

Ethnic diversity and economic development

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Abstract

This paper analyzes the role that different indices and dimensions of ethnicity play in the process of economic development. Firstly, we discuss the advantages and disadvantages of alternative data sources for the construction of indices of religious and ethnic heterogeneity. Secondly, we compare the index of fractionalization and the index of polarization. We argue that an index of the family of discrete polarization measures is the adequate indicator to measure potential conflict. We find that ethnic (religious) polarization has a large and negative effect on economic development through the reduction of investment and the increase of government consumption and the probability of a civil conflict.

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1. Introduction

In recent years, there has been increasing interest in the economic consequences of ethnic heterogeneity. In many situations, ethnic polarization generates conflicts that could eventually lead to political instability and civil wars (CW), with long-lasting economic effects. In other cases, the potential conflict represented by an ethnically polarized society

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can affect negatively the rate of investment and induce rent-seeking behavior that increases public consumption. These situations—armed conflicts, reduced investment, or higher government consumption—have been shown to have a negative effect on economic development (Barro, 1991; Tavares and Wacziarg, 2001).

This paper analyzes the effects of ethnic heterogeneity on economic development. For this purpose, we compare the empirical performance of different dimensions of ethnicity as well as alternative indices to measure diversity and potential conflict. There is a growing body of literature on the relationship between ethnic diversity, the quality of institutions, and economic growth. Mauro (1995) shows that a high level of ethnolinguistic diversity implies a lower level of investment. Easterly and Levine (1997) show that ethnic diversity has a direct negative effect on economic growth. La Porta et al. (1999) suggest that ethnic diversity is one of the factors explaining the quality of government. Bluedorn (2001), based on the study of Easterly and Levine (1997), presents empirical evidence of democracy's positive role in ameliorating the negative growth effects of ethnic diversity. All these studies use the index of ethnolinguistic fractionalization (ELF), also called ELF, calculated using the data of the Atlas Narodov Mira (Taylor and Hudson, 1972).

More recently, the economic research agenda on ethnic diversity has studied the relationship between religious diversity, democracy, and economic development. Barro (1997a,b) includes the proportion of population affiliated to each religious group as explanatory variables for the level of democracy. Tavares and Wacziarg (2001) use the index of ethnolinguistic fractionalization and religious dummies to examine the indirect channels for the effect of democracy on growth. With a few exceptions, they find that the religious dummies have no effect on the basic channels. Collier and Hoeffler (2002) find that religious fractionalization has no effect on the risk of conflict. Alesina et al. (2003) argue that while ethnic and linguistic fractionalization have a negative effect on the quality of government, religious fractionalization has no effect. They also find that religious diversity has no effect on growth, using the basic regression of Easterly and Levine (1997). Therefore, the general result is that religious diversity, measured as a fractionalization index, has no effect on economic growth or quality of government.

However, both ethnolinguistic and religious diversity can potentially have a strong conflict dimension. For this reason, we propose a new measure of potential conflict in heterogeneous societies based on an index of polarization instead of the traditional fractionalization index. Several authors have argued theoretically in terms of “polarization” but used as an empirical proxy the index of fractionalization. We argue that polarization and fractionalization are two different, and on occasion, conflicting concepts. We also show how to derive our polarization index as the representation of the total resources devoted to lobbying in a simple rent-seeking model.

Given the importance of the conflict dimension of ethnic and religious diversity, we explore empirically the indirect effects of ethnolinguistic and religious polarization on growth through their impact on civil wars, investment, and government consumption. Civil wars are tragic events for economic development having a long-run impact on income per capita. Consistent with previous research, we find that religious fractionalization has no direct effect on economic growth, while ethnolinguistic fractionalization does.

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