

Inequality, Populism and Voting Behaviour:

A study on post-colonial developing economies

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Abstract

States and societies worldwide are increasingly accepting populist policies to cope with the insecure future though the perspectives and ramification of the same are completely different among the developed and developing world. It is true that a large volume of research has recently emerged on the issue but such researches are mainly developed economies centric. Moreover, it is also observed that the studies on populism are mainly centered on the orientation of demand for populism. Literature on supply of populism is meager and on sustainability it is almost absent. On this perspective this study has tried to develop an integrated algebraic model on the demand, supply and sustainability of populism in post-colonial developing economies through studying the patterns in voting behavior with the help of economic reasoning. The extensive use of the tenets of behavioural economics within the current study with the help of heterodox tradition has made this study different from the existing. The findings of the mathematical model have been tested over a set of secondary data with the help of econometric tools.

One of the prominent features of the post-colonial developing economies is the existence of high degree of economic inequality. To overcome this inequality the poorer section follows the consumption of the elites. Not only that, to overcome the fear of inequality induced perceived insecurity they overweight the present with reference to the future. Short run populist measures are seen here as an important weapon to bridge this inequality. The extent of economic inequality

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appears here as the context in the formation of demand for populism. In other words, *Expenditure Cascade Hypothesis* plays an important role in these economies to develop the context of populism. Following the same hypothesis, it can be said that when there is an inequality within the economies individuals take greater risks to discount the rational future and accept the sub-optimal populist present. These economies are comprised of different sets of *enculturated* agents – the society and the state, where society is comprised of rich and poor. The demand and supply for populist strategies within these economies are endogenous and governed by economic factors along with the context of reference and the set of mental schemas of the agents. The set of alternative mental schemas within an individual is created through past experiences and the social structures through which the agent has traversed. The context of the decision moment and the mental schemas interact to influence the agent to overweight a particular mental schema and to take the decision. This phenomenon of overweighting an element from a set of alternatives can be referred to as *saliency*. The current study of saliency based economic interpretation of populism induced voting behavior is based on the following assumptions.

- Let the state is termed as St and society is termed as Sy . Player St is consist of politicians, interest groups and bureaucrats. Whereas the Player Sy is consist of general mass. Thus, the initial player set is $Pl = (St, Sy)$.
- Society creates the demand for a particular strategy while the state can supply that particular strategy.
- The players are utility maximisers and the elements of the strategy set are strategy NS (G^{NS}) – which is economically rational and not-supporting populism and strategy S (G^S) – which is populist in nature. Thus, the strategy set can be defined as $G = (G^{NS}, G^S)$
- There are two mental states of the agents M^{NS} and M^S corresponding to G^{NS} and G^S .
- Due to inequality society is comprised of rich (R) and poor (P) thus $Pl = (R, P)$.
- Both R and P follow the same strategy set (G^{NS}, G^S).
- Income from wealth of the rich and poor are denoted by W_R and W_P , where $W_R, W_P \geq 0$
- Labour income of the rich and poor are denoted by L_R and L_P , where $L_R, L_P \geq 0$; $L_R > L_P$.
- The poor also receives transfers (T) from the state which is funded by the tax collected from the supporting and not-supporting rich thus $T_j > 0$, for $j = \{S, NS\}$.

- Rich citizens face a tax on aggregate income, wealth and consumption at a rate defined by $\check{\gamma} \in (0,1)$ or $\gamma \in (0,1)$, $\check{\gamma} > \gamma$, which depends on whether a populist policy is accepted or not. The poor section of the society is not covered under income or wealth taxes and they are also privileged by not paying the consumption taxes.
- Being in favour of populism develops an expectation of psychological benefits to rich and poor, denoted by α_R and α_P . These psychological impacts can be described as outcomes of mental schema-based salience θ_R and θ_P of the rich and poor respectively.
- There are three periods termed as t-1, t, t+n. These periods relate to the sequence as: t – 1: the demand for populism, t: the economic policies of the populists in power, t + 1: re-election of a populist party.
- The relationship between rent-seeking (K_i) by the state and the considered time horizon is negative. At populism level pop_1 the corresponding rent-seeking is K_1 and at a lower level of populism with greater time horizon it is K_2 , i.e., $K_2 < K_1$

Then on the basis of the above assumptions the pay-off matrix of the game between the state and the society can be represented as follows.

Game I			
		State (Player St)	
		Rational Policy (Strategy NS)	Populist Policy (Strategy S)
Society (Player Sy)	Rational Policy (Strategy NS)	$(1-\gamma)(W_R+L_R) + W_{P+}$ $L_{P+T_{NS}}, K_2$	$(1-\gamma)(W_R+L_R) + W_{P+}$ $L_{P+T_{NS}}, K_1$
	Populist Policy (Strategy S)	$(1-\check{\gamma})(W_R+L_R) + W_{P+}$ $L_{P+T_S} + \alpha_P + \alpha_R, K_2$	$(1-\check{\gamma})(W_R+L_R) + W_{P+}$ $L_{P+T_S} + \alpha_P + \alpha_R, K_1$

Due to economic inequality the players do not act as a rational player or *homo-economicus* as described under traditional public choice theory instead they act as an *enculturated* agent and accepts the alternative (G^S, G^S) – which is tempting to them at the point of decision. In describing a tempting alternative, the *context of reference* and the *mental schemas* of the players interact with each other to generate salience for a particular strategy. Society also accepts irrational beliefs when it pays off in terms of feeling better which compensates for material losses due to populist policies. This idea of *rational irrationality* can influence the utility function to accept the irrational choice. Apart from *rational irrationality* the existence of *rational ignorance* also plays an important role in the construction of context. On the other hand, in supplying a particular level of populism the state depends upon the level of rent-seeking. The acceptance of a particular level of rent-seeking depends upon the utility function of the state. In shaping this utility function the mental schemas of the state interact with the contexts related to the state. Here the cost associated in the acquiring the information about the final outcome of the populist policy, the group size of the society and the academic endowment of the concerned society act as the context.

Let θ^R and θ^P are the salience of choice behavior for the rich and the poor respectively. Rich and poor could have traversed through different histories and their context of reference can become different but their extent of salience to a particular strategy can be equal. In other words, either $\theta^R \neq \theta^P$ or $\theta^R = \theta^P = \theta$. For the sake of simplicity here it is assumed that $\theta^R = \theta^P = \theta$ i.e, the pattern and extent of salience of both the rich and poor are not different though their histories and contexts are different. The salience function of the rich can be defined as $\theta^R = \theta^R(M^{NS,R}, M^{S,R}, \psi^{t-1,R})$, where $M^{NS,R}$ and $M^{S,R}$ are *mental schemas* of the rich related to situation NS and situation S respectively. $\psi^{t-1,R}$ is the context being faced by the rich in period t-1, where $\psi^{t-1,R} = \psi^{t-1,R}(PE)$, PE is the quality of public expenditure. Similarly, the salience function of the poor can be defined as $\theta^P = \theta^P(M^{NS,P}, M^{S,P}, \psi^{t-1,P})$, where $M^{NS,P}$ and $M^{S,P}$ are *mental schemas* of the poor related to situation NS and situation S respectively. $\psi^{t-1,P}$ is the context being faced by the poor in period t-1 where $\psi^{t-1,P} = \psi^{t-1,P}(\epsilon)$, ϵ is the extent of inequality within the society.

Now let the utility functions of the rich and the poor in period $t - 1$ are U_{t-1}^R and U_{t-1}^P . These functions are the weighted sum of the corresponding value functions of rich and poor where the weights have been developed by the salience at period $t - 1$, then

$$U_{t-1}^R = \pi(\theta). V_{t-1}^{NS.R} + [1 - \pi(\theta)]. V_{t-1}^{S.R}$$

$$U_{t-1}^P = \pi(\theta). V_{t-1}^{NS.P} + [1 - \pi(\theta)]. V_{t-1}^{S.P}$$

Here $V^{NS.R}$ and $V^{NS.P}$ are the value functions of the rich and poor individuals in situation NS and $V^{S.R}$ and $V^{S.P}$ are the value functions of the rich and poor individuals in situation S. On the other hand, $\pi(\theta)$ is the extent of disproportionate weight developed by salience θ which takes the value of 0 or 1. If $\pi(\theta) = 0$ then both rich and poor accept the populist policy and if $\pi(\theta) = 1$ then reject the populist policy. Again $\pi(\theta) = 0$ means that the rate of discounting the future outcome is higher in comparison to the present. The value function related to a particular mental state or strategy of the rich and poor can be written as

$$V_{t-1}^{G.Pl} = O_t^{G.Pl} + \sum_1^n \frac{O_{t+n}^{G.Pl}}{(1+\lambda_i)^n}$$

Here $O_t^{G.Pl}$ is the expected outcome of strategy G of player R or P in period t. λ_i is the rate of discount and $\lambda_i \in R_+^n$. Thus, it is actually the salience towards a discounting rate (λ_i) that ultimately plays the most important role in the acceptance or refusal of the populist policies.

On the other hand, let the state also has two mental schemas related to the stated two strategies. Mental schema NS of prevalence of strategy NS i.e. rational economic policy and mental schema S of prevalence of strategy S i.e. populist economic policy. If U_t be the weighted sum of the values from these two *schemas* at period t, then

$$U_t^{St} = \mu(\theta). V_t^{NS.St} + [1 - \mu(\theta)]. V_t^{S.St}$$

Here $V^{NS.St}$ is the value function of the state related to schema NS and $V^{S.St}$ is the value function of the state related to schema S. $\mu(\theta)$ is the extent of disproportionate weight developed by salience θ which takes the value of 0 or 1. If $\mu(\theta) = 0$ then the state accepts the populist policy and if $\mu(\theta) = 1$ then it rejects the populist policy.

The salience function of the state can be defined as $\theta^{St} = \theta^{St}(M^{NS.St}, M^{S.St}, \psi^{t-1.St})$, where $M^{NS.St}$ and $M^{S.St}$ are *mental schemas* of the state related to situation NS and situation S respectively. $\psi^{t.St}$ is the context being faced by the state in period t. Again $\mu(\theta^{St}) = 0$ means that the rate of discounting the future outcome is higher in comparison to the present. For $\mu(\theta) = 1$ the rate of discounting of the present is higher in comparison to the future. Then the value function related to a particular mental state or strategy can be written as follows. Here K_i is the extent of rent-seeking.

$$V_t^{G.St} = V_t^{G.St}(K_i)$$

Again

$$\psi^{t.St} = \psi^{t.St}(c, g, a)$$

Here c is the cost associated in the acquiring the information about the final outcome of the populist policy, g is the group size of the society and a is the academic endowment of the concerned society. Salience of supporting populist policy increases with the fall in academic endowment of the society and with the increase in c and g.

Thus, due to consumption cascading effect, rational irrationality, rational ignorance and salience even if strategy NS is available player Sy will stick to suboptimal strategy S in period t. On the other hand, in the post-colonial developing economies due to fragile nature of governance it would be easier for the player St to extend the adverse impact time lag and enhance the associated cost with the collection of correct information. The lower level of academic endowment in these economies also helps the player St to sustain the supply of populism and accept the strategy S for period t. These demand and supply conditions for the players St and Sy help to generate a prisoners' dilemma type of Nash equilibrium in Game 1 where demand and supply of populist policies become the natural at (G^S, G^S) .

But the sustainability of this Nash equilibrium over t+n periods depends upon the economic characteristics and psychological behaviour of the rich and the poor within the society. On the basis of the same assumptions as stated above the pay-off matrix between rich and poor with reference to the strategies NS and S can be presented as follows.

Game 2			
		P	
		NS	S
R	NS	$(1-\Upsilon)(W_R+L_R),$ $W_P+L_P+T_{NS}$	$(1-\Upsilon)(W_R+L_R),$ $W_P+L_P+T_S+ \alpha_P$
	S	$(1-\ddot{\Upsilon})(W_R+L_R)+ \alpha_R,$ $W_P+L_P+T_{NS}$	$(1-\ddot{\Upsilon})(W_R+L_R)+ \alpha_R,$ $W_P+L_P+T_S+ \alpha_P$

The prisoners' dilemma type of Nash equilibrium in Game 1 as achieved through G^S, G^S corresponds to the S,S strategy in Game 2 with pay-off $(1-\ddot{\Upsilon})(W_R+L_R)+ \alpha_R, W_P+L_P+T_{NS}+ \alpha_P$ of the rich and poor. This is possible iff $\alpha_R, \alpha_P > 0$ with $\alpha_R > (\ddot{\Upsilon}-\Upsilon)(W_R+L_R)$ and $T_S+ \alpha_P > T_{NS}$. Then accepting populism is the dominant strategy. To examine the continuity of the populism here the game is used as an evolutionary process.

Let the share of rich population not-supporting and supporting the populist policy are x_{NS} and x_S respectively, such that $x_{NS}+ x_S = 1$. Likewise, the share of poor population not-supporting and supporting the populist policy are y_{NS} and y_S respectively, such that $y_{NS}+ y_S = 1$. Let the psychological benefits of supporting the populist policy are

$$\alpha_R = \theta - \beta_1 x_{NS} - \beta_2 y_{NS}$$

$$\alpha_P = \theta - \delta_1 y_{NS} - \delta_2 x_{NS}$$

Here $\theta \geq 0$ is endogenous component or salience which appear from past experiences. $\beta_1 \geq 0, \beta_2 \geq 0, \delta_1 \geq 0$ and $\delta_2 \geq 0$ are the impacts of groups not supporting the populist policy. The salience based psychological benefits increase with the fall in the number of the persons supporting the populist policy i.e, $\frac{\partial \alpha_R}{\partial x_{NS}} < 0, \frac{\partial \alpha_R}{\partial y_{NS}} < 0, \frac{\partial \alpha_P}{\partial y_{NS}} < 0$ and $\frac{\partial \alpha_P}{\partial x_{NS}} < 0$.

Then the expected payoffs of poor and rich can be described as follows,

$$E_{NS}^P = x_{NS} (T_{NS} - T_S) + W_P + L_P + T_S$$

$$E_S^P = x_{NS} (T_{NS} - T_S) + W_P + L_P + T_S + \theta_P - \delta_1 y_{NS} - \delta_2 x_{NS}$$

$$E_{NS}^R = (1-\Upsilon)(W_R+L_R)$$

$$E_S^R = (1-\check{\Upsilon})(W_R+L_R) + \theta_R - \beta_1 x_{NS} - \beta_2 y_{NS}$$

Then the corresponding average payoffs of the rich and poor can be

$$\bar{E}^P = y_{NS}(E_{NS}^P) + y_S(E_S^P)$$

$$\Rightarrow \bar{E}^P = y_{NS}(E_{NS}^P) + (1 - y_{NS})(E_S^P)$$

$$\Rightarrow \bar{E}^P = y(E_{NS}^P) + (1 - y)(E_S^P) \text{ if } y_{NS} \text{ is written as } y.$$

$$\text{and } \bar{E}^R = x_{NS}(E_{NS}^R) + x_S(E_S^R)$$

$$\Rightarrow \bar{E}^R = x_{NS}(E_{NS}^R) + (1 - x_{NS})(E_S^R)$$

$$\Rightarrow \bar{E}^R = x(E_{NS}^R) + (1 - x)(E_S^R) \text{ if } x_{NS} \text{ is written as } x.$$

So, the replicator dynamics are presented through the following differential equations system,

$$\dot{x} = x[E_{NS}^R(.) - \bar{E}^R] = x(1-x)[(\check{\Upsilon}-\Upsilon)(W_R+L_R) - \theta_R + \beta_1 x + \beta_2 y]$$

$$\dot{y} = y[E_{NS}^P(.) - \bar{E}^P] = y(1-y)[\delta_1 y + \delta_2 x - \theta_P]$$

According to the above equation system the proportion of citizens using NS strategy increases if its expected payoff is bigger than the average expected payoff of the group population. This increase in proportion signifies the fitness of the NS strategy. On the other hand, a fall in this proportion signifies the fading of NS strategy and gradual acceptance of S strategy. It can be seen from the above system of equation if $(\check{\Upsilon}-\Upsilon)(W_R+L_R)$ is falling then \dot{x} would also fall. Thus if (W_R+L_R) – the earning of the rich or $(\check{\Upsilon}-\Upsilon)$ or both of them are falling then \dot{x} would fall or the NS strategy will start to extinct. Falling $(\check{\Upsilon}-\Upsilon)$ means either $\check{\Upsilon}$ is falling or Υ is rising, means either populist regime tax rate is falling or not-populist regime tax rate is rising.

The optimum non-populist tax rate for the continuity of the populist regime for t+n periods depend upon the equilibrium combinations of the tax tolerance attitude of the rich and the extent of rent-seeking by the state. As the state is discounting the future it will be less interested about the future growth and would like to raise tax rate to the prohibitive region rate of Υ as determined by Laffer Curve. Let this increased Υ corresponds to the Nash equilibrium within this study with strategies (G^S, G^S) and here the equilibrium level of populism is pop_1 – the society wants this amount of populism when the state supplies the same. At this level of

populism let the equilibrium discounting rate is λ_1 , where $\lambda_1 > 0$. Let λ_1 corresponds to the time horizon J_1 . Thus pop_1 relates to λ_1, J_1 and Υ . The greater the extent of populism greater will be the discounting rate, lesser will be the time horizon, higher will be the tax rate.

The supply of a level of populism by the utility maximiser state depends upon the corresponding level of rent seeking (K_i), determined by the utility function of the state. Thus

$$pop_i^{St} = pop_i^{St}(K_i, U_t^{St})$$

$$\Rightarrow pop_i^{St} = f[K_i, \{\mu(\theta^{St}). V_t^{NS} + [1 - \mu(\theta^{St})]. V_t^S\}]$$

$$\text{as } V_t^{G.St} = V_t^{G.St}(K_i), \mu = \mu(\theta^{St}), \theta^{St} = \theta^{St}(M^{NS.St}, M^{S.St}, \psi^{t-1.St}) \text{ and } \psi^{t.St} = \psi^{t.St}(c, g, a)$$

$$\text{Then } pop_i^{St} = f(K_i, M^{G.St}, c, g, a)$$

$$\text{Thus } (K_1, M^{G.St}, c, g, a) \rightarrow (J_1, \Upsilon, pop_1)$$

On the other hand the acceptance of rising Υ by the rich can be justified through the quality of public expenditure PE_i . Quality of public expenditure PE_i has a trade off with the rent seeking of the state K_i . Where

$$PE_i = \varphi_0 - \varphi_1 \dot{p}_i - \varphi_2 Cr_i - \varphi_3 Fr_i$$

$$\dot{p}_i, Cr_i, Fr_i = f(U_{t-1}^R)$$

Here \dot{p}_i is the inflation rate related to pop_i , Cr_i is the crime rate related to pop_i and Fr_i is the extent of fragility of the state related to pop_i . Thus the rising tax rate can be tolerated by the rich and pop_i can emerge as the dominant strategy if inflation rate, crime rate and fragility of the state are decreasing. Here the term fragility refers to the weakness of governance of a state which cannot protect its citizens from the vulnerability of different shocks. The acceptable extent of inflation rate, crime rate and fragility depends upon the utility function of the rich. Thus the demand for populism is

$$pop_i^{Sy} = f(U_{t-1}^R, U_{t-1}^P) \text{ where}$$

$$U_{t-1}^R = \pi(\theta). V_{t-1}^{NS.R} + [1 - \pi(\theta)]. V_{t-1}^{S.R}$$

$$U_{t-1}^P = \pi(\theta). V_{t-1}^{NS.P} + [1 - \pi(\theta)]. V_{t-1}^{S.P}$$

$$\text{Where } V_{t-1}^{G.Pl} = O_t^{G.Pl} + \sum_1^n \frac{O_{t+n}^{G.Pl}}{(1+\lambda_i)^n}, \theta^P = \theta^P(M^{NS.P}, M^{S.P}, \psi^{t-1.P}), \theta^R = \theta^R(M^{NS.R}, M^{S.R}, \psi^{t-1.R})$$

$$\text{Here } O_t^{G.P} = O_t^{G.P}(T, PE), O_t^{G.R} = O_t^{G.R}(PE), \psi^{t-1.P} = \psi^{t-1.P}(\varepsilon) \text{ and } \psi^{t-1.R} = \psi^{t-1.R}(PE)$$

$$\text{Then } pop_i^{Sy} = f(M^{G.Pl}, \varepsilon, T, PE)$$

$$\Rightarrow pop_i^{Sy} = f(M^{G.Pl}, \varepsilon, T, \dot{p}_i, Cr_i, Fr_i)$$

Thus the convergence of demand and supply of populism to a certain level corresponds to specific levels of K_i , $M^{G.St}$, $M^{G.Pl}$, ε , c , g , a , T , \dot{p}_i , Cr_i and Fr_i . Any distortion on any of these variables can lead to different voting behavior of the society.

Proposition I: It appears from the preceding discussion that when the earnings of the rich (W_R+L_R) is falling then NS strategy will start to extinct. The same will happen when Y is rising beyond the level of acceptance subject to a given quality of public expenditure. Thus, the richer section within the society is going to proliferate the populist policies when the non-populist regime tax rate is rising subject to their tax tolerance attitude. With the gradual extinction of the non-supporting riches the gradual extinction of the non-supporting poor would also start. Thus, the majority vote would shift in favour of the populists and the populist regime is going to sustain in $t + n$ periods when the populist regime tax rate is falling, when the not-populist regime tax rate is rising with greater quality of public expenditure and when the earnings of the rich are falling.

Proposition II: If the state wants to increase K_i then supply of populism is also expected to increase. As the populism increases the importance of present will go up and subsequently the tax rate Y will also rise. The acceptance of higher rate of tax Y would require greater tolerance to the higher tax rate which would require higher quality of public expenditure PE i.e, lower levels of inflation (\dot{p}_i), crime rate (Cr_i) and fragility (Fr_i). If these are not met then the tax payers would like to vote against the populist regime or like to follow tax avoidance. The avoidance of tax would lead to gross failure of populist measures which would encourage the non-tax payers also to vote against the incumbent populist state.

Proposition III: If the society starts to require greater level of PE with the same level of populism (pop_i) then the state should adjust their preference (U_t^{St}) and reduce the level of rent seeking (K_i). This means a significant change in the structure of expenditure of the policy makers. Lower level of rent seeking with the same level of populism would be beneficial to the state if the time horizon (J_i) is extended further or the discounting rate (λ_i) is reduced. This adjustment of time horizon (J_i) with the same level of populism (pop_i) dictated tax rate (Y_i) would require newer adjustment within the relationship between the tax rate and time horizon. If the state fails to implement these adjustments then populist votes will shift towards a different class of incumbents.

For empirical verification of the algebraic model, a regression operation of 'share of capital expenditure in total budget allocation of the state' (here it is proposed to measure populism by examining resource allocation in the government budget, the greater the share of capital expenditure in the budget, the lower the populism) is conducted on a set of explanatory variables,

which includes Gini coefficient (as measure of economic inequality), ease of doing business (as measure of rent seeking, the easier environment of doing business implies lower rent seeking), population size (as measure of group size), literacy rate (as measure of educational attainment), inflation rate, crime rate and fragility index, using country level panel data collected from 25 post-colonial developing economies. Required data are collected from reputed international sources like The World Bank, World Inequality Database, Crime Index by Country and Fragile States Index. National level statistics are also collected from respective government sources. The study found statistically significant negative coefficients for Gini coefficient, ease of doing business index and fragility index, which implies that populism, is positively associated with economic inequality, level of rent seeking in the economy, level of inflation and fragility index of the state. Apart from these variables the other regressors as found by the algebraic model also behaved according to the broad findings of the study though their influences are statistically insignificant. The result obtained from this empirical econometric analysis supports the direction of causation derived from the current theoretical model.

This study wanted to understand the economic reasons behind the demand, supply and continuity of populist regimes within post-colonial developing economies. To that respect an algebraic interpretation is developed to understand the long-term voting behaviours within such pluralistic democracies. On the basis of the developed mathematical model it is observed that the demand for sub-optimal present instead of rational future appears from the interaction between the historical imprints within the psychological space of the citizens and the context of economic inequality. It is not only the observed inequality but also the perceived inequality induced insecurity which help to construct this context. On the other hand, supply of populism arises from the interaction between the mental schemas of the state and the institutional variables like hiding cost, population size and the academic endowment of the society. But the continuity of the same depends upon some equilibrium combinations of the rent-seeking by the state and the quality of public expenditure with acceptable transfers to the poor, where quality of public expenditure depends upon the inflation rate, severity of crime within the society and the fragility of the state. Any distortion on any of these variables can lead to different voting behavior of the society. The econometric testing within this study also observed that voting of the individuals towards the populist regime depends upon the extent of economic inequality within the society, the level of rent seeking by the state, inflation rate and efficiency of the state to govern. It is observed that that the acceptance of the populist regime increases with the extension of economic inequality, rent seeking by the state, inflation rate and the fragility of the state.