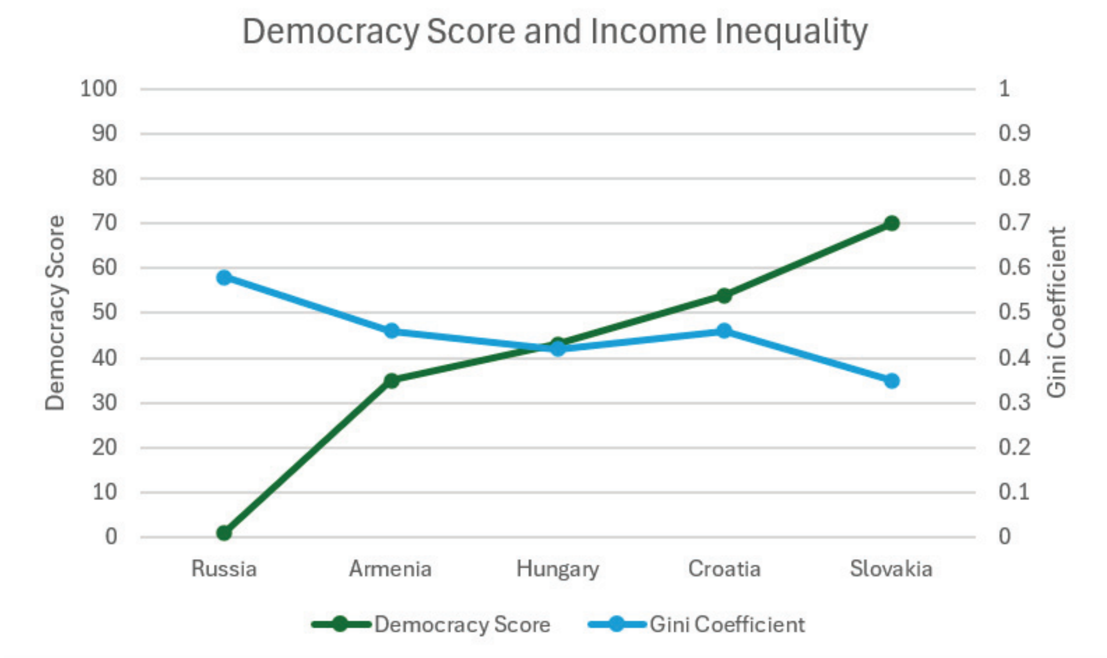

Figure-2, Democracy Score against respective Gini coefficient, 2024-2025

Source: Based on Data from Freedom House & World Inequality Database

A similar trend is observed in the relationship between the democracy index and Gini coefficients. An increase in the democracy score is observed to be coincident with a decrease in the Gini coefficient. Among the chosen countries, Russia has the lowest democracy score and the highest Gini coefficient whereas Slovakia has the highest democracy score and the lowest level of income inequality.

The observed inverse relationship between democracy and inequality becomes clearer when considering the mechanisms through which democratic institutions operate.

7. Press Freedom Index

Press freedom and internet access, in particular, play a central role. Independent media and a free press enhance government accountability by exposing corruption, misuse of public funds, and policy failures. Such scrutiny pressures governments to respond with redistributive policies, social welfare measures, or reforms that benefit broader sections of society rather than narrow elites.

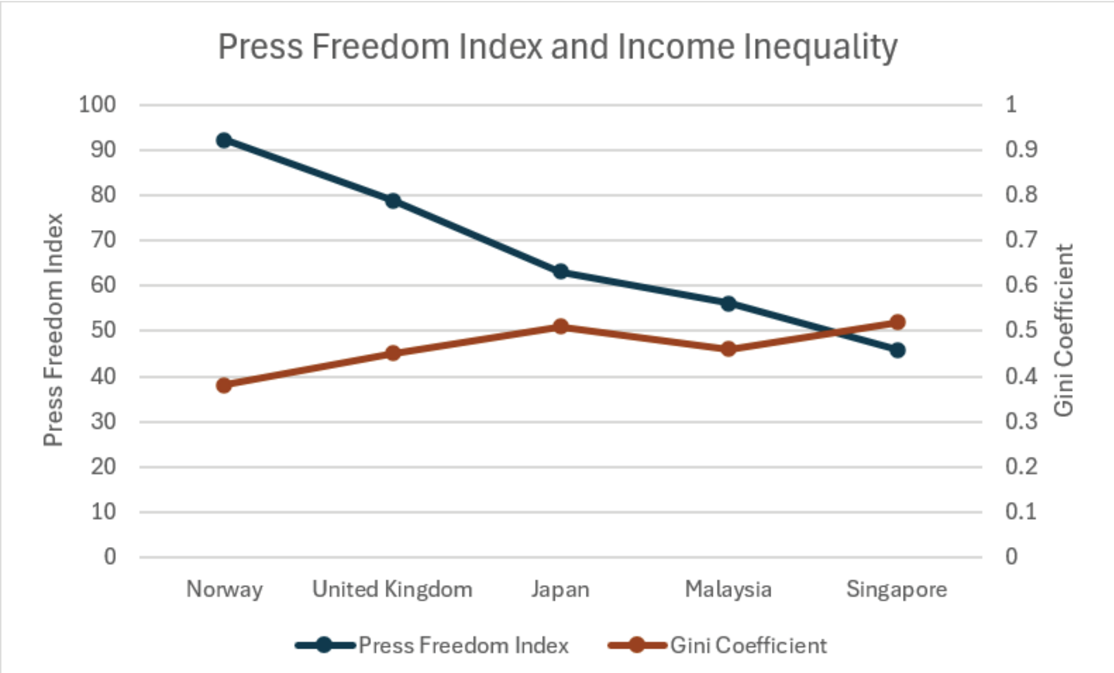

Figure-3, Press Freedom Index against respective Gini coefficient, 2024-2025

Source: Based on Data from Reporters without Borders & World Inequality Database

Press Freedom Index, for which the lowest value represents the highest freedom, exhibits a positive relationship with the Gini Coefficients of the respective countries. As the Press freedom of a country decreases, the level of income inequality in that country increases (except for Malaysia).

8. Internet Freedom Score

Similarly, internet freedom reduces information asymmetries between citizens and state institutions. By lowering barriers to information access, it empowers marginalized groups to mobilize, articulate demands, and hold leaders accountable. Online platforms also amplify citizen voices that are often excluded from traditional political channels, thereby widening participation in the democratic process. Over time, this broader participation can translate into more inclusive policymaking and a reduction in economic inequality.

A downward trend line is found again in plotting Gini coefficients of countries in the increasing order of their respective internet freedom scores. While this inverse relationship is not absolute, given that Cambodia has higher internet freedom scores than both China and Iran, and still has higher income inequality than them, the downward trend line tells us that an inverse relationship between the two is the best fit for the data.

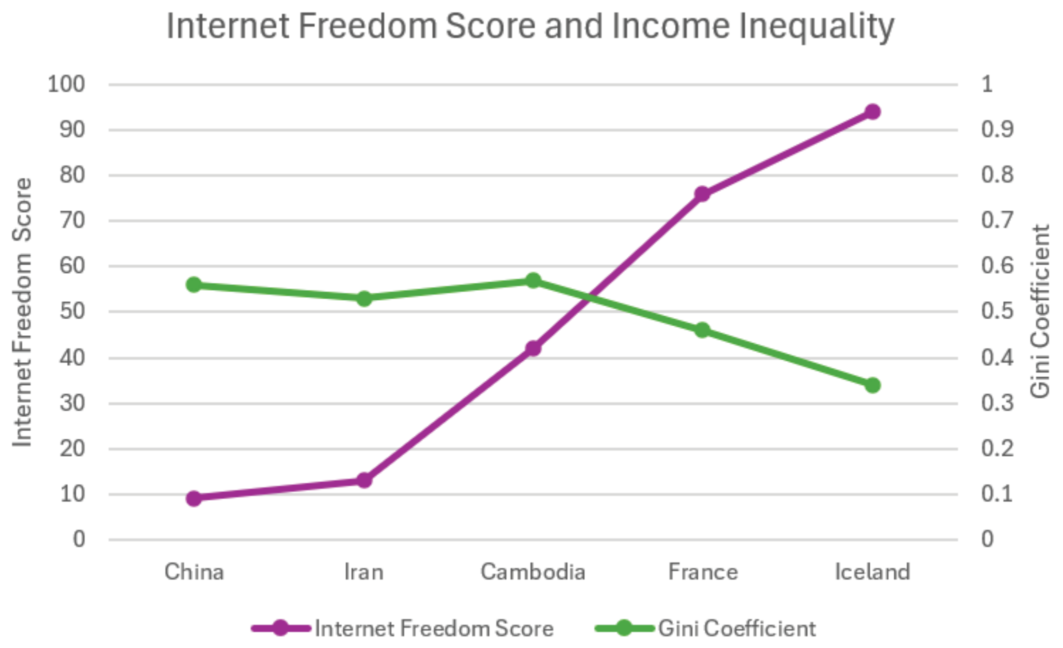

Figure-4, Internet Freedom Score against respective Gini coefficient, 2024-2025

Source: Based on Data from Freedom House & World Inequality Database

These mechanisms suggest that the inverse correlations observed in the data are not coincidental but are underpinned by institutional processes that connect freedom of expression and information access with distributive outcomes.

In all four of our chosen indices to measure the extent of democracy in a country, we find an inverse relationship between the level of democracy and the level of income inequality, thereby confirming that as the level of democracy in a country increases, the inequality in that country tends to decrease. While we do see a pattern of decreasing inequality with increasing democratisation, this evidence is not complete and hence not generalizable.

9. Why is it difficult to measure the relationship between democracy and inequality?

While it is possible to ascertain a causal relationship between democracy and inequality using proxies, it is extremely difficult to find a robust relationship between the two which transcends country wise differences and is worthy of generalisation. There are many factors endogenous to both the phenomenon of democracy and inequality which always escape empirical investigations about a potential relationship between the two.

Krauss (2015) identifies multiple methodological and empirical limitations in assessing this potential relationship. Most common approaches for studying this relationship employs per country per year data, which have several drawbacks. A per year analysis has the limitation of evaluating democracy as a phenomenon fixed in time, whereas democratisation is better understood as a process (d) evolving (Muller, 1988).

With the advent of globalisation, government and governance have also assumed a role transcending national boundaries and so has the prevalence of inequality. A per-country analysis not only fails to incorporate the subjectivity of conditions in different countries but also ignores the phenomenon of exogenous inequality creation that occurs due to power imbalances in trade relations.

Another limitation that plagues an empirical analysis is the difficulty in assessing whether promised democratic rights and freedoms in a constitutional document are actually realised and experienced by the citizens. Democratic institutions may also suffer from the problem of distributing *de jure* political power but failing to ensure *de facto* realisation of that distribution, which in turn might affect inequality and also become hard to assess empirically.

Authoritarian regimes in the past have been seen to enact radical land distribution reforms, leading to a more equitable distribution of land and other resources, and liberal democracies have passed laws cutting down on taxes of the top income earners of the country, thereby failing to address the already wide inequality. While the causal relationship between democracy and inequality can be identified by employing proxies, the complex entanglement of these two phenomena makes it difficult to find a strong association which could then inform policy decisions.

A critical limitation of this analysis must be explicitly noted: the cross-sectional design cannot identify causality. Three specific threats to causal inference are present:

1. **Reverse causality:** While this paper hypothesizes that stronger democracy reduces inequality, the reverse could be true - more equal societies may find it easier to maintain democratic institutions.

2. **Omitted variable bias:** Unmeasured factors (e.g., natural resource wealth, colonial history, education systems, or regional trade patterns) may simultaneously influence both democracy levels and inequality, creating spurious correlations.

3. **Endogeneity:** Democracy proxies (press freedom, internet access) may themselves be influenced by inequality levels or by common underlying factors, confounding the relationship.

Without a research design explicitly addressing these issues (such as instrumental variable analysis, natural experiments, or causal inference methods), the empirical patterns presented should be interpreted as descriptive associations rather than evidence of causal effects.

10. Are modern democracies fundamentally unequal?

While the empirical trends presented earlier suggest that higher levels of democracy are often associated with lower levels of income inequality, these findings are not absolute and resist easy generalization. This tension points to a deeper structural issue: even where democratic institutions correlate with more equal outcomes, modern democracies may still fail to deliver substantive equality. Their entanglement with market forces and neoliberal economic arrangements often undermines the redistributive potential of democratic institutions. Thus, the normative critique that follows should be read as an extension of, rather than a departure from, the empirical evidence, explaining why the observed correlations might be fragile or inconsistent across contexts.

In our entire study and all other studies that have attempted to find an association between the two, a key assumption is the possibility of democracies being equal. All countries in the world are plagued by one or the other form of inequality, and this inability of seemingly democratic nation states to establish equality raises a question: Is inequality intrinsic to the conceptualisation of modern democracy?

When Cleisthenes proposed democracy in the city of Athens, he did it in opposition to the existing political setup at the time, Aristocracy, the rule of the elite. Modern democracies, more or less, are closer to an aristocracy than to democracy. The principal idea of democracy was that every citizen gets to participate and takes an active role in the governance process through their elected representatives. However, modern-day democracies have invisibilised this idea of democracy as a 'process' of and have reduced it to an institution of ‘one vote per person’. During the speeches leading to the writing of the American Constitution, the governor of Virginia in his speech said, “There’s a real danger of democracy breaking out”, and that happening during the constitutional convention of the most ‘liberal’ democracy in the world is very telling in itself.

The failure of modern democracy in ensuring equality also needs to be seen in light of its marriage with capital and the market economy. The logic on which modern capitalism is premised as a zero-sum game: that there will always be losers and winners in the market (due to different levels of endowments and ‘merit’), and inequality therefore becomes a non-issue. While authoritarian inequality is created due to the lack of state willingness to address it, and such regimes are expected to be unequal due to an absence of the promise of equality, democratic inequality is primarily a creation of capital and the phenomenon of capital requires inequality for its survival.

Another marker for a democracy, which was also one of the first, is the access to voting rights. While voting rights encourage the citizens’ participation in the process of forming the government, it is also a limit to their participation. While the importance of voting rights cannot be undermined, its efficacy in ensuring fair elections is questionable. The Gibbard-Satterthwaite theorem of social choice states that every voting rule is manipulable, and instances of this have been observed in the election processes of major democracies in the world, thereby raising questions about voting rights as a measure of democracy. Graeber (2013) conceptualizes democracy as a core-periphery process, where the core is the elected representatives and the periphery is its citizens. He argues that the process of democracy is essentially a negotiation between the core and the periphery and the purpose of the periphery is to question, criticize and hold accountable anyone who assumes the position in the core. This idea of democracy as a continuous process was also shared by Dr. B.R. Ambedkar and his teacher John Dewey. While democracy for them and many others was to be a bottoms-up process, with the citizens at the periphery making rules through participation, modern democracy has become a top-down process, with the core dictating the rules to the periphery, very often without any consultation or negotiation.

Sen (1970), in his seminal text on the impossibility of Paretian liberal, states that it is impossible to achieve the conditions of pareto optimality (equality) and liberalism (democracy) together, and while he talked of this in context of individual preferences, an analysis of modern democratic states indicate the generalizability of this paradox.

11. Conclusion & Policy Implications

While I had set out to investigate the relationship between democracy and inequality, only one thing has been firmly established in the course of this paper: democracy is a complex phenomenon. This complex nature of democracy makes it not only hard to study its relationship with inequality but also raises concerns about the possibility of equality.

Most literature that has attempted to assess this relationship has done so to understand whether policy reforms addressed to reduce income and wealth inequality can lead to an increase in robustness of democratic institutions and an increase in political freedom. However, as noted earlier, such an attempt assumes a principle of equality embedded in the systems of modern democracy. This paper not only attempts to study the reverse relationship, i.e., how and if the extent of democracy in a country shapes the state of economic distribution, endowment, and earnings, but it also attempts to change the fundamental assumption that modern democracies are inherently based on a principle of equality.

The findings of this paper carry significant implications for policymakers seeking to strengthen democracy while addressing inequality. First, they suggest that fostering robust democratic institutions like independent media and internet freedom can act as indirect mechanisms of redistribution by enhancing transparency and government accountability. Second, the evidence highlights that democratization alone is insufficient to ensure equality unless it is accompanied by policies that directly tackle wealth and income disparities, such as progressive taxation, social safety nets, and equitable access to education and healthcare. Third, the study underscores the need to reconceptualize democracy as a participatory process rather than a static institutional arrangement. Policies that expand citizen engagement beyond periodic elections, such as deliberative assemblies or participatory budgeting may create avenues for more inclusive and equitable governance. Ultimately, while structural constraints tied to neoliberal capitalism limit the extent to which democracies can eradicate inequality, incremental reforms that strengthen accountability and redistribute resources can mitigate its extremes and preserve the legitimacy of democratic regimes.

While there is a sense of pessimism to the conclusion, it does not indicate hopelessness. It might not be possible to achieve absolute equality in a democracy, or any political regime for that matter. Our goal should be to ask for reforms to reduce inequality as much as possible. The hope for democracy in addressing inequality, therefore, lies only in the practice of its core principles:

active participation of the citizens in the process of policymaking, a process of continuous negotiation to hold governments accountable, increasing attempts to check the concentrations of power, and involving themselves proactively in ensuring democratic institutions remain robust.

References

Acemoglu, D., & Robinson, J. A. (2001). A theory of political transitions. *American Economic Review, 91*(4), 938–963.

Acemoglu, D., & Robinson, J. A. (2006). *Economic origins of dictatorship and democracy*. Cambridge University Press.

Ansell, B., & Samuels, D. (2010). Inequality and democratization: A contractarian approach. *Comparative Political Studies, 43*(12), 1543–1574.

Besley, T., & Burgess, R. (2001). Political agency, government responsiveness and the role of the media. *European Economic Review, 45*(4–6), 629–640.

Boix, C. (2003). *Democracy and redistribution*. Cambridge University Press.

Burgess, R., Jedwab, R., Miguel, E., Morjaria, A., & Padró i Miquel, G. (2015). The value of democracy: Evidence from road building in Kenya. *American Economic Review, 105*(6), 1817–1851.

Freedom House. (2025). *Freedom House* [Data set]. https://freedomhouse.org/

Graeber, D. (2013). *The democracy project: A history, a crisis, a movement*. Random House.

Krauss, A. (2015). *The scientific limits of understanding the relationship between complex social phenomena: The case of democracy and inequality* [Unpublished manuscript].

Levin-Waldman, O. (2016, October 10). How inequality undermines democracy. *E-International Relations*. https://www.e-ir.info/

Muller, E. N. (1988). Democracy, economic development, and income inequality. *American Sociological Review, 53*(1), 50–68.

Reporters Without Borders. (2025). *World press freedom index*. https://rsf.org/

Sen, A. (1970). The impossibility of a Paretian liberal. *Journal of Political Economy, 78*(1), 152–157.