Political Economy of Ethnic Income Inequality: Lessons from Guyana

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The Guyana Context and Motivating Questions

- An ethnically divided society
  - How does intergroup competition influence the state's capacity?
  - Why does this competition produce despotic states on the one hand, but weak or failed states on the other?
- Indo-Guyanese—the majority group—won all the elections from 1992-2014
  - What are the long-term political economy dynamics of income inequality within- and between- groups?
- Cross-ethnic voting in 2015 unseated the predominantly Indo-Guyanese government
  - How does electoral turnover affect within- and between-group income inequality?
  - When does class conflict trump intergroup competition?
  - When does cross-ethnic/group voting emerge?

Ethnic Distributional Conflict?

Figure 1: Counter-Clockwise Dynamic in Government & SOEs Employment
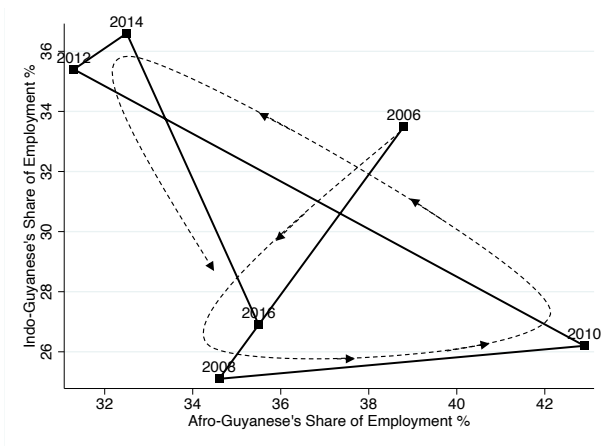
Data Source: Latin American Public Opinion Project Surveys

Building Block I

- Economy is populated by two ethnic groups:
  - Indo-Guyanese and Afro-Guyanese
- Each group is divided into workers and entrepreneurs
- The political class of each group (Ω_i) is composed of workers and entrepreneurs
- Political mobilisation and voting are based on group-identity (ethnicity) because:
  - There are conflicting group-based claims over resources
  - Group membership provides protection from the opposing group
  - There are within-group possibilities for economic gains
  - There are economic and psychological dividends from group dominance

Building Block II

- Indo-Guyanese form the **Dominant Group**:
  - Their voting population is numerically larger
  - They own the greater share of capital ($\beta_I > \beta_A$), where the subscripts I and A denote Indo- and Afro-Guyanese respectively.
- Each political class (Ω_i) maximises the probability of electoral victory or staying in power:
  - By maximising its ethnic group's share of wages (α_i) and capital income (β_i)
- **Thus, politics is an ethnic distributional conflict**

Maximisation Problem of the Indo-Guyanese Political Class (Ω_I)

$$\max_{\alpha_I, \beta_I} \quad Pr(\Omega_I) = 1 - \delta_1 \alpha_A - \delta_2 CV - \delta_3(1 - \beta_I)$$

$$\text{s.t.} \quad \alpha_I + \alpha_A = 1 \quad \text{Ethnic Distribution of Wage Income} \tag{1}$$

$$\beta_I + \beta_A = 1 \quad \text{Ethnic Distribution of Capital Income}$$

- where
  - $\alpha_I < 1$ and $\beta_I < 1$, therefore the out-group is not expropriated
  - CV is an exogenously given variable that assumes a value of -1 if there is no cross-ethnic voting but $+1$ if there is
- The probability of electoral victory $\Uparrow$ when:
  - The Afro-Guyanese's share of wage income falls, ergo, stronger Indo-Guyanese political solidarity
  - There is no cross-ethnic voting
  - The Indo-Guyanese's share of profit income increases, $\therefore$ campaign contributions $\Uparrow$

Dynamics: Afro-Guyanese's Share of Wage Income

$$\dot{\alpha}_A = \gamma(\alpha_A^e - \alpha_A) \tag{2}$$

- Afro-Guyanese's expected share of wage income:

$$\alpha_A^e = 1 - \alpha_I^e \tag{3}$$

- Indo-Guyanese form their expectations based on:
  - The probability ρ of political victory and rate of economic growth y
  - The relative rates of growth of the working-age populations
  - β_I: as Indo-Guyanese entrepreneurs disproportionately hire Indo-Guyanese labour

$$\alpha_I^e = a_0 + a_1\rho + a_2 y + a_3\beta_I + a_4(wap_I - wap_A) \tag{4}$$

The paper endogenises growth but I do not do that here

Steady State: Afro-Guyanese's Share of Wage Income

- Substitution of Equations (1) and (3-4) into (2) yields the following when $\dot{\alpha}_A = 0$:

$$\alpha_A^* = \frac{(1 - a_0 - a_1 + a_1\delta_3) + a_1\delta_2 CV - \beta_I(a_1\delta_3 + a_3) - a_2(y)}{1 - a_1\delta_1}$$
$$\frac{-a_4(wap_I - wap_A)}{1 - a_1\delta_1} \quad (5)$$

- CV and β_I increases and decreases α_A^* respectively:
    - In other words, group dominance increases ethnic income inequality:
        - Through ethnic voting (no CV),
        - Ethnic elites (β_I) financing ethnic politics, and
        - Discriminatory hiring practice in the labour market by ethnic elites (β_I)

Dynamics: Indo-Guyanese's Share of Capital Income

$$\dot{\beta}_I = b_0 + b_1\alpha_A - b_2\alpha_A^2 - \beta_I \tag{6}$$

- When the Afro-Guyanese's share of wage income is initially low:
  - An increase in α_A accelerates the Indo-Guyanese's share of capital income:
    - Increases demand for goods/services produced by Indo-Guyanese capital owners
    - Below a threshold wage share $\bar{\alpha}_A$, intra-group solidarity is low
    - Afro-Guyanese labour is keen to $\Uparrow \beta_I$, i.e. lower rich and poor Afro-Guyanese inequality. Class trumps ethnicity
- When α_A is beyond some threshold $\bar{\alpha}_A$:
  - Employment rises and $\Uparrow$ their bargaining power *vis-à-vis* β_I
  - Rich and poor Afro-Guyanese inequality $\Downarrow = \Uparrow$ in group solidarity
    - Wages are pooled to develop competing enterprises, and/or
    - Wages are used to support Afro-Guyanese capital owners. Ethnicity trumps class

Steady State: Indo-Guyanese's Share of Capital Income

- The steady-state or long-run share of Indo-Guyanese profit income is given below, when $\dot{\beta}_I = 0$.

$$\beta_I^* = b_0 + b_1\alpha_A - b_2\alpha_A^2 \tag{7}$$

- In turn, the maximum share of Indo-Guyanese profit income is given by $\bar{\alpha}_A$

$$\bar{\alpha}_A = \frac{b_1}{2b_2}. \tag{8}$$

- It follows that political and economic factors motivate Indo-Guyanese to maintain $\alpha_A < \bar{\alpha}_A$
  - Otherwise, Indo-Guyanese group solidarity and political prospects are undermined

Steady-State Equilibrium

Long-Run Equilibrium Distribution of Income: Within and Between Ethnic Groups

Figure 2: Long-Run Equilibrium Distribution of Income: Within and Between Ethnic Groups
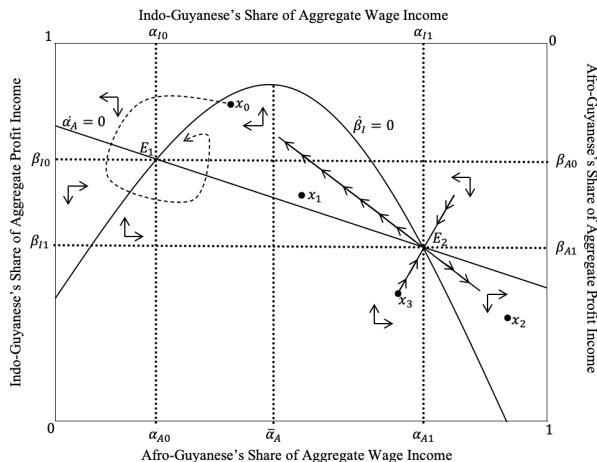
Key Result

- The stable equilibrium of E_1 is the outcome the political economy converges to, where the Afro-Guyanese wage and profit income shares are at their lowest
  - Ethnic democracy (ethnic voting) perpetuates extreme ethnic income inequality
  - If a minority group is unable to achieve some distributional outcome consistent with equilibrium E_2 through democratic political and economic processes, the probability increases that the outrage of a subordinate group spills over into non-democratic behaviour, and armed conflict

Comparative Statics for Cross-Ethnic Voting I

Figure 3: Long-Run Equilibrium Distribution of Income: A Shock to Cross-Ethnic Voting
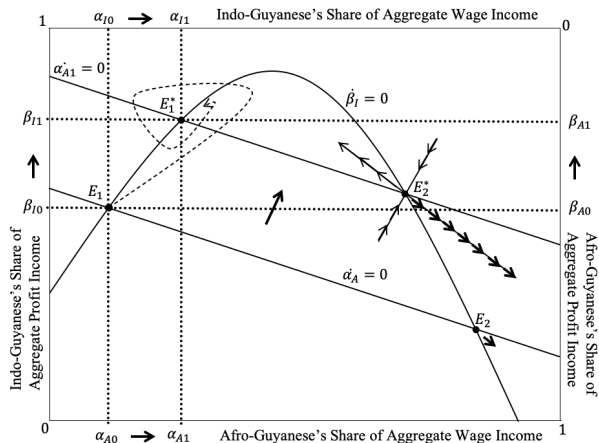
# Comparative Statics for Cross-Ethnic Voting II

- When the Afro-Guyanese's share of wage income is below some threshold $\bar{\alpha}_A$, cross-ethnic voting
  - Decreases the Indo- and Afro-Guyanese's share of wage and profit income respectively
  - Increases within Indo-Guyanese-group income inequality
    - The Afro-Guyanese political class is unfortunate: it suffers the disapproval of its economic elites and the discontent of Indo-Guyanese voters. *CV* is unlikely to repeat.
- When $\alpha_A > \bar{\alpha}_A$, cross-ethnic voting
  - Produces an ethnic minority dictatorship
    - Since $\alpha_A > \bar{\alpha}_A$, group solidarity is strong and *CV* provides the opportunity to gain and retain political power. In other words, we observe a dictatorship through the ballot
  - But in this case, *CV* is not realised since the dominant group fears expropriation—they will not politically empower an economically powerful out-group

An Application

Figure 4: The Emergence and Dynamics of Weak, Despotic and Inclusive States
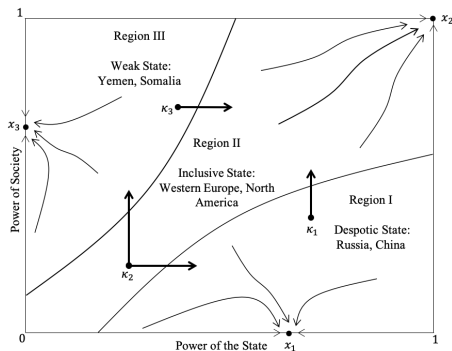
(a) A&R 2017: Homogeneous Society and Elites
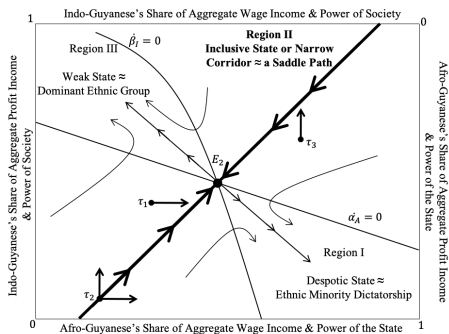
(b) Heterogeneous Society and Elites

An Application: Key Insights

- Acemoglu and Robinson's narrow corridor is a saddle path:
  - Placement on the path lowers ethnic inequality and constraints the power of both state and society
    - A constrained society means more voice and a higher income share for the out-group
    - A constrained state means that policy is not exclusively driven by group logic
  - The propensity for a minority dictatorship is significantly reduced
- In heterogenous societies:
  - A strong civil society can easily mean the dictatorship of an ethnic majority or a dominant group
  - A strong state can empower the dominant group—the larger share of civil society

Mains Lessons from Guyana

- Group and Class inequality should be jointly studied: poor whites voting against class interest in the US is one developed country justification
- Cross-group or swing voting is *not* a great equaliser: it may sow the seeds of its own reversal
- Redistribution to out-groups (e.g. reparations) may lower labour inequality between groups but also worsen capital inequality between groups, at least up to a point
  - Would the dominant group choose to redistribute beyond this critical point?
- Uncritically defending the ballot in heterogenous societies may justify extreme group-based income inequality and incentivise non-democratic behaviour
- More critical thinking on the concept of civil society in heterogenous societies