Introduction: Findings of development economics and their limitations

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Introduction

There seems to be a general consensus in development economics, based on both cross-country regressions and individual country studies, that ethnic diversity, especially in the Sub-Saharan African context, is one of the causal factors behind relatively poor development performance. While much of the past relevant literature focuses on diversity's impact on economic growth, we also have evidence that it adversely affects income distribution and poverty as well as human development. But much less is known about the impact of such diversity on economic stability or instability in Africa.

It is generally accepted that more than two thousand ethnic groups, usually lacking the ability to exit from poverty, find themselves in Sub-Saharan Africa. Although some have expressed the view that land-locked conditions may have contributed to such marked ethnic diversity, the development economics literature generally takes ethnicity as exogenous and invariable over time. Indeed, most of the major findings of development economics fundamentally rest on the assumption that ethnicity is exogenous to democracy, geography and other factors that affect economic development. This is because those findings are derived mostly from the applications of statistical methods (cross-country regressions) which are invalid if this assumption does not hold. This is but one of the reasons why such regressions are, at best, the beginning, not the end, of wisdom.

Economic historians and anthropologists have long argued – correctly – that ethnicity is an identity that evolves over time in response to economic, demographic and political developments. To a large degree,

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ethnicity is 'constructed' as evidence in Kenya and elsewhere amply demonstrates. Where there is no economic growth or where the economy is unstable, new ethnic alliances may emerge or ethnic antagonisms may be heightened. In other words, ethnicity and economic development (or growth) are mutually dependent – there is no simple, one-way causal relationship as commonly assumed in development economics.

We all agree that it would be a mistake to talk about 'the' African economy. Much of the development economics literature distinguishes African economies between natural-resource-rich country cases, coastal cash crop exporters and land-locked, internally oriented economies, each encompassing approximately one-third of the total population of Sub-Saharan Africa. But to economic historians and political scientists, such a demarcation is inadequate and could mask more fundamental differences.

Historians and anthropologists argue, again correctly, that economic characteristics of African countries – and their relative development – cannot be understood without reference to the impact of colonial administrations on the political and economic institutions in the post-colonial regime in each country. For example why have Botswana and Sierra Leone – both equally rich in diamonds – followed such sharply divergent post-colonial development paths? Equally important, interactions between ethnicity and the market – through trade of natural resources and labour and through contests for land – historically have shaped much economic development in Africa, with influences still in evidence today.

Therefore, long-term economic performance of African economies can be fully understood only on the basis of proper dialogue between economics, history, political science and anthropology. The purpose of this introduction is to provide a starting point for such a dialogue. In what follows we will offer (1) a summary of some of what seems to be known in the development economics literature with respect to the impact of diversity, however defined, on development; and (2) some preliminary hypotheses about diversity and economic volatility. Finally, we will provide a quick guide to the book, and briefly summarise and suggest some future research priorities.

Diversity and development

Following Barro's lead (Barro 1991), some economists have detected no unique African explanation for Africa's poor performance but blame it all on poor policies and the well-known violations of Washington Consensus strictures – including the lack of openness, low savings rates and flawed monetary and fiscal policies – as well as lack of access to the sea, a tropical climate, Dutch disease, corruption and sometimes even the kitchen sink. Sachs and Warner (1997), for example, follow this line of reasoning.

On the other hand, Paul Collier (2007), as well as Collier and Gunning (1999) and Easterly and Levine (1997) point to the importance of ethnic diversity. Collier and Gunning, for example, claim that ethno-linguistic fractionalisation (ELF), accounts for 35 per cent of the growth shortfall in Sub-Saharan Africa, or for 45 per cent if closely linked poor policies are included.[1] José Garcia Montalvo and Marta Reynal-Querol (2005) prefer polarisation as the measure of diversity of greatest relevance in most country cases but share the general view of the importance of diversity's impact on growth.[2]

The main argument being put forward by such authors as Easterly and Levine is that polarised societies cannot agree on needed public goods and are more likely to engage in rent-seeking activities. Collier (1998) similarly points to ELF as reducing trust, increasing transaction costs and adversely affecting development generally. Bates (2000) does not embrace the ELF measure in the same way but agrees to emphasise that contacts and contracts, implicit or explicit, can be quite strong and can promote both human capital and human development within but not across groups. Habyarimana *et al.* (2009) provide a framework for examining ethnic versus rival explanations for the lack of productive collective action.

Most specialists on the subject seem to hold the view that Africa's generally low population density makes it difficult to generate the kind of trust which crosses ethnic boundaries that is required for the provision of public goods. Frequent human contact ensures the creation of the required social capital. Individuals as well as entire clans tend to look at each other and worry about patent inequalities, vertical as well as horizontal, rather than about their absolute levels of welfare. It is in this sense that, in ethnically divided societies, each group has its own

[1] ELF is measured by the probability that two randomly chosen individuals in a given country do not belong to the same ethnolinguistic group.

[2] Polarisation is measured by the degree of homogeneity within groups, the degree of heterogeneity across groups plus, most importantly, the small number of similarly sized groups.

egalitarian impulse, but that impulse does not extend across ethnic lines, either by virtue of insurance or altruism. This is in sharp contrast to the case of some of the more densely populated countries of Asia, where land scarcity and labour abundance have led to co-operation across ethnicities, especially in the case of intensive agriculture.

Development economists also argue that strong, within-group loyalty can hurt growth in another way. Namely, it does not pay for the individual member of a clan to be a successful stand-out, i.e. do well or get promoted, if this results in the rest of his extended family descending on him. Anthropologists too find this proposition rather convincing.

To measure ethnic diversity, Alesina *et al*. (2003) favour the ELF, while Reynal-Querol (2002) as well as Esteban and Ray (1994) prefer the concept of polarisation, a closely balanced, and therefore contested, ethnic majority dominance. There are findings showing that low levels of ELF as well as very high levels do not pose as much of a threat to development as intermediate levels. Others conclude that we should really be counting much more on polarisation when two contending parties are very close in terms of their power, which may lead not only to bad policy and bad development outcomes but also to less stability. The correlation between fractionalisation and polarisation is apparently positive and very high at low levels of ELF but zero or even negative at intermediate and high levels.

Diversity and democracy

While many authors have discussed the underlying causes of adverse development outcomes, many issues remain open for discussion, and some of these are by no means irrelevant to understanding the relationship between ethnicity and economic development. Issues which remain open for debate include the importance of initial conditions, including colonial heritage, natural resource endowment, the role of institutions, broadly defined, as well as the relevance of the extent of democracy (or lack thereof) in affecting the relationship linking diversity, growth and stability.

With respect to the initial conditions, the relative abundance of land and the low level of population density have already been mentioned. While economists are generally ready to accept kinship relationships as exogenously given, there can be little doubt that they are a substitute for social security networks and that any inequality in the initial distribution of land and other assets has historically permitted clan elites to capture the commanding heights of politics. Unlike the case of the more homogeneous Asian superfamilies, we have here smaller kinship-loyal families, sustaining co-operation within the group, but without altruism travelling across ethnicities. Consequently, increased diversity leads to less collective action with respect to public goods and, at the aggregate level, to more engagement in free-riding, consequent lower growth and some of the other aforementioned adverse developmental outcomes.

As Avner Greif (1993) has also emphasised, citing European historical evidence, legal and political institutions foster intra-elite co-operation but inter-group non-co-operation. The same asymmetry exists with respect to social capital, relatively strong within ethnic groups but not extending across these groups. Within groups, there is bonding going on, which is relatively weak across groups. Bridging across groups is, of course, difficult, even if better for optimisation in the economic sense. The greater the extent of diversity, the more internal bonding occurs, with less bridging.

The strength of natural resource endowments represents another important dimension of the initial conditions. Natural resources are an important cause of the likely asymmetry between different ethnic groups, depending on the vagaries of nature and culminating in the reduced incentive of those blessed with relative abundance to provide public goods to others. In Nigeria, for example, a minority ethnic group sitting on oil is demanding a larger provision of national public goods, currently creating conflict. Moreover, resource-dominant groups are likely to suffer from some manifestation of the so-called natural resource curse, encouraging rent-seeking and weakening the pressure for economic or institutional reforms, all of which, of course, contribute to sustained unequal distributions of income, both of the vertical and horizontal type.

In this setting, local public goods are always preferred over national public goods and the same sort of asymmetries affect the overall quality of social capital which is based on intensive trust within rather than across groups. As Jonathan Temple (1998) points out, an initial unequal distribution of income generally affects development negatively. Similarly, Knack and Keefer (1997) support the position that trust is more pronounced, *ceteris paribus,* when incomes are more equally distributed.

Clearly, the spillover of social capital across ethnic boundaries, as well as the willingness to provide national public goods, depends very much on the overall distribution of income, both of the vertical and horizontal types, which are, to some extent, overlapping. As Fosu *et al.* (2006) point out, heterogeneous societies are better at private goods provision, working through the market, but not very good at providing public goods. Greif emphasises that land or mineral rights are usually critical and are not at all helped by dysfunctional institutions which obstruct egalitarian outcomes. Kinship groups can be useful in the private sector, as ethnic minorities benefit. But in the public sector they can be harmful because ethnic majorities benefit. What is not clear and what is worthy of investigation is whether diversity improves the quality of private goods via an increase in variety.

All of this argues for the possible importance of decentralisation. There exists, of course, a large volume of literature concerning vertical decentralisation, both pro and con, with the pros emphasising that local communities have more information and that they are likely to contain much less ethnic diversity than those at the centre, and the cons pointing to the greater likelihood that local elites will dominate. Vertical decentralisation is seen as reducing friction but may also, as some authors point out, lead to the creation of regional parties with less interest in public goods at the national level. In other words, if too many groups form at the local level, none is strong enough to control the state and none is in a position to mobilise an 'encompassing interest', *à la* Mancur Olson, at the national level. Diversity fosters trust within groups and, while vertical decentralisation is helpful at the local level, it reduces trust at the national level, as well as the provision of public goods, with results already referred to.

Others, including Bardhan and Mookherjee (2000), express some concern about the enhanced possibilities for corruption at the local level, often dominated by local elites. But the comparison between corruption at central and local levels is an unresolved issue that can only be settled by empirical, individual country analysis. In any case, with vertical decentralisation leading to smaller jurisdictions exhibiting less diversity, ELF is reduced, but there is a greater danger of polarisation with, for example, a large minority opposing the central government, as pointed out by Yuichi Sasaoka (2007). The fact is that most central governments are in the hands of a small elite using public goods to exercise patronage of one kind or another, mostly in the form of civil service employment.

Much less attention is devoted in the literature to another kind of decentralisation – the horizontal type – shifting power from the executive, especially the finance ministry, to other ministries, to the legislative branches at all levels, as well as to the judiciary, thus providing greater access for minorities, which can make a large difference (Brancati 2006). Trust can be strongly influenced by such an independent judiciary, a feature rarely in evidence.

As far as I can surmise, the jury is still out with respect to the impact of democracy on all this. Alesina *et al*. (2003) have reported diversity as less serious in democracies because minorities are more likely to feel represented. Barro (1996) finds that democracy enhances growth at low levels of income and depresses it at intermediate levels. Most of the parliamentary systems turn out to be more stable than presidential ones, especially when there are many clans represented by various political parties. With ethnic diversity more pronounced at the centre, a diverse society benefits more from democracy, and a more competitive political system lowers rent-seeking and increases efficiency. Bates *et al*. (2004) report that authoritarian governments lower innovative capacity (TFP) and thus impede growth as well as development in other dimensions.

On the other hand, Besley and Kudamatsu (2007) point out that autocratic regimes may be extremely effective, possibly performing better than democracies if the electorate is sufficiently well organised. If central government elites are sedentary bandits, this may lead to resistance, possibly violence and lower growth, something that Bates *et al*. call ‘a political trap’. But if the bandits are of the roving type, this is more likely to generate instability as public goods become exceedingly scarce and are fought over. To conclude that democracy has little impact on growth but could have an impact on stability is a subject to which we shall return.

The role of markets in development in Africa is another open issue. In the private sector, minority kinship groups benefit from its relative impersonality while, in the public sector, minority kinship groups are disadvantaged and majorities benefit. Therefore, the ruling elite usually prefer the public sector, even if it is less efficient. With respect to particular production sectors, in agriculture the majority of kinship groups usually eschew social capital beyond their own jurisdiction. In industry, to which minority groups are likely to gravitate, they benefit from the relatively larger, more urban, private activity. Hence, for any given distribution of political and economic resources, one might expect a more market-oriented, arm's length, impersonal system to be superior in terms of developmental outcomes. However, markets may also accentuate or even create horizontal inequalities, especially given an initial unequal distribution of natural resources (Mukherji 2009). Moreover, a strong market orientation is often associated with a lower level of public goods. It therefore gives minorities less of an obligation to respect the state in terms of taxes or any other indication of support.

Diversity and volatility

In contrast to the nexus of diversity, democracy and development discussed above, very little research to date has focused on the relationship between diversity and instability. We therefore present a number of preliminary hypotheses which may hopefully help stimulate future research.

There can be little doubt that the unequal distribution of natural resource wealth across different clans can be a cause of instability, as those who are not favoured by nature are likely to object and provoke political instability, leading to economic instability. There is clearly a tendency for those blessed by nature to deny public goods to the rest of the body politic across ethnic borders, if only to yield sporadically, when under pressure. This may be one reason why it has been found in several empirical studies that the intermediate level of diversity, as measured by the ELF, leads to the worst case of political instability and, therefore, economic instability.

Terms-of-trade fluctuations are likely to be another major source of instability, especially affecting the commercially advantaged clans relative to those which are less advantaged. There is ample evidence that terms-of-trade fluctuations have very much affected growth in Sub-Saharan Africa. It would not require much additional research to show that, within particular countries, the more diverse the society, the more likely that terms-of-trade fluctuations will lead to fluctuations in development, including growth, poverty and income distribution outcomes, since they are bound to affect different groups differently. Exposure to terms-of-trade volatility indeed is 50 per cent higher in Sub-Saharan

Africa than in other developing countries, after controlling for differences in income per capita. Food insecurity, also unequally affecting different clans and currently on the rise, can similarly enhance economic volatility and therefore demands analysis.

In addition, terms-of-trade fluctuations are usually managed poorly by governments (Ranis 1991). During downturns a government typically tries to supplement demand via government budget deficits and monetary expansion, while, during upturns, it becomes very bullish and tries to further enhance growth by means of foreign borrowing and, once again, domestic expansionary fiscal and monetary policies. Such asymmetry over the cycle often ultimately leads to crisis, to the imposition of import restrictions, to devaluations, and to other sudden changes in overall policy, all in a system under duress, all of which has the effect of generating instability. Easterly *et al.* (1993) indicate that terms-of-trade shocks explain much of the growth fluctuation in Africa. Country characteristics matter of course, but policies matter less than the extent of externally caused volatility, affecting different groups differently. Internal policies may add to the problem. For example, export marketing boards, which are still prevalent in some countries, have erratic price-setting policies, often favouring the commercialised regions of a country and contributing to overall volatility. To reduce such boom-and-bust oscillations one needs a democracy with relatively strong checks and balances, as, for example, in the Botswana diamond case.

It can also be assumed that frequent political turnover and regime change, which has been an endemic feature of much of Sub-Saharan Africa, leads not only to political but also to economic instability. It should not be difficult to trace the number of coups, changes in government and even ministers of finance, as causal agents in this respect. Oscillation between a market orientation and a controls orientation in policy, which is often referred to as sub-optimal for development generally, can also be considered a likely cause of instability, especially if these decisions are the result of continuous bargaining between different ethnic groups and the central government. Power-sharing as a solution, via proportional representation, mutual veto and decentralisation (Lijphart 1977) has not been much in evidence in Africa.

Decentralisation may also be a cause for concern. If it takes the usual form of delegation or deconcentration, instead of true devolution to local bodies in the form of fiscal decentralisation, reliance on the centre's funds for public goods is retained. This maintains power in the hands of those who control lives and is likely to lead to lobbying, continuous bargaining, uncertainty, conflict and economic fluctuations. As Kimenyi (2006) points out, ethnic heterogeneity leads to the under-provision of non-excludable public goods, but it favours excludable patronage goods. Resistance against this system from minorities risks higher instability, especially if combined with the central government's inequitable tax and other direct interventions in favour of the elite, permitting trust to fluctuate and decline over time. Of course, if clan population proportions change, especially in closely split polarised societies, another reason for volatility makes its appearance. The possibility of alternating roving and stationary bandit regimes is not at all unrealistic and is also relevant to the issue of instability.

Another source of instability results from the gradual shift in much of Sub-Saharan Africa from traditional communal land ownership, with virtually unlimited supplies of land, to private ownership and modern property rights, as land shortage, combined with population increase, leads to titling, insecurity and volatility.

Finally, agents of globalisation may well contribute to economic instability. Examples here include the following:

(1) Remittances from abroad may be aggravating horizontal and vertical inequality because certain better-off ethnic communities are more able to adapt and migrate abroad.
(2) Unequal development of private capital markets is also likely to have a differential impact on different ethnic groups.
(3) It is no secret that foreign aid agencies often play favourites, supporting natural resource-rich regions or politically attractive clans from their own foreign policy points of view, thus exacerbating both horizontal and vertical inequalities and causing political as well as economic instability. More generally, multilateral financial institutions and bilateral aid agencies have not been sufficiently aware of or sensitive to the impact of the policies they advocate and the projects they implement on the provision of public goods to different communities, causing horizontal inequalities. Aid-funded projects are likely to induce rent-seeking, favour the affluent, weaken the social fabric and represent instability – creating political and economic shocks. Moreover donors are often driven to make abrupt changes in the priority they attach to different sectors or regions.