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Finance and Inequality: Theory and Evidence

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Abstract

In this paper, we critically review the literature on finance and inequality, highlighting substantive gaps in the literature. Finance plays a crucial role in the preponderance of theories of persistent inequality. Unsurprisingly, therefore, economic theory provides a rich set of predictions concerning both the impact of finance on inequality and about the relevant mechanisms. While subject to ample qualifications, the bulk of empirical research suggests that improvements in financial contracts, markets, and intermediaries expand economic opportunities and reduce inequality. Yet, there is a shortage of theoretical and empirical research on the potentially enormous impact of formal financial sector policies, such as bank regulations and securities law, on persistent inequality. Furthermore, we lack a conceptual framework for considering the joint and endogenous evolution of finance, inequality, and economic growth.

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