

Ethnic Diversity and Social Capital in Indonesia

DIMITRIS MAVRIDIS*

Paris School of Economics, France

Summary. — This paper uses the variations of ethnic diversity between districts in Indonesia to show that diversity leads to lower social capital outcomes. I find that distinguishing between ethnic polarization and fractionalization matters for the results, as polarization has a larger negative effect. The results cannot entirely be attributed to selection on unobservables, and at least part of the relationship should be interpreted as causal. Finally, diversity seems to increase tolerance, despite its negative effect on other social capital variables such as trust, perceived safety, and participation to community activities, and voting in elections.
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1. INTRODUCTION

Markets and institutions are known to function better in societies with higher levels of trust. Arrow (1972) points out that complete contracts cannot be written for every transaction, and market failures can be avoided where trust abounds and enforcement is made easier by implicit rules. An obvious question then arises: what affects trust? One of the potential variables that has been under close scrutiny is ethnic diversity.

Putnam (2007) provides an extensive review of the evidence linking ethnic diversity to levels of trust and social capital, but his review does not distinguish between different types of diversity measures. By distinguishing between polarization and fractionalization, Montalvo and Reynal-Querol (2005a) show they have different implications: for example, polarization is a better predictor of conflicts and tensions. Whether and how these measures relate to trust is hence open to inquiry. Looking at studies using cross-country, or within-country but cross-district variations, whether in developed or in developing countries, trust seems to be lower in more ethnically diverse places.¹ However, most of the within-country-between-district evidence comes from developed countries. Much less is known about the relationship between trust (or other social capital measures) and ethnic diversity when one looks at within-country variations of ethnic diversity in developing countries,² where legal institutions might have less influence in mitigating the negative effects of diversity.

Due to its archipelago formation, Indonesia is one of the most ethnically diverse countries in the world. Around 300 ethnicities are reported, with the number changing depending on the level of detailing of the source.³ Ethnic composition and mixing varies greatly across the country and hence it provides an ideal setting for studying the relationship between ethnic diversity and economic and social capital outcomes. Using three different data sources, this paper exploits the between-district variations in ethnic diversity to observe its relationship to different social capital measures. Although ethnicity is an exogenous variable, it can be argued that location is not. The results could therefore be read as descriptive rather than as causal effects of ethnic diversity. However, one of the aims of this paper is to show that the results cannot be entirely attributed to selection issues, and that part of the association between ethnic diversity and social capital is causal.

This paper makes three contributions. The first is to look at many different individual-level measures of social capital. Various indicators of trust are used (trust in police, neighbors, general trust) as well as perceived safety, tolerance, participation in community activities, voting in elections, and subjective well-being (SWB). The variety of social capital measures allows to inquire how different levels (local, district, national) and dimensions (trust, safety, participation, tolerance) are related to ethnic diversity. The common prior belief is that diversity will affect measures of social capital that depend on interactions with people at the level where diversity is measured: for example, district diversity should not affect national-level trust, nor neighborhood-level trust. A second contribution lies in inquiring whether one is affected differently depending on the belonging to an ethnic minority/majority, and if polarized districts are different than fractionalized ones. The third contribution consists of providing within-country evidence to a literature that was mostly using between-country variations when looking at developing countries.

Previous studies have looked into Indonesia's large ethnic diversity: Bertrand (1998) provides a history of ethnic and religious conflict in Indonesia since its independence. Sidel (2006) documents in detail the rise in conflicts since the 1990s, and traces its roots back to the policies and institutions set up during the Dutch colony. Anecdotal evidence from Chua (2004) suggests that, across Southeast Asia, inter-ethnic group antagonism is worse when inequalities are higher between rather than within ethnic groups. Economists have recently also looked at the effects of ethnic diversity in Indonesia. For example, Barron *et al.* (2009) find that local diversity is correlated with local conflicts. Gaduh (2012) finds that local religious diversity is associated with lower trust, but positively associated with tolerance to other religions.

The results in this paper suggest that local ethnic diversity is significantly and negatively correlated with perceived safety, to all different measures of trust, to participation in community activities and to voting in elections at various levels. Furthermore, SWB increases with the share of one's ethnicity in the district. An important finding is that the effect of diversity is relatively small for all the outcomes studied: moving from the most to the least diverse district corresponds to an increase

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of a tenth of a standard deviation for trust measures. Curiously, tolerance toward different ethnicities *increases* with local diversity. The results are similar to those found in Putnam (2007) for the United States, where diversity is linked to lower trust but not to lower declared tolerance of other ethnicities.

The remainder of the paper is organized as follows. Section 2 provides a brief review of the literature on the relationship between ethnic diversity and social capital. Section 3 describes the different data sources. Section 4 presents the results and Section 5 concludes.

2. LITERATURE REVIEW

Ethnic diversity has been under close scrutiny by economists since a paper from Easterly and Levine (1997) explained the lower sub-Saharan African growth rates using ethnic diversity as an explanatory variable, and found that more racially fragmented countries grew less. Collier (2000) also finds that in Africa, over the period from 1960 to 1990, ethnic diversity is associated with lower growth in a cross section of countries, but the effect only holds in countries with lower levels of political rights. The interpretation given was that well-functioning institutions cancel the negative effects of ethnic diversity. Alesina and La Ferrara (2005) confirm Collier's findings: using a larger dataset including both developed and developing countries, they find that controlling for a country's institutional quality mitigates the effect of ethnic diversity on growth. In rich and well-functioning democracies, diversity does not have a negative effect on growth rates. Recently, Goren (2014) used a large cross-country dataset and disentangles diversity from polarization, to find that they have very different effects on growth rates. The literature in development economics has since then moved away from cross-country growth regressions, due to their obvious shortcomings, and is more centered today in trying to identify the microeconomic channels through which ethnic diversity can affect growth, or other outcomes such as social capital.

Ethnic diversity can bring substantial benefits. Page (2007) suggests diversity correlates with creativity and innovation. Alesina and La Ferrara (2000) posit that ethnic groups can have complementary skills in the production of private goods, so diverse places are more likely to thrive. The anecdotal examples of cities that are ethnically diverse and successful, such as Singapore, New York, London, or Los Angeles suggest that skill complementarity can be an important driver for good economic outcomes.

The vast majority of papers that look at within-country variations of ethnic diversity in developed countries have found a negative relationship between diversity and social capital.⁴ For example, Leigh (2006) makes the distinction between *localized trust* (trust in neighbors) and *generalized trust* (trust in the overall population). Using data from Australia he finds that ethnic and linguistic fractionalization at the neighborhood level is negatively correlated with localized trust, but not with generalized trust. Bakker and Dekker (2011) use Dutch data and find that the level of trust in one's neighborhood increases with the proportion of one's own ethnic group in the neighborhood. Also looking at Dutch neighborhoods, Lancee and Dronkers (2008) find that trust decreases with local ethnic diversity. Ivarsson and Strömnes (2013), with data from the three largest Norwegian urban areas, find that as the percent of non-western immigrants increases in the municipality, trust is lower. However, their results no longer hold after controlling for the local

unemployment rate—a suggestion that unemployment could be the main driver for this result. Dinesen and Sonderskov (2012) follow Danish municipalities from 1979 to 2009. They use changes in ethnic diversity to identify the effect of diversity on trust, and they find that increases in diversity are associated with a fall in trust. Stolle *et al.* (2008) use data from Canadian and U.S. districts and find that diverse neighborhoods have lower levels of individual trust. Schmid *et al.* (2014) conducted their own survey in the UK. They found that diverse neighborhoods have lower levels of out-group trust, neighborhood trust and also in-group trust. They also find, however, that diversity increases out-group contact, which in turn reduces perceived threats.

Alesina and La Ferrara (2000) find that income inequality, ethnic and racial diversity correlate negatively with participation to various local-level community activities in the United States. Their results also suggest that diversity only affects participation to groups with a low degree of excludability or with a high degree of close interaction. For example, participation to church groups (low excludability) decreases with diversity; but professional associations (where interactions are not as frequent) are not affected. There might also be a substitution between types of groups: local diversity *increases* the probability of participation in a nationality group (high degree of excludability). Costa and Kahn (2003) find that across the United States, trust is lower in more diverse communities, a result also found in Alesina and La Ferrara (2002) and in Putnam (2000, 2007). However, when looking at a cross section of developed countries, the relationship between ethnic diversity and lower social capital is not always robust. Delhey (2005) and Bjørnskov (2006) use cross sections of countries and find a negative effect of diversity on trust. But Hooghe *et al.* (2009) look at OECD countries and find no relationship between country-level ethnic diversity and individual-level measures of trust. Uslaner (2009) finds that after controlling for urban segregation, the same relationship reappears and more segregated countries are also those where trust is lower.

In developing countries, ethnic diversity has been found to correlate negatively to growth.⁵ But it has also been found to be related to lower spending in public goods in Miguel and Gugerty (2005), and lower quality of government.⁶ There is extensive micro-evidence that diversity is linked to lower levels of trust, which affects many types of transactions. For example, Karlan (2005) finds that in Peru, recipients of group-loans are less likely to default when members of the group are more culturally similar. Fafchamps (2000) finds that for manufacturing firms in Kenya and Zimbabwe, supplier credit is more likely to be allowed when ethnicity and socialization with suppliers is taken into account.

Recently, the literature has moved away from documenting correlations, and toward identifying causal effects of diversity. For example, Clingingsmith *et al.* (2009) used a lottery in Pakistan that randomly selects families among those that applied for a slot in the Hajj pilgrimage to the Mecca. Their results suggest that compared to those who applied and did not travel to the Mecca, those who traveled have much more tolerant worldviews. The interpretation given is that through the exposure and contact to other cultures of Islam during the pilgrimage, the families become more tolerant of differences. Algan *et al.* (2011) uses the exogenous allocation of people in the French social housing units, to estimate the effect of ethnic diversity on social relationships and the quality of public spaces in small, within-neighborhood areas. Their results show that diversity reduces the quality of public spaces, an effect that is explained either through vandalism,

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