



The economic consequences of political alienation: Ethnic minority status and investment behavior in a post-conflict society [☆]



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ABSTRACT

How does minority status influence individual investment and savings decisions in a post-conflict society? We argue that minority status is associated with lower trust in third-party institutions controlled by an ethnic out-group, and, as a result, leads to a preference for certain earnings over potentially risky investments. We test this hypothesis with multiple sources of evidence from Bosnia and Herzegovina. First, we experimentally elicit investment behavior among members of the same ethnic group on two sides of the boundary that makes some individuals majorities and others minorities. Second, we induce minority status in the lab. Analyses across the studies show that both natural and induced minority statuses lead to lower levels of investment. We provide ecological validity to the experimental results with the analysis of a large, representative household survey and an original survey of businessmen. The results have large implications for understanding of inter-ethnic relations and the sense of security in development.

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1. Introduction

History is replete with stories of successful entrepreneurs who were ethnic minorities in their host countries, with Maghribi traders, Jewish merchants in Medieval Europe, and Chinese merchants in Southeast Asia among the most salient cases (Chirost & Reid, 1997; Chua, 1998; Fafchamps, 2000; Greif, 1993; Jesudason, 1989). Researchers have also examined patterns of behavior of disadvantaged minorities, especially in the US, often finding that they are less likely to save and engage with financial institutions than their majority counterparts (Light, 1972; Myrdal, 1944).

We argue that focusing on the majority-minority divide in attitudes and behavior can advance scholarship on the effects of ethnicity, especially in post-conflict environments. Ethnic diversity

has been shown to significantly affect economic outcomes, with higher ethnic fragmentation associated with lower levels of growth (Easterly & Levine, 1997; Hjort, 2014; Montalvo & Reynal-Querol, 2005) and public goods provision (Algan, Hémet, & Laitin, 2016; Miguel & Gugerty, 2005). However, previous studies overlook the role of the hierarchy of ethnic groups, and in particular, group statuses in relation to the state. But as Wimmer, Cederman, and Min (2009, p. 317) write, “the modern state is not an ethnically neutral actor or a mere arena for political competition, but a central object of and participant in ethnopolitical power struggles.” They argue and demonstrate that minority status in institutional hierarchies, in the form of ethnic exclusion from state power and competition over governmental spoils, breeds conflict. Research in this paradigm also finds that relative group positions, especially in access to political power, are strong predictors of coups and economic downturn (Cederman, Wimmer, & Min, 2010; Gurr, 1995). These studies, however, look only at the outcomes of group positions in the aggregate (usually on the national level) and do not explore individual-level effects.

Our study investigates the individual-level consequences of ethnic minority status on investment, a critical determinant of economic growth (Acemoglu, 2008; Banerjee & Duflo, 2005). The decision to invest or save instead of consuming is inherently risky and requires at least a baseline level of trust in third parties, i.e. financial institutions, loan officers, etc. (Dixit & Pindyck, 1994).

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We operationalize ethnic minority primarily in terms of a group's political status, rather than its size.¹ This definition implies that institutions are composed of and controlled by members of the majority group. We predict that political minority status decreases trust in third-party institutions and, as a result, increases their preference for certain kinds of short-term profits vis-a-vis potentially risky long-term investments. We also hypothesize that alienation from state institutions controlled by an ethnic out-group does not necessarily coincide with distrust towards members of an out-group who are not in positions of power.

We test our hypothesis with evidence from Bosnia and Herzegovina (hereafter BiH) – a paradigmatic example of a divided society.² We focus on BiH for several reasons. In general, the effect of minority status on investment behavior is difficult to estimate with observational data due to omitted-variable bias and self-selection. The political history of BiH presents an opportunity to partially solve issues of endogeneity by exploiting the exogenous imposition of ethnic majority and minority statuses that occurred through adjustments to the boundary between two constituent parts of the country (see Study 1). Second, while in other contexts political majority and minority groups differ along many cultural dimensions (Chua, 1998), in BiH members of the same ethnic group are the political majority in one part of the country and a political minority in the other part. Therefore, comparing the behavior of minorities and majorities within BiH allows us to isolate the role of political group status from their cultural background. In addition, there are several influential studies on inter-ethnic relations that were conducted in BiH,³ which increases the comparability of our results with the results of previous scholarship.

We conducted two lab-in-the-field experiments using novel protocols for measuring preferences for investment. In the first study, to identify the role of minority statuses, we rely on exogenously imposed ethnic hierarchies. We exploit the imposition of the Inter-Entity Boundary Line (IEBL) – a boundary between two autonomous entities of BiH: the Federation of Bosnia and Herzegovina (hereafter FBiH) and Republika Srpska (hereafter RS). Participants belonging to the same ethnic group were recruited from municipalities in close proximity to the IEBL, where on one side of the border their group was the majority, and on the other it was the minority. We ran a modified investment game (Gneezy & Potters, 1997) on both sides of the IEBL; individuals chose whether to invest in a risky option with a positive expected value or to go with the safe option with a guaranteed reward. The third-party in charge of realizing the outcome of the investment, which had a fair and objective probability of success, was a member of the other ethnic group on both sides of the border. We hypothesized that those in the minority will be less likely to trust the third party and, in turn, will invest less.

In the second study, we experimentally induce a minority status in the lab in order to test our prediction that minority statuses had an effect on the trust of third parties. We conducted a modified trust game (Berg, Dickhaut, & McCabe, 1995), where participants decided how much of an endowment to invest with a paired partner, who then chose how much of the multiplied amount of this investment to send back. Because the paired partner could decide

to keep the entire sum, the amount invested serves as a measure of trust that a “fair” amount would be returned. We introduced a third-party enforcer that had the authority to punish others for “unfair” behavior. In our setup, this third-party served as a proxy for institutions that have the ability to enforce standards of behavior. For one group of participants, the third-party was completely anonymous; in the other group, the name of the enforcer, which in our context has a clear ethnic connotation, was revealed to the participants. As a result, participants who belonged to a different ethnic group become the minority. We hypothesized that these minorities would invest less.

The results of these two studies show that minority status is, indeed, associated with sizeable and significant decreases in investment. To further demonstrate the ecological validity of our experimental findings, we analyze a large representative household dataset and conduct an original survey of businessmen. The results from different data sources converge in demonstrating the significant negative effect of minority status on investment behavior. All four studies also show that minorities either do not differ from majorities in their levels of out-group trust, or have even more favorable attitudes towards out-group members than those in majority positions. Additionally, the studies show that minorities have much lower levels of trust in third-party institutions, including executive agencies, courts, police and banks. Thus, we infer that institutional, not interpersonal trust is likely to drive the economic impact of minority status.

Our study makes three primary contributions. First, we advance the literature on co-ethnicity (Habyarimana, Humphreys, Posner, & Weinstein, 2009) by incorporating political group statuses in the exploration of inter-ethnic relations. We highlight that in our research, minority status and co-ethnicity differentially impact trust and trustworthiness and, therefore, might work through different mechanisms. While the co-ethnicity effect arises from strategic behavior (Habyarimana et al., 2009), the impact of minority group position, as our study suggests, is driven primarily by the psychological mechanism of alienation from state institutions controlled by an ethnic out-group.

Second, we extend the line of research on inter-ethnic relations in post-conflict settings. Studies by Alexander and Chirstia (2011) and Whitt and Wilson (2007) that investigated interethnic cooperation in the post-conflict period were also conducted in Bosnia and Herzegovina, and therefore serve as good benchmarks for our results. Our results are largely consistent with the findings from Alexander and Chirstia (2011) and Whitt and Wilson (2007) in showing little out-group bias. However, we emphasize that intergroup animosity is not the only relevant outcome of post-conflict development. People might be willing to trust their non-co-ethnic neighbors, but, as our study shows, are more reluctant to trust institutions of power controlled by an out-group.

Finally, our study contributes to the understanding of the economic success of ethnic minority groups. The results of our research that show that minority status causes a group to invest less are in stark contrast to the well-known aforementioned cases of successful entrepreneurial minorities like Jewish merchants in Europe or the Chinese in South Asia. Our study suggests that, in addition to the cultural traits highlighted in previous studies which explain the emergence of market-dominating minorities (Chua, 1998 for a review), one also needs to pay attention to political factors. In most cases of economically successful minorities, local rulers who wanted to benefit from their business acumen granted them a guarantee of explicit protection. For example, Jewish bankers in early modern Europe were at the forefront of lending to kings, but at a trade-off: the king secured access to financing without risking being overthrown by the enriched group, while the Jewish bankers amassed wealth and were protected by the king from the perfidies of the local majority population (Duggan,

¹ In the empirical analysis, we do not differentiate institutional from demographic conceptions of minority. In the discussion section we highlight the implication of their potential divergence.

² Bosnia and Herzegovina is characterized by the highest indexes of ethnic (0.63), language (0.67) and religious (0.68) fractionalization in Europe (Alesina, Devleeschauwer, Easterly, Kurlat, & Wacziarg, 2003).

³ Whitt and Wilson (2007) use a dictator game to show that 10 years after the end of the war a strong tendency towards fairness in inter-ethnic interactions still was in place. Alexander and Chirstia (2011) use a public goods game to show that the introduction of institutions of integration positively affected cooperation between ethnic groups.

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