Income and Ethnic Fractionalisation: Evidence from British Microdata

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Abstract

Are income levels of a population affected by the degree of ethnic diversity in the population? This study attempts to answer this question, contributing to both the literature on the determinants of income, and the debate on the implications of ethnic diversity. Specifically, we examine the effects of ethnic diversity on household income. We argue that variations in the degree of ethnic diversity across British neighbourhoods can explain a substantial part of the differences in income levels. Using data from the European Values Study, we measure diversity using indices of ethnic fractionalisation for British neighbourhoods, and measure income using household income. We adopt econometric methods that account for endogeneity and find evidence of a negative effect of ethnic diversity on income. We further propose several potential channels that link ethnic fractionalisation to income. Specifically, we explore trust, social capital, discrimination and inequality as important channels through which ethnic diversity influences income. Results are robust to several sensitivity checks.

JEL Classification: J15, D31
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1. Introduction

The effects of ethnic diversity on economic, political and social factors are widespread. In economics, starting with the work of Easterly and Levine (1997), a relatively large body of literature examines the effects of ethnic diversity. Using indices of ethnolinguistic fractionalisation, Easterly and Levine show that ethnic diversity hinders economic development. Following Easterly and Levine's work, cross-country work has further examined the implications of ethnic diversity for a wide range of outcomes including economic development (see, e.g., Alesina *et al* 2003; Desmet *et al* 2012), technology adoption and use (see, e.g., Awaworyi Churchill *et al* 2016), and quality of government (see, e.g., Mauro 1995; Alesina and Zhuravskaya 2011). Although the empirical literature presents evidence for both negative and positive effects of ethnic diversity, the majority of the studies point to a negative effect of ethnic diversity.

Sitting alongside the literature on ethnic diversity is a relatively large body of literature on the determinants of income (see, e.g., Fujii and Mak 1983; Auten and Carroll 1999; Jenkins 2000; Sharpe and Abdel-Ghany 2006). The relevance of understanding the determinants of income cuts across various fields including economics and development research. In development, income is considered as a proxy for welfare, and thus various measures of income have featured as dependent variables in several economics and development studies (see, e.g., Tschirley and Weber 1994; Miles 1997). Despite an enormous amount of empirical work on the determinants of income, there are considerable gaps to be filled in the literature. One such determinant that has not been explored in the existing literature is ethnic diversity. The primary objective of this paper is to broaden our knowledge of the effects of ethnic diversity on income by examining data for Great Britain.

We examine the hypothesis that differences in ethnic diversity in British communities explain a substantial part of the differences in household income. We construct indices of fractionalisation for British neighbourhoods using data from the European Values Study (EVS). Our index of fractionalisation captures the probability that two randomly selected individuals in a neighbourhood (British postcode area) belong to different ethnic groups. Relating indices of fractionalisation to income, results show that an increase in fractionalisation is associated with lower income. We further investigate channels that may explain the effect of fractionalisation on income. Specifically, we explore trust, social network, discrimination and inequality as channels through which ethnic diversity affects income. Results suggest that not only is trust lower in fractionalised communities, but the strength of social networks is weaker as well.

Our study contributes to the literature that seeks to understand the determinants of income, wellbeing and welfare, as well as the growing literature on the implications of ethnic diversity. Answering the questions surrounding the effect of ethnic diversity on income not only gives us further insights into the determinants of income, but is also relevant to decision-making and the identification of relevant policy instruments that would be most effective in promoting welfare. Evidence from this study also provides a new perspective on why income levels differ across societies.

The remainder of the paper is structured as follows. The next section provides an overview of why we expect ethnic diversity to affect income. Section 3 presents the data and empirical strategy. Section 4 presents the results while section 5 concludes.

2. Why Should Ethnic Diversity Affect Income?

Conceptually, there are several reasons for why we expect ethnic diversity to affect income. In this study, we focus mainly on social capital and inequality as channels through which ethnic diversity affects income. Johnson (1973) identified the environment as an important factor that plays a major role in

determining earning power. The environments we find ourselves in contribute to, what Johnson calls, cultural capital, an important resource that promotes skill development, and subsequently income. Subsequent studies such as Borjas (2011) developed the term ethnic capital, which refers to a similar concept to that introduced by Johnson. The concepts of cultural and ethnic capital promote several reasons why ethnic diversity could affect entrepreneurship, income and inequality. For instance, ethnic diversity has been associated with innovation because each ethnic group is endowed with unique skills, and thus a diverse community could be characterised by an increase in talent pool (Fafchamps 2000). This increase in talent pool could lead to an increase in the variations of entrepreneurial and profit-making activities in a society, thus increasing income.

Likewise, ethnic diversity can determine the income generating capabilities of economies (Light and Gold 2000). Specifically, some ethnic groups dominate certain occupations, and thus entrepreneurial activities vary by ethnic groups (Stiles and Galbraith 2004). For instance, fishing in Ghana is often associated with the Ewes and Fantes of the Volta and Central Regions, respectively, while cattle rearing has been dominated by groups in the North. Similarly, the Luos in Kenya dominate the fish trade, while Kenyan-Asians are known to dominate the textile manufacturing industry. Consequently, some ethnic groups have been considered more entrepreneurial than others considering the various predispositions to start new business (Fawcett and Gardner 1994). Light and Gold (2000) show that ethnic groups with the predisposition to start new businesses earn more income than those who work as employees.

Consider also an example in the context of discrimination and inequality. Fractionalisation induces categorisation of ethnic groups, which leads to higher levels of discrimination in society. For instance, according to Awaworyi Churchill *et al* (2016), ethnic diversity is characterised by an inherent hierarchical system which projects one ethnic group as superior to the other, and thus places such labels as ethnic minorities and majorities. This promotes discrimination, and some individuals become increasingly insular in order to protect their identity. Evidence from Britain suggests that this has led to higher levels of inequality and decreased involvement by some ethnic minorities in wider society. For example, British people of South Asian origin are actively withdrawing from interactions with wider British society in fear of discrimination and rejection (Phillips 2006). Discrimination and inequality associated with ethnic diversity may hamper income. For instance, in the first model of economic discrimination, Becker (1957) shows that discrimination can force firms out of business, as discrimination and prejudice can result in lower income and profits.

The link between ethnic diversity and social factors such as trust and social network has implications for income as well. A relatively large body of literature shows that trust is lower in highly fractionalised communities (see, e.g., Leigh 2006; Alesina and Zhuravskaya 2011). This lack of trust influences negatively the formation and strength of social networks (Awaworyi Churchill and Mishra

2017). However, trust and social networks, often referred to in the literature as social capital, have significant implications for income. For instance, the literature has shown that individuals equipped with high levels of social capital are more likely to find jobs and other wage-earning opportunities. Social capital such as networks are characterised by privileged information about market opportunities, and thus in a world of imperfect information, individuals with stronger networks and connections have the advantage to pursue better market/ wage-earning opportunities (Kranton 1996; Fafchamps 1998). Previous research on job-finding processes has extensively demonstrated the importance of social networks in finding jobs (see, e.g., Lin and Dumin 1986; Boxman *et al* 1991).

Studies have also shown a correlation between trust and the emergence of large organisations (see, e.g., La Porta *et al* 1997), trust and financial development (Guiso *et al* 2004), and also trust and growth (Zak and Knack 2001; Dincer and Uslaner 2010). The role of trust in promoting wage-earning activities has been discussed, and the consensus in the literature suggests that trust reduces the cost of economic transactions. According to Arrow (1972 p 357), 'virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can be plausibly argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence.' Furthermore, it has been argued that trusting societies are likely to have higher returns, given the incentives to innovate and accumulate physical capital (Knack and Keefer 1997). However, trust is lower in highly fractionalised communities.

The preceding discussion leads us to believe that, *a priori*, the effect of ethnic fractionalisation on income could be positive or negative, although we are more inclined to expect a negative relationship given the vast literature that reports negative implications from ethnic diversity.

3. Data and Empirical Methods

Our primary goal is to establish whether ethnic fractionalisation is associated with household income in Britain. To do this, we adopt a regression framework of the following form;

$$Income_i = \alpha + \beta F_j + \sigma' \boldsymbol{X}_i + \varepsilon_{ij} \quad (1)$$

where $Income_i$ is the annual household income for respondent i living in community or neighbourhood j. F_j is our measure of ethnic diversity in neighbourhood j. $\boldsymbol{X}$ is a vector of individual level covariates that are likely to affect income.

Our estimation technique is ordinary least squares (OLS) with robust standard errors adjusted for heteroscedasticity. The OLS robust estimates account for heteroscedasticity and deal with observations that exhibit relatively large residuals, influence, or leverage. For robustness, we further supplement OLS robust regressions with ordered logit regressions, two-staged least square (2SLS), and the Lewbel 2SLS (Lewbel 2012).

Given the ordinal nature of our measure of income, ordered logit regressions may be justified. To ensure that our OLS results are robust, we also adopt the ordered logit regressions technique. Additionally, if there are potential endogeneity issues, the use of OLS is not appropriate. However, in the ethnic diversity literature indices of fractionalisation are often taken as exogenous, although some studies have treated them endogenously. In our case, we do not contend with issues regarding reverse causality, as intuitively it is unlikely that ethnicity is driven by income. However, one may put an argument across about omitted variable bias, given the relatively large body of literature that relates fractionalisation to several political and economic outcome variables. Thus, to ensure our results are robust to endogeneity, we adopt two approaches to address issues of endogeneity.

First, we use the 2SLS with conventional external instruments. Consistent with the existing literature, we instrument fractionalisation with latitude. Distance from the equator (latitude), has been argued in the literature to be negatively correlated with ethnolinguistic diversity (see, e.g., Ahlerup and Olsson 2012; Michalopoulos 2012; Ashraf and Galor 2013). The exclusion restriction for using this instrument holds, as the main channel through which this exogenous geographic variable can affect income is fractionalisation.

We also adopt the Lewbel 2SLS technique to further ensure robustness of our results to endogeneity. The Lewbel 2SLS uses internally generated instruments, where external instruments are either weak or unavailable, and is used in the literature as a robustness check on findings from 2SLS with conventional instruments (see, e.g., Belfield and Kelly 2012; Emran and Shilpi 2012; Buch *et al* 2014; Mishra and Smyth 2015). We present results for Lewbel 2SLS, first, with just internally generated instruments; and also results for regressions with both external and internal instruments.

3.1 Data

Data for this study is drawn from the European Values Study (EVS) Database. The EVS is a large-scale, cross-national, and longitudinal survey research programme on basic human values. It provides insight into the ideas, beliefs, preferences, attitudes, values and opinions of citizens all over Europe. It is a unique research project on how Europeans think about life, family, work, religion, politics and society (http://europeanvaluesstudy.eu/). To maximise observations, we use EVS Longitudinal Data 1981–2008 (EVS 1981–2008).

Our dependent variable, income, is an income scale, which reflects 12 income categories, with 1 representing the lowest income group, and 12 the highest income group. Specifically, the annual income scale is based on the following categories with income levels in pound sterling: 1 – income less than 1,800; 2 – income from 1,800 to under 3,600; 3 – income from 3,600 to 6,000; 4 – income from 6,000 to under 12,000; 5 – income from 12,000 to under 18,000; 6 – income from 18,000 to under 24,000; 7 – income from 24,000 to under 30,000; 8 – income from 30,000 to under 36,000; 9 – income from 36,000

to under 60,000; 10 – income from 60,000 to under 90,000; 11 – income from 90,000 to under 120,000; 12 – income 120,000 or more.

Given data availability issues, we are not able to use income levels. Moreover, since we use longitudinal data covering 1981 to 2008, the use of an income scale instead of income values addresses problems of potential variations in currency value across different time periods. The use of an income scale puts respondents in an appropriate scale relative to the highest income category in each time period across the years 1981 to 2008.

Our main explanatory variable, ethnic diversity (fractionalisation) is based on the Herfindahl-type fractionalisation index (Greenberg 1956). Specifically, where is the share of ethnic group in neighbourhood *j*, $FRACTIONALISATION_J = 1 - \sum_{e=1}^{N} S_{eJ}^2$. The index of fractionalisation in a given neighbourhood measures the probability that two randomly selected individuals belong to different ethnic groups. Consistent with Leigh (2006), we calculate ethnic diversity based on country of birth. The EVS classifies respondents as born in Britain, or otherwise. The survey also has respondents' postal codes corresponding with suburbs, which is a precise geographical identifier that allows us to calculate ethnic diversity at the neighbourhood level. Based on these identifiers, we calculate ethnic diversity for small geographic areas within Britain. We construct indices of fractionalisation for 81 British neighbourhoods.

Additionally, we control for respondent's marital status, gender, employment status, and educational level. For gender, marital status and unemployment, we include dummy variables for respondents that are male, married and unemployed, respectively. We also include a dummy variable that captures whether or not respondents are divorced. The education level variable is a scale following the International Standard Classification of Education (ISCED). The ISCED presents the following classifications: ISCED level 1 – Primary education, ISCED level 2 – Lower secondary education, ISCED level 3 – Upper secondary education, ISCED level 4 – Post-secondary non-tertiary education, ISCED level 5 – first stage tertiary education, ISCED level 6 – second stage tertiary education. We also control for the age of respondents and quadratic term of age.

Table 1 presents a list and description of variables used in the analysis, along with the summary statistics.

4. Results

Table 2 presents results for the association between ethnic fractionalisation and income. Column 1 presents results for OLS; Column 2, results for ordered logit regressions; Column 3, results for 2SLS with our external instrument (latitude); Column 4, results for Lewbel 2SLS with both our external and internally generated instruments; Column 5, results Lewbel 2SLS with only internally generated instruments.

Quite robustly, results show a negative association between ethnic fractionalisation and income. Across the various specifications, an increase in ethnic fractionalisation is associated with a decline in individual income.

Table 1: Description and Summary Statistics of Variables

Variable	*Description*	*Mean*	*Std. Dev*
Income	Income scale, 1 representing the lowest income group and 10 the highest income group	6.592	2.462
Fractionalisation	Probability that two randomly selected individuals in a neighbourhood (UK postcode area) belong to different ethnic groups	0.166	0.161
Male	Dummy variable equals to 1 if respondent is male	0.489	0.411
Married	Dummy variable equals to 1 if respondent is married	0.443	0.496
Divorced	Dummy variable equals to 1 if respondent is divorced	0.102	0.303
Unemployed	Dummy variable equals to 1 if respondent is unemployed	0.474	0.499
Age	Log age of respondent	4.024	0.348
Age squared	Log of age squared	8.049	0.696
Education	Respondent's educational level	3.081	1.457
Latitude	Latitude of neighbourhood	52.352	1.167

Specifically, a 1-standard deviation increase in fractionalisation is associated with a decline of 0.392 to 0.542 standard deviations in income, depending on the estimation method. OLS reports the lowest standardised coefficient, of 0.392, while 2SLS with external instruments reports the highest, 0.542.

All other control variables are statistically significant except for our gender variables. We find that married individuals tend to have higher income whereas divorced individuals tend to report lower income. Additionally, age is a positive function of income, and thus with results showing positive coefficients, we can argue that in the case of Britain, as individuals grow older they tend to report higher income. The coefficient of the quadratic term of age is statistically insignificant. Results also show that individuals that are employed as opposed to those that are not report higher income. Higher levels of education are also associated with higher income.

4.1 Test for Potential Channels

Section 2 discusses various potential channels which could explain fractionalisation's effect on income. These channels include factors such as innovation, trust, social networks, discrimination and inequality, among others. However, given data availability issues, it is impossible to examine empirically the role of all these potential channels. Thus, in this section, we focus on the dimensions of social capital and inequality. The focus on only these dimensions does not pose a problem, because social capital is usually considered as the most important channel that links ethnic diversity to various

Table 2: Ethnic Fractionalisation and Household Income

VARIABLES	(1) OLS	(2) Ordered Logit	(3) 2SLS	(4) Lewbel 2SLS#	(5) Lewbel 2SLS##
Diversity	–6.141***	–8.336***	–8.337*	–7.541***	–7.391***
	(2.250)	(2.902)	(4.766)	(2.074)	(2.079)
	[–0.392]	[–0.532]	[–0.542]	[–0.490]	[–0.472]
Married	1.279***	1.398***	1.332***	1.280***	1.281***
	(0.134)	(0.155)	(0.137)	(0.133)	(0.129)
	[0.247]	[0.271]	[0.259]	[0.249]	[0.248]
Divorced	–0.841***	–1.124***	–0.912***	–0.935***	–0.834***
	(0.194)	(0.248)	(0.198)	(0.197)	(0.189)
	[–0.105]	[–0.141]	[–0.114]	[–0.116]	[–0.105]
Male	0.158	0.062	0.101	0.143	0.154
	(0.111)	(0.133)	(0.108)	(0.108)	(0.105)
	[0.031]	[0.012]	[0.020]	[0.028]	[0.030]
Age	0.085***	0.105***	0.081***	0.086***	0.084***
	(0.020)	(0.025)	(0.021)	(0.020)	(0.020)
	[0.634]	[0.791]	[0.609]	[0.646]	[0.633]
Age squared	–0.001***	–0.001***	–0.001***	–0.001***	–0.001***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
	[–0.646]	[–0.745]	[–0.622]	[–0.666]	[–0.643]
Employment status	1.758***	2.216***	1.675***	1.695***	1.761***
	(0.140)	(0.177)	(0.145)	(0.139)	(0.135)
	[0.346]	[0.436]	[0.331]	[0.335]	[0.347]
Education	0.418***	0.514***	0.439***	0.427***	0.419***
	(0.047)	(0.058)	(0.047)	(0.046)	(0.045)
	[0.224]	[0.276]	[0.237]	[0.230]	[0.225]
Constant	2.448***	9.775***	2.682***	2.287***	2.457***
	(0.524)	(0.736)	(0.567)	(0.538)	(0.517)
Neighbourhood dummies	Yes	Yes	Yes	Yes	Yes
Observations	1,295	1,295	1,295	1,295	1,295
R-squared	0.618	–	0.601	0.610	0.618
J p-value	–	–	–	0.226	0.321

Robust standard errors adjusted for heteroskedasticity in parentheses
Standardised coefficients in brackets
*** p<0.01, ** p<0.05, * p<0.1
# – Lewbel with external and internal instruments
– Lewbel with internal instruments only

economic outcomes. For instance, as Arrow (1972) notes, trust is an important factor in economic transactions and facilitates various outcomes including productivity and the provision of public goods. Social capital also underlies other channels, as described in Section 2 and in the existing literature. Thus, the literature has often focused on this dimension in exploring mechanisms through which ethnic diversity influences a wide range of outcomes (see, e.g., Alesina and Zhuravskaya 2011; Awaworyi Churchill 2017a).

Consistent with the existing literature (see, e.g., Leigh 2006; Alesina and Zhuravskaya 2011; Awaworyi Churchill and Mishra 2017), we adopt the measure of generalised trust. Data from the EVS addresses the question: 'Generally speaking, would you say that most people can be trusted or that you cannot be too careful in dealing with people?' Respondents are coded as trusting if they agree that most people can be trusted. We measure social networks using the 'social groups' question from the EVS. The EVS asks questions relating to the involvement of respondents in various groups. Our measure of social network is a dummy variable that captures respondents who belong to a particular social group. Specifically, the EVS asks the question 'Do you belong to a local community action on issues like poverty, employment, housing, or racial inequality?' We code respondents as belonging to a social network if they affirm their membership to this group.

Our measure of discrimination is consistent with the existing literature (see, e.g., Awaworyi Churchill 2017a; 2017b) and uses the definition of discrimination as an 'incarnate' of labour market discrimination (Becker 1957). Economists define labour market discrimination as the unequal treatment of equally qualified or productive groups. This exists when unequal treatments exist as a result of differences such as gender, sexual orientation, religion, race and so on. The EVS asks respondents whether they agree or disagree with the statement 'when jobs are scarce, men should have more right to a job than a woman'. We code respondents as discriminating if they agree with the statement that when jobs are scarce, men should have more right to a job than a woman. Inequality is calculated using the Gini index.

Table 3 presents results for the effects of fractionalisation on trust, social networks, discrimination and inequality. Columns 1 to 4 present results for the effects of fractionalisation on trust, social network, discrimination and inequality, respectively. Results show a statistically significant negative effect of fractionalisation on trust and social network. This suggests that trust and social network are lower in highly fractionalised communities. On the other hand, we find a positive effect of fractionalisation on both discrimination and inequality, suggesting that discrimination and income inequality are higher in more fractionalised communities.

Following Alesina and Zhuravskaya (2011), we proceed to include these potential channel variables into our main (income) specification, to examine if they qualify as potential channels of influence. For these variables to qualify as potential channels, they have to be related to both income and ethnic diversity, and their inclusion as additional covariates in the income model should lead to a decrease in the magnitude of the coefficient on ethnic diversity. Results are presented in Table 4. With the introduction of these variables into the model, the effect of fractionalisation on income has reduced in magnitude, although it is still negative and significant across specifications. Column 1 and 2, respectively, add trust only and social network only into our main specification. These results show that higher trust and social network are associated with

Table 3: Test for potential channels

VARIABLES	*(1) Trust*	*(2) Social Network*	*(3) Discrimination*	*(4) Inequality*
Diversity	–0.660**	–0.422***	0.232*	0.054***
	(0.294)	(0.163)	(0.132)	(0.012)
	[–0.218]	[–0.313]	[0.168]	[0.146]
Married	0.023	–0.045***	0.004	
	(0.033)	(0.017)	(0.017)	
	[0.023]	[–0.102]	[0.009]	
Divorced	–0.094*	–0.041*	–0.031	
	(0.052)	(0.023)	(0.022)	
	[–0.061]	[–0.060]	[–0.044]	
Male	0.017	0.044***	–0.025*	
	(0.029)	(0.013)	(0.013)	
	[0.017]	[0.100]	[–0.055]	
Age	0.007	0.008***	0.001	
	(0.005)	(0.002)	(0.002)	
	[0.261]	[0.664]	[0.081]	
Age squared	–0.000	–0.000***	–0.000	
	(0.000)	(0.000)	(0.000)	
	[–0.184]	[–0.515]	[–0.144]	
Employment status	0.099***	0.019	0.003	
	(0.033)	(0.014)	(0.016)	
	[0.101]	[0.045]	[0.007]	
Education	0.060***	0.034***	0.009	
	(0.012)	(0.006)	(0.006)	
	[0.166]	[0.213]	[0.058]	
Population				0.011**
				(0.004)
				[0.074]
Unemployment Rate				0.001***
				(0.000)
				[0.211]
Constant	–0.063	–0.223***	0.017	0.017
	(0.136)	(0.056)	(0.055)	(0.046)
Neighbourhood dummies	Yes	Yes	Yes	No
Observations	1,295	1,295	1,295	81
R-squared	0.244	0.143	0.151	0.063

Robust standard errors adjusted for heteroskedasticity in parentheses
Standardised coefficients in brackets
*** p<0.01, ** p<0.05, * p<0.1

higher income. We also include interaction terms that capture the interaction between the potential channel variables and ethnic diversity. From Columns 1 and 2, the interaction between trust and diversity, as well as social networks and diversity, are both negative and significant, thus confirming the idea that

Table 4: Ethnic Fractionalisation and Household Income (with potential channels)

VARIABLES	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*
Diversity	–5.119***	–5.287***	–4.807***	–5.831***	–5.565***
	(2.189)	(2.301)	(2.062)	(2.349)	(2.335)
Trust	0.319***				0.284**
	(0.118)				(0.119)
Trust*Diversity	–1.843***				–0.950***
	(0.355)				(0.195)
Social Network		0.601**			0.538**
		(0.262)			(0.261)
Social Network*Diversity		–1.764***			0.160
		(0.291)			(0.181)
Discrimination			–0.139		–0.191**
			(0.180)		(0.027)
Discrimination*Diversity			0.107		0.155
			(0.121)		(0.137)
GINI Index				1.176	1.131
				(1.217)	(1.177)
GINI index*Diversity				0.101	0.135
				(0.100)	(0.187)
Observations	1,295	1,295	1,295	1,295	1,295
R-squared	0.621	0.621	0.619	0.619	0.623

Robust standard errors adjusted for heteroskedasticity in parentheses
*** p<0.01, ** p<0.05, * p<0.1

ethnic diversity influences income through these channels. Column 3 and 4, respectively, introduces discrimination only and inequality only, into the specification but the coefficients for both variables are statistically insignificant. In column 5, we introduce all potential channel variables into the model. Results show that trust and social network are associated with higher income while an increase in discrimination lowers income. The coefficient of the Gini index (inequality) remains statistically insignificant. The interaction between trust and ethnic diversity, however, remains significant in this model as well.

5. Summary And Conclusions

This study has sought to examine the association between ethnic diversity and income. Based on data from the European Values Study (EVS), we construct indices of ethnic fractionalisation for 81 British neighbourhoods and examine the impact of ethnic diversity, measured by fractionalisation on household income. We find detrimental effects of ethnic diversity on income. We examine the sensitivity of our results to various estimation methods and further examine trust, social network, discrimination and inequality as potential channels through which ethnic diversity influences income.

Our results point to the need for policies that can mitigate the negative influence of ethnic diversity. For instance, evidence from the sociology literature (see, e.g., Sherif 1958) shows that the use of superordinate goals can be useful in reducing tensions and promoting trust among heterogeneous groups. Thus, in highly fractionalised areas, policymakers can focus on relevant policies along these dimensions to help reduce the negative consequence of diversity on factors such as trust and social capital, which are relevant for development.

Overall, understanding the impact of ethnic diversity on such outcomes as income provides policymakers with a new perspective to consider, when formulating policies to enhance economic development.

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Endnote

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