

Ethnic diversity and entrepreneurship: Evidence from post-Apartheid South Africa

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This paper studies the effect of ethnic diversity on individual entrepreneurship initiative among the black in South Africa and finds a positive relationship between the two. Theoretically, diversity can be both positively and negatively related to economic performance. On the one hand, higher levels of diversity is associated with lower levels of trust, lower social cohesion and higher costs of coordination, all of which are important to entrepreneurship. On the other hand, heterogeneity can improve performance in problem-solving, knowledge-creation and foster creativity. Empirically, most of the contributions on the topic rely on cross-country comparisons. And since ethnic diversity is correlated with many other characteristics, it is difficult to disentangle its “pure” effect from other confounders.

South Africa is unique in both ethnic diversity and entrepreneurship. Firstly, inter-ethnic relationships might be different from elsewhere because different ethnic groups suffer from the common discrimination against the black during Apartheid. Secondly, self-employment of the black in the “white area” was strictly abandoned during Apartheid.

We focus on the Black South Africans living in the “white area”, which corresponds to 210 (magisterial) districts. Using census data from 1996, we measure ethnic diversity by constructing a fractionalization (Herfindahl-Hirschman) index and a polarization (à la Reynal-Querol) index based on the individuals’ ethno-linguistic group identified from the first language they speak. These native groups are Xhosa, Zulu, Swazi, Tsonga, Sotho, Ndebele, Tswana and Venda. Entrepreneurship is measured at the individual level by a binary variable, which takes value one if the individual reports to be self-employed or employer.

The empirical specification is based on a cross sectional estimate of the relationship between individual entrepreneurship and ethnic diversity at the district level, controlling for a set of covariates at the individual (age, gender, level of education, marital status, whether the father is still alive and ethnicity fixed effect) and district level (population density, urban status, presence of a river, intensity of mines, proportion of African natives, ruggedness and slope of the terrain). The linear probability model and the logit model give the consistent result that diversity positively relates to entrepreneurship. Furthermore, we find that ethnic diversity does not divert individuals inside the labour force from wage employment to entrepreneurship; rather it pushes people who are outside labour force to enter the labour market as entrepreneurs.

In order to strengthen the results and deal with endogeneity issues, we propose an instrumental variable approach. In particular, exploiting the historical pattern of each ethnic group settlement and the fact that migration decreases with distance, we argue that places close to multiple (one) ethnic settlements are more ethnically diverse (homogeneous). Relying on a gravity model, we predict the stock of individuals belonging to each ethnic group in the 210 districts in 1985. We then construct the diversity indices from these predicted shares of each ethnicity in the total black population and use them to instrument the diversity indices in 1996. Results confirm the positive and significant effect of diversity on entrepreneurship, suggesting that the benefits associated to it override the costs.