Billionaires Vs. the People

A greater presence of billionaires in a country can actually slow down its economic growth. At best, it doesn't boost it.

By Jan Svejnar, the 2015 recipient of the IZA Prize in Labor Economics, and the Director of the Center on Global Economic Governance at Columbia University[1].

After I escaped Communist Czechoslovakia in 1970, I enrolled at Cornell University. In my introductory sociology course there, I was taught that becoming a billionaire was impossible – in effect, realizing the "American Dream," at least at the very top of the income scale, was over. The last few decades have certainly proved this thesis wrong.

This shift has had significant consequences for income and wealth inequality not just on U.S. shores, but also in many countries around the globe. In fact, the top 1% globally will soon hold over one-half of the world's wealth. And their share is growing.

This stunning fact makes it all the more important to ask what this means for the rest of us. Given the amazing level of accumulation of wealth at the top, improving our understanding of the economic role of billionaires has certainly become a public policy issue of the highest order.

In order to make headway on understanding the implications, we must obviously do more than just look from one year to the next at the increasing concentration of wealth.

The key questions that need an urgent answer are these: Is a greater presence of billionaires in a country a positive, as some might argue? Or is there evidence that it is a negative? Leaving aside moral questions, do billionaires accelerate or slow down a country's economic growth?

Depending on the answer to these questions, even those generally inclined in the media and politics to boost the fortunes of billionaires might have to rethink their stance.

After all, if it turns out that having more billionaires is not favoring more GDP growth, then the policy suggestion to reduce income concentration at the top moves from a moral argument to one about economic growth and prosperity.

This is the set of questions that I, along with my colleague Sutirtha Bagchi of Villanova University, have examined. Using data on billionaires published by Forbes magazine, we applied econometric techniques and arrived at a finding that will perplex some and delight others: A greater presence of billionaires in a country actually slows down its economic growth.

Controlling for other relevant factors, such as the country's level of income and education, we demonstrate that countries could grow their economies faster if there were less money controlled by the uber-rich. This implies that economies could be more efficient if more money were allocated to others than those at the top of the income and wealth pyramid.

Other key factors to be considered are the sources and nature of inequality. Indonesia and the United Kingdom, for instance, have a similar value of the most widely used indicator of income inequality (the so-called Gini coefficient). However, the two countries differ markedly on the role that political connections play in achieving economic success and, as a consequence, the distribution of income and wealth.

Broadly speaking, billionaires come in two types – those who would not have made it without political connections (i.e., political cronies), and those who became billionaires because of their ingenuity, ability to innovate and willingness to take risks (i.e., the politically unconnected).

These two types of billionaires may have very different effects on the economic performance of countries. While politically connected billionaires may be found in many countries, they are disproportionately represented also in the post-communist countries, including Russia where many emerged as political cronies of Boris Yeltsin, as well as in China.

Dividing the world billionaires into these two categories, one must obviously take particular care to assign the “politically connected” category of billionaires only to the most clear-cut cases, such as the Yeltsin-related oligarchs or Suharto-related nouveau riches.

Others, such as those in the vein of Bill Gates and Warren Buffet-style wealth, surely also have extra political influence because of their wealth, but political connections aren’t the source of their wealth.

We discovered that billionaire wealth that arises from being politically connected has a strongly negative effect on growth. In contrast, the effect of politically unconnected billionaire wealth on the overall economy is indistinguishable from zero.

That means that billionaire cronies constrain economic growth, while billionaires who aren’t cronies on average don’t do so.

Why are these findings important for the rest of us? They indicate that public policy toward income and wealth distribution needs to take into account the nature of wealth accumulation.

They also relate directly to the findings of economists like Stiglitz and Piketty. They predicted that we live in a world where the rich will get richer faster, which has proved true, and that we ought to develop tax policies that prevent the poor from becoming ever poorer.

The implication for countries such as the United States and others where political cronyism only plays a minor role in wealth attainment is no less spellbinding.

Americans, in particular, have been taught to think that billionaires have a positive effect on the economy. Why? Because they are "exceptional" people who have proved that they can accomplish great things.

The key finding that, on average, they have an insignificant effect on growth prospects, even in the case of the politically unconnected, represents a huge negative surprise for the boosters of the billionaire class.

[1] Awarded by the non-profit Institute for the Study of Labor, based in Bonn, Germany, www.iza.org.