Abstract
The relationship between ethnic heterogeneity and economic growth is a complex one. Empirical research working with cross section data finds a negative, or statistically insignificant, relationship. However, research at the city level finds usually a positive relationship between diversity and wages/productivity. In this paper we perform a systematic analysis of the effect of the size of geographical units on the relationship between ethnic diversity and growth. We find a positive relationship for small geographical areas and no effect for large areas and countries. We argue that a possible mechanism to explain the positive relationship between diversity and growth is the increase trade in the boundaries across ethnic groups due to ethnic specialization. Therefore, heterogeneity is good for trade and exchange. But homogeneity can promote good institutions as found in the literature. Therefore what we observe indicate that, at the local level, for a given institutional framework, diversity is good for local development.