

Ethnic cleavages, institutions and the duration of economic slumps

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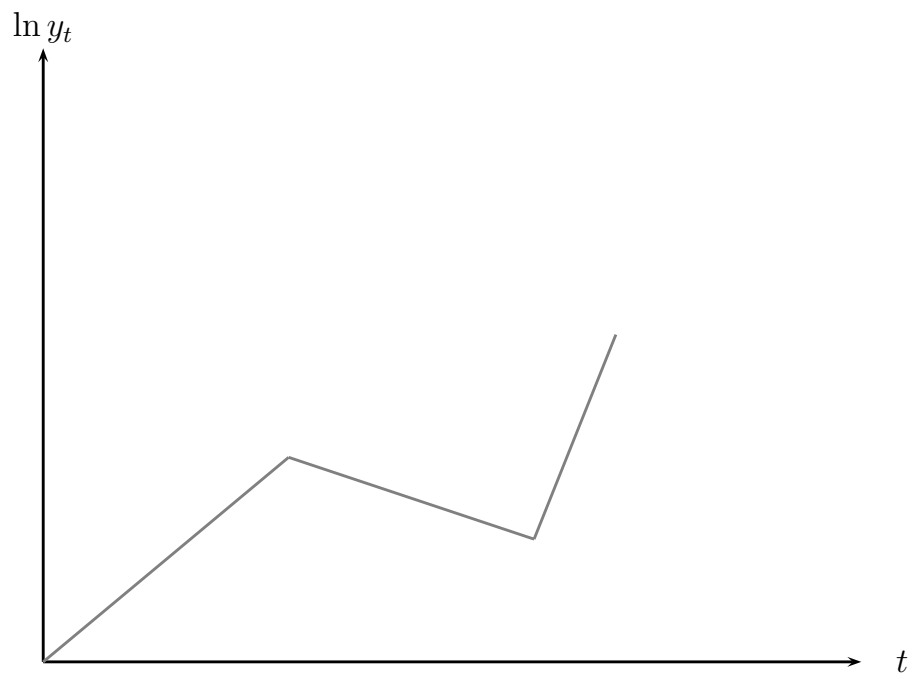
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Why do economic declines in some countries last so much longer than in others?



Duration of declines



Intuition behind the model

An exogenous slump occurs, ethnic groups in the executive need to agree on a policy and economy recovers immediately when they do. It's a cooperation game.

However, slump can hit groups unequally (post-recovery outcome is uncertain).

Political institutions are modeled as constraints on how much one group can expropriate from the other (e.g. Besley and Persson, 2011).

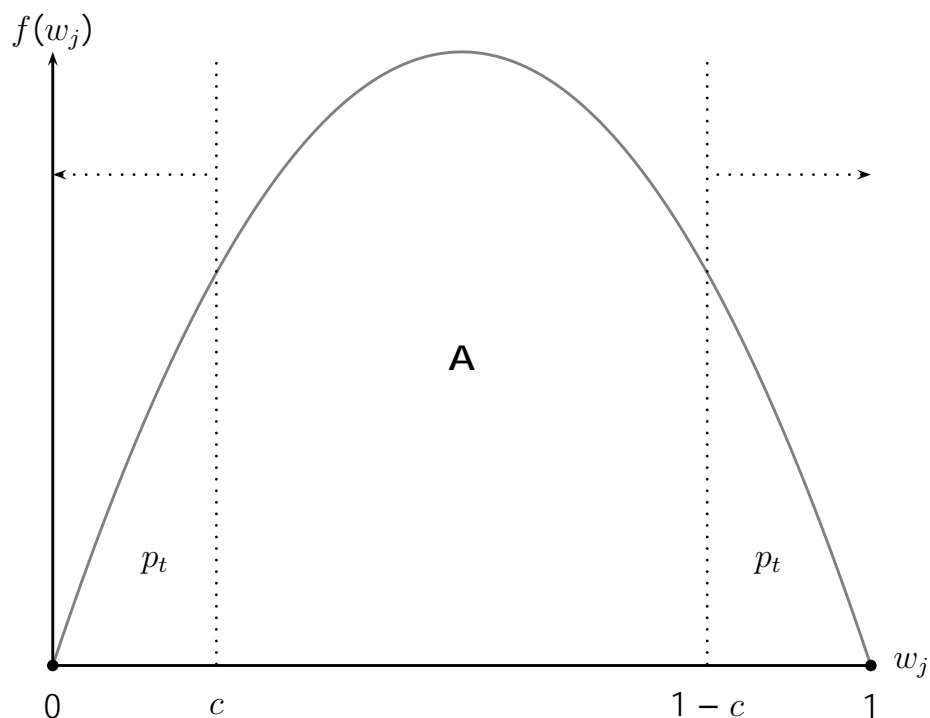
'Winner-takes-all' effect: if one group becomes too weak, the other group takes the remainder.

"Loosing" means political (or even physical) extinction.

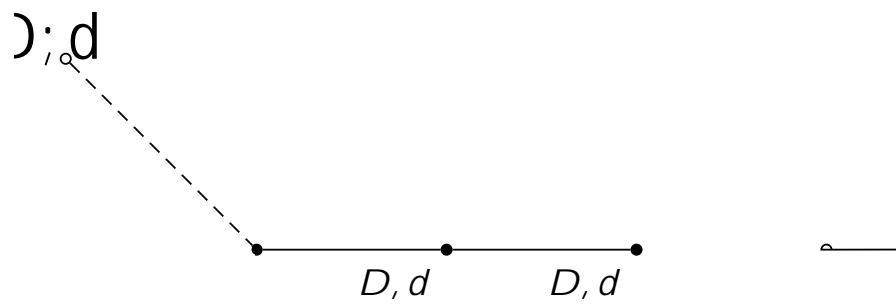
Groups that are politically relevant today can fortify their position by delaying cooperation.



Threshold effects



A sketch



Cooperating in period t when the other group cooperates in period t :

$$v_j^t(C, c) = \frac{1}{1 - \rho} (1 - 2\rho^t) E[g(w_j)/w_j \mid A] + \rho^t (g(0) + g(1))$$

Cooperating in period $t + 1$ when the other group cooperates in period t :

$$v_j^t(D, c) = g((1 - \rho)y_j) + \frac{1}{1 - \rho} (1 - 2\rho^{t+1}) E[g(w_j)/w_j \mid A] + \rho^{t+1} (g(0) + g(1))$$

Data and empirical approach

Dependent variable is the (log) duration of declines $\ln \bar{t}$ (years) from Bluhm et al. (2014). We have 58 episodes. Executive constraints ($XCONST_0$) from Polity IV data proxy for model parameter c . Scaled 1 (lowest) to 7 (highest). *Ethnologue data* (Desmet et al. 2012) and *Ethnic Power Relations* (EPR) data from Wimmer et al. (2009) for diversity.

$$\text{Fractionalization: } ELF_i = 100 \times \left(1 - \sum_{j=1}^J \frac{n_{ij}}{N_i} \right)^2$$

$$\text{Polarization: } POI_i = \sum_{j=1}^J \frac{n_{ij}}{N_i}$$



Baseline predictions

Variables

Dependent Variable: $\ln \bar{t}$



Concluding remarks

Outcomes with delay occur in equilibrium but are not the social optimum. Groups are not able to commit to compensating the losers; that is, give back their potential post-recovery gains. No such enforceable contracts.

Results are particularly relevant for understanding declines in Africa where political divisions are mostly ethnic and power is shared (Francois et al. 2015, ECTA).

Effective coordination and policy responses to slumps are difficult with weak institutions and group heterogeneity.

Stronger, more cohesive, institutions help to resolve these issues, at any level of heterogeneity.



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