Income Inequality and Political Instability

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1. Introduction

Income inequality is often regarded as an inevitable phenomenon which is caused by the competition for resources in the market. However, given inequality is a fundamentally political issue, it may also have political consequences in the form of rising social discontent and political instability (Parvin, 1973). Establishing a point where income inequality triggers political unrest has long been a challenging task for scholars. Previous empirical studies have focused on various political and economic factors including political regime type, economic growth, inflation rates and youth unemployment as the main determinants of political instability (e.g., Blanco and Grier, 2009; Miljkovic and Rimal, 2008; Gasiorowski, 1998; Urdal, 2006). However, no consensus has been reached as to what exactly is the channel through which the above-mentioned factors, particularly, income inequality affects political instability.

Contrary to the equity-efficiency tradeoff which asserts that economic inequality in the market is positively associated with economic efficiency, several studies have claimed that higher levels of income inequality exert a negative influence on investments and economic growth (Alesina and Perotti, 1996; Nel, 2003). The inequality–political instability nexus is thus attributed to such negative consequences of income inequality by the previous research. This argument, however, may not always carry clear implications for understanding the cross-country differences in the role played by income inequality as a determinant of political instability.

This research makes three contributions toward the understanding of the cause-and-effect chain of income inequality and political instability. First, it studies the impact of income inequality on civil society participation. Second, it examines the extent to which civil society participation affects political stability. Third, and more important contribution of this study is

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that it uses civic participation as a mediating variable between income inequality and political instability, and institutional quality as a moderating variable between (a) income inequality and civic participation, and (b) civic participation and political instability. Civic participation may bring about a different effect on political instability depending on its underlying cause. This cause is determined by the quality of institutions. Our regression results obtained from panel data for an unbalanced sample of 180 countries over the period from 1996 to 2019 confirm the negative relationship between Gini index and political stability when the representative countries had low institutional quality.

2. Related literature

Although global inequalities between countries have decreased throughout the past two decades, income inequality has increased within most countries (Chancel et al., 2022). This has spurred interest on its wide range of socio-economic and political consequences. The most prominent topics investigated so far revolve around the relationship between income inequality and economic growth (Barro, 2000; Kuznets, 1955), unemployment (Dumont, 2012), inflation (Beetsma and Van Der Ploeg, 1996) and financial instability (Bordo and Meissner, 2012).

Another issue which can emerge in conjunction with the rise in income inequality is political instability. Yet, existing research investigating this relationship is surprisingly scarce. In one of the earliest empirical studies on the inequality-political instability nexus, Parvin (1973) concluded that higher income inequality can contribute to political unrest. Furthermore, Alesina and Perotti (1996) examined a sample of 71 countries for the period 1960-85 and found that large disparities in income distribution and the absence of wealthy middle class negatively impact political stability.

A similar study by Nel (2003) utilized OLS technique to measure the effects of income inequality on economic growth and political instability, and revealed that higher levels of inequality are positively correlated with political instability. In addition, the results of this research indicate that higher political instability has a negative effect on investment and depresses economic growth prospects. Although these studies are arguably the earliest academic works which offer an insight into the income inequality and political instability relationship, they have not contributed much to an understanding of the transmission channels between the two. This research attempts to address this void by proposing civil society participation as a bridge

which connects income inequality and political instability. Moreover, it considers institutional quality as a pillar of this bridge, such that it serves as a moderating factor in the relationship between (1) income inequality and civic participation, and (2) civic participation and political instability.

2.1. Participatory consequences of income inequality

Civic participation is an important means for citizens to have a greater voice and increased effectiveness in society. Along with many other socio-economic consequences such as unemployment, unequal access to education and health, a rise in income inequality is expected to have repercussions on civil society participation. Two strands of literature exist with regards to the connection between income distribution and civic participation. The first strand focuses on income inequality as a source of growing social distances between the rich and poor. According to the *Resource Theory*, higher income differences disproportionately increase the availability of resources for the individuals with superior economic status. This could lead the poor to opt out of participation in civic activities (Lancee and Van de Werfhorst, 2012; Uslaner and Brown, 2005).

Another barrier that prevents the less privileged from civil society participation is lack of collective action. Apart from volunteering time to work as a group, civic engagement requires people to spend money to contribute to campaigns. This has a higher opportunity cost for low income individuals than their middle and high income counterparts as they have fewer resources to mobilize (Schlozman et al., 1999). Moreover, higher economic disparities can diminish trust among the poor for political institutions and create a sense of powerlessness. This could depress civil society participation and result in the acceptance of the *status quo* (Gaventa and Martorano, 2016).

The impact of economic inequality in driving down civic engagement is claimed to be stronger in democratic societies. The decline of middle class which is caused by unequal distribution in income may erode democratic consensus as not all income groups can enjoy the same status in society (Levin-Waldman, 2012). Solt (2008), analyzing cross-country data collected from 22 industrialized democracies, concluded that greater economic inequality reduces citizen's interests and resources available for political participation. Given civil society engagement is a stimulator of political activity, it can be argued that income inequality is negatively associated with civic involvement in democracies.

The second strand of literature supports the view that income inequality increases civic participation. For example, Holm (2018) studied the effect of income inequality in citizen participation at the city level across small and medium sized American cities, and found that more unequal cities had more civic participation. In their reflective work, Godfrey and Cherng (2016) show that greater income inequality could spur youth's involvement in civic activities. There are several reasons as to why higher disparity in income may increase young people's participation in civil society organizations. In general, youth are more energetic and optimist than adults. Hence, they may not see income inequality as insuperable as adults would, and want to spend more effort to change it. Furthermore, young people with poorer economic background tend to question the underlying causes of income inequality more than andults. This could trigger new debates about political and economic issues in society.

One important topic absent from prior literature on the relationship between income inequality and civic participation is the moderating role of institutional quality in the relationship between civil society participation and political stability. Institutions such as rule of law, protection of property rights, and judiciary independence can be viewed as a building block of trust in state-society relations. If the quality of institutions remain low causing a deterioration of trust in government, high levels of civic participation, contrary to the predictions, may fuel social discontent and yield political instability.

2.2. Conceptual framework

This paper proposes a different conceptual framework to investigate to what extent and through what channels income inequality triggers political instability. It examines the effect of income inequality on political instability through three hypotheses. First, we argue that there is a relationship between income inequality and civil society participation. A growing body of evidence suggests that heightened economic inequality impinges on civic participation in society (Lancee and Van de Werfhorst, 2012; Levin-Waldman, 2012; Sairambay, 2020). However, the question on whether unequal distribution of income serves as a spark or stumbling block for civic participation remains unresolved. Hence, this research explores this question by analyzing in what ways and to what degree income inequality affects civil society participation.

Second, changes in civil society participation will trigger changes in political stability. Participation in civic life is generally thought to foster political participation as it helps citizens effectively learn their rights and obligations. This will shape the involvement of people in political activities and thus influence political outcomes. Therefore, we investigate whether active participation in civil society organizations decreases or increases support for political systems and make them stable or unstable. In this sense, civic participation is considered as a mediating variable between income inequality and political instability.

Third, we contend that it is the quality of institutions which moderates the relationship in both cases. We show that, although the relationship between (a) income inequality and civic participation, and (b) civic participation and political instability may generally hold, it is crucially affected by the quality of institutions across countries.

Quality of institutions including protection of property rights, rule of law, control of corruption and safeguard of human rights shape market outcomes. This is supported by the findings of various cross-country empirical studies (Hall and Jones, 1999; Acemoglu et al., 2001; Rodrik et al., 2004). Therefore, income inequality in countries with high institutional quality is considered as market-induced, and it is less likely to cause political instability. On the other hand, income inequality in countries with low institutional quality is deemed as a distributional outcome of mostly non-market forces. The subversion of rule of law can result in unequal allocation of power in society which will put individuals who hold positions of authority in a more advantageous position over others. Income inequality is one of the direct consequences of such inequality of opportunity.

Thus, political stability can be shaken by the joint impact of income inequality, civic participation, and institutional quality when all other things are held equal. Evidence from this research has important policy implications. To maintain political stability in countries with severe income inequality and weak institutions, it is not enough to implement redistributive policies only. Efforts to ensure political stability should be more directed toward reforming economic and political institutions.

3. Data and methodology

The general form of the baseline panel data model that we will estimate looks as follows:

$$Pol\_st_{i,t} = \beta_0 + \beta_1 Gini_{i,t} + \beta_2 Inst\_qual_{i,t} + \beta_3 Gini_{i,t} \cdot Inst\_qual_{i,t} + Controls_{i,t} + \varepsilon_{i,t} . \quad (1)$$

The control variables of our model include GDP per capita growth, degree of political competition, share of population using the internet, inflation rate, and the rate of youth unemployment.

As our dependent variable in the above model, we use the index called *Political Stability and Absence of Violence* from the Worldwide Governance Indicators (WGI) of the World Bank. Our measure of income inequality is the *standardized Gini index* obtained from the latest version of the UNU-WIDER World Income Inequality Database (WIID). Additionally, as a robustness exercise, we run the above regression with an alternative measure of income inequality called the *Palma ratio*,[2] which is also obtained from the WIID. (The results are given in the Appendix.) We construct the variable *institutional quality* by using the WGI's five governance indicators, namely, *Voice and Accountability*, *Government Effectiveness*, *Regulatory Quality, Rule of Law*, and *Control of Corruption*. For that, we take the normalized average of the mentioned five indices, so that our *institutional quality* index takes on the values between zero and one.

To investigate civil society participation as the possible transmission channel between income inequality and political stability, we also estimate the following models:

$$Civic\_part_{i,t} = \gamma_0 + \gamma_1 Gini_{i,t} + \gamma_2 Inst\_qual_{i,t} + \gamma_3 Gini_{i,t} \cdot Inst\_qual_{i,t} + Controls_{i,t} + \epsilon_{i,t} ; \quad (2)$$

$$Pol\_st_{i,t} = \delta_0 + \delta_1 Civic\_part_{i,t} + \delta_2 Inst\_qual_{i,t} + \delta_3 Civic\_part_{i,t} \cdot Inst_{qual_{i,t}} + \\ + Controls_{i,t} + e_{i,t} . \quad (3)$$

The data on civic participation (i.e., popular involvement in civil society organizations) are obtained from the V-Dem Dataset (v12) of the University of Gothenburg's Varieties of Democracy Project, and the data on political competition (used as a control in equations 1 and 3) and the Polity score[3] (used as a control in equation 2) come from the Polity5 Project of the Center for Systemic Peace. The data on the percentage of population using the internet originates from the International Telecommunication Union's (ITU) World Telecommunication/ICT Indicators Database. Additionally, we use the data on annual inflation rate (based on consumer

[2] The Palma ratio was proposed by Cobham and Sumner (2014) as an alternative measure of income inequality; it is the ratio of top 10 percent to bottom 40 percent of population income distribution.

[3] The Polity score ranges from -10 to +10, where -10 stands for 'full autocracy' and +10 stands for 'full democracy'.

prices) originating from the International Monetary Fund and the data on youth unemployment rate (% of total labor force ages 15-24) from the International Labor Organization.

We estimate our models using the fixed effects (within) estimator that allows us to account for country-specific time-invariant factors. In addition to the standard fixed effects estimation, we also estimate several other regressions including year dummies in order to control for secular changes. The descriptive statistics of our variables are given in Table 1.

Table 1. Descriptive statistics of variables used

	Obs.	Mean	SD	Min.	Max.
Political stability	3,907	-0.0579	0.974	-3.181	1.760
Gini index	1,375	40.53	9.678	15.16	73.96
Civic participation	3,550	0.922	1.147	-2.902	3.148
Institutional quality	3,881	0.487	0.225	0	1
GDP p.c. growth	3,792	2.335	5.298	-62.38	121.8
Political competition	3,236	6.749	3.191	0	10
Polity score	3,190	3.845	6.280	-10	10
Internet users	3,588	30.13	29.60	0	99.70
Inflation	3,563	7.704	71.66	-18.11	4,145
Youth unemployment	3,651	16.62	11.99	0.370	65.44

4. Results and discussion

The results of our baseline fixed effects regressions are given in Table 2. They suggest that the effect of income inequality (i.e., the standardized Gini index) on political stability is conditional on the quality of institutions: at low levels of institutional quality an increase in Gini is strongly associated with higher political instability, while this destabilizing effect fades away with improvements in the quality of institutions. This finding supports our theoretical conjecture that institutional quality moderates the relationship between income inequality and political stability. The institutional quality itself seems to be positively associated with political stability, but its coefficient loses significance when we include the year dummies in addition to controls. When we use the Palma ratio, the alternative measure of income inequality, the effect of institutional quality remains significantly positive (at the 1% significance level) even after controlling for additional variables and the year dummies (see the Appendix). While economic growth may be

thought to have a politically stabilizing effect, we fail to find evidence for such an effect when we control for other factors.

Political competition correlates positively (at the 5% significance level) with political stability. Political competition refers to the competitiveness of political participation, and it measures both the degree of institutionalization of political participation and the extent to which this participation is free from government control.[4] Hence, our estimates suggest that well-institutionalized and competitive political parties and processes may improve political stability. Moreover, our results show that an increased use of the internet, higher inflation and a higher rate of youth unemployment are all significantly negatively associated with political stability. While the politically destabilizing effects of inflation and youth unemployment are not a new finding, the effect of internet usage may need deeper consideration. Although our finding suggests that the overall usage of the internet may lead to more political instability in general, this relationship is likely to be more nuanced in that it may depend on the type of information that people consume. For example, Ceron (2015) finds, using Eurobarometer survey data for 27 countries, that consumption of news from websites of traditional media outlets is associated with higher trust in political institutions, while access to information available on social media is associated with lower trust. This kind of investigation, however, is out of scope of our current research.

Table 3 presents the results of fixed effects regressions of civic participation on the Gini index, institutional quality, their interaction, and other controls. It can be seen that the direct effect of Gini (when the quality of institutions is very low) is strongly positive at the 1% level of significance. Improvements in institutional quality increase civic participation on the one hand, and dampen the positive effect of income inequality on participation on the other. Thus, our results provide no support for either the Resource Theory or the Relative Power Theory[5] in countries with low-quality institutions. In contrast, the Conflict Theory predicts that higher levels of income inequality lead the views of the poor and the rich to oppose each other strongly, hence resulting in "more political interest and participation, on parts of both the rich and the poor" (Pelke, 2020). The Conflict Theory seems to be more relevant for countries having low quality of

[4] Polity5 Dataset Users' Manual (2020).
[5] The Relative Power Theory contends that high levels of economic inequality lead to the concentration of power, where the powerful minority determines the political discourse and the less affluent majority, aware of their powerlessness, give up on any engagement in political processes (Solt, 2008).

institutions. For countries that have high-quality institutions, increased income inequality will instead reduce civic participation: according to our results, this negative effect of the Gini index already starts when our institutional quality index is above 0.604 (i.e., half a standard deviation above its mean of 0.487 in the overall sample). Hence, our finding that higher income inequality depresses civic participation in countries with high levels of institutional quality corroborates the findings of earlier studies, including Lancee and Van de Werfhorst (2012) and Levin-Waldman (2012).

As a political variable explaining civic participation, we use the Polity score rather than the index of political competition used in the regressions of Table 2. The reason is that the degree of political competition is unlikely (based both on intuition and on the lack of empirical evidence) to have a direct causal effect on civil society participation, while being democratic or autocratic (which is captured by the Polity index) may have such an effect. As can be seen from Table 3, the degree of popular involvement in civil society organizations is significantly higher in more democratic countries. The coefficient on internet users is positive and significant (at the 5% level) when we exclude the year dummies, and is negative and significant (at the 5% level) when we include the year dummies. This suggests that the positive effect of internet usage when the year dummies are excluded is most probably due to the secular changes in the use of the internet and civic participation. An interesting finding is that youth unemployment is significantly positively associated with civil society participation. While the reason why this is the case requires deeper investigation, it should be noted that this finding does not necessarily imply that it is the unemployed youth who get more involved in civil society activities: it may be that in countries with high youth unemployment rates, people (especially the youth) may be more aware that they need to engage in civil society organizations in order not to end up unemployed.

Table 4 presents the results of regressions of political stability on civil society participation, institutional quality, their interaction, and other controls. The results suggest that higher civic participation increases political instability at the very low levels of institutional quality. This politically destabilizing effect of civic participation, however, vanishes with improvements in the quality of institutions. When the index of institutional quality reaches the threshold point of approx. 0.61 (i.e., about half a standard deviation above its mean of 0.487 in our sample), civic participation starts exerting positive influence on political stability. Moreover, countries with better institutional environment are more politically stable.

Overall, our estimates in Tables 3 and 4 suggest that, absent necessary institutional environment (i.e., where the quality of institutions is very low), higher income inequality leads to higher civic participation, which in turn leads to more political instability. When a country has sufficiently high quality of institutions, however, greater income inequality seems to depress civic participation. However, due to higher stabilizing effect of institutional quality, lower civic participation caused by higher inequality does not inflict damage on political stability.

Table 2. Fixed effects regressions: the conditional effect of the Gini index on political stability

	(1)	(2)	(3)	(4)	(5)	(6)
Gini index	-0.0283***	-0.0327***	-0.0293***	-0.0334***	-0.0371***	-0.0361***
	(0.00861)	(0.00867)	(0.00861)	(0.00866)	(0.00987)	(0.00982)
Inst. quality	1.640**	1.679**	1.639**	1.696**	1.595*	1.428
	(0.778)	(0.772)	(0.778)	(0.770)	(0.885)	(0.879)
Gini × Inst. quality	0.0517***	0.0512***	0.0523***	0.0509***	0.0580***	0.0588***
	(0.0177)	(0.0176)	(0.0177)	(0.0175)	(0.0199)	(0.0198)
GDP p.c. growth			0.00432*	0.00684***	-0.000305	0.00301
			(0.00226)	(0.00254)	(0.00253)	(0.00285)
Polit. competition					0.0201**	0.0239**
					(0.00933)	(0.00954)
Internet users					-0.00283***	-0.00225**
					(0.000491)	(0.00107)
Inflation					-0.00227**	-0.00311***
					(0.000999)	(0.00103)
Youth unemployment					-0.00575***	-0.00539***
					(0.00192)	(0.00199)
Constant term	-0.820**	-0.511	-0.805**	-0.508	-0.545	-0.462
	(0.398)	(0.402)	(0.399)	(0.403)	(0.462)	(0.462)
Year FE	No	Yes	No	Yes	No	Yes
Observations	1,361	1,361	1,327	1,327	1,145	1,145
Within R-squared	0.168	0.205	0.173	0.216	0.217	0.256
Number of countries	180	180	177	177	152	152

Standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

Table 3. Fixed effects regressions: the conditional effect of the Gini index on civic participation

	(1)	(2)	(3)	(4)
Gini index	0.0208***	0.0265***	0.0348***	0.0338***
	(0.00761)	(0.00762)	(0.00812)	(0.00814)
Inst. quality	2.682***	2.760***	2.930***	3.102***
	(0.689)	(0.679)	(0.728)	(0.730)
Gini × Inst. quality	-0.0341**	-0.0356**	-0.0582***	-0.0560***
	(0.0157)	(0.0155)	(0.0163)	(0.0163)
GDP p.c. growth			-0.000881	-0.00154
			(0.00221)	(0.00255)
Polity score			0.0523***	0.0460***
			(0.00432)	(0.00448)
Internet users			0.000960**	-0.00191**
			(0.000400)	(0.000891)
Inflation			-0.000383	0.000542
			(0.000822)	(0.000857)
Youth unemployment			0.00753***	0.00699***
			(0.00157)	(0.00164)
Constant term	-0.430	-0.882**	-1.091***	-1.261***
	(0.353)	(0.355)	(0.379)	(0.383)
Year FE	No	Yes	No	Yes
Observations	1,317	1,317	1,139	1,139
Within R-squared	0.035	0.091	0.198	0.222
Number of countries	165	165	150	150

Standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

Table 4. Fixed effects regressions: the conditional effect of civic participation on political stability

	(1)	(2)	(3)	(4)
Civic participation	-0.284***	-0.274***	-0.255***	-0.260***
	(0.0257)	(0.0258)	(0.0382)	(0.0385)
Inst. quality	4.245***	4.217***	3.796***	3.640***
	(0.151)	(0.151)	(0.199)	(0.202)
Civic part. × Inst. quality	0.355***	0.360***	0.389***	0.426***
	(0.0667)	(0.0667)	(0.0917)	(0.0925)
GDP p.c. growth			0.00215	0.00354**
			(0.00141)	(0.00148)
Polit. competition			0.0215***	0.0234***
			(0.00515)	(0.00524)
Internet users			-0.00216***	-0.00165***
			(0.000305)	(0.000580)
Inflation			-0.000320***	-0.000350***
			(0.000073)	(0.000074)
Youth unemployment			-0.00579***	-0.00633***
			(0.00140)	(0.00142)
Constant term	-2.125***	-2.064***	-1.984***	-1.857***
	(0.0690)	(0.0733)	(0.0919)	(0.0965)
Year FE	No	Yes	No	Yes
Observations	3,545	3,545	2,835	2,835
Within R-squared	0.233	0.239	0.229	0.239
Number of countries	170	170	157	157

Standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

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Appendix: Robustness exercise

Table A1. Fixed effects regressions: the conditional effect of the Palma ratio on political stability

	(1)	(2)	(3)	(4)
Palma ratio	-0.133***	-0.138***	-0.135**	-0.149***
	(0.0485)	(0.0487)	(0.0534)	(0.0534)
Inst. quality	3.309***	3.322***	3.648***	3.386***
	(0.358)	(0.361)	(0.426)	(0.431)
Palma × Inst. quality	0.260**	0.239**	0.231*	0.264**
	(0.112)	(0.113)	(0.122)	(0.123)
GDP p.c. growth			0.000377	0.00381
			(0.00258)	(0.00289)
Polit. competition			0.0201**	0.0252***
			(0.00945)	(0.00963)
Internet users			-0.00266***	-0.00188*
			(0.000495)	(0.00109)
Inflation			-0.00247**	-0.00340***
			(0.00100)	(0.00104)
Youth unemployment			-0.00541***	-0.00503**
			(0.00193)	(0.00199)
Constant term	-1.782***	-1.618***	-1.917***	-1.731***
	(0.186)	(0.192)	(0.223)	(0.232)
Year FE	No	Yes	No	Yes
Observations	1,315	1,315	1,108	1,108
Within R-squared	0.173	0.210	0.224	0.267
Number of countries	174	174	148	148