Abstract
Capital market theory predicts that the wealth distribution should affect interest rates. This paper empirically analyzes the relationship between the wealth distribution and interest rates in the US. We use data on wealth inequality from various sources. Measures of wealth inequality are linked positively to the real commercial paper rate and to the real rate on government securities. This result is consistent with predictions from capital market equilibrium models with moral hazard. Accordingly, rich individuals can only commit credibly to providing effort if the rate of return is not too high. When the rich are poorer, the rate of return has to be lower in order to guarantee entrepreneurial effort. Capital demand will therefore fall as inequality is reduced. The capital market is in equilibrium at a lower rate of return.