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INCOME INEQUALITY, POVERTY, AND THE LIQUIDITY OF STOCK MARKETS

Benjamin M. Blau^a

Abstract:

Using a broad cross-sectional sample of countries, this study tests whether stock market liquidity affects the level of income inequality. After holding a variety of factors constant – including traditional measures of financial development, results show that liquidity in a country's stock market is negatively related to various measures of inequality. We find that this relationship does not exist in the most developed countries. Instead, our results are stronger in underdeveloped and moderately developed countries. In addition, we find that stock market liquidity is negatively associated with poverty rates. In our final set of tests, we attempt to identify the mechanism through which liquidity reduces inequality. After decomposing wage growth into the portion that is driven by stock market liquidity and the portion that is orthogonal to liquidity, we find strong evidence that liquidity-induced wage growth drives the reduction in both inequality and poverty.

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