

**What is the Context Necessary for  
Cultural Diversity to Bring Positive  
Economic Results in Terms of  
Higher Innovativeness,  
Creativity and Openness?**

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# **What is the Context Necessary for Cultural Diversity to Bring Positive Economic Results in Terms of Higher Innovativeness, Creativity and Openness?**

## **Summary**

Most modern societies experience a significant increase of ethnolinguistic diversity. The existence of different cultures within a single state often can lead to tensions and social conflicts. At the same time, this tension can become a source of increased creativity and innovativeness. The question that arises is what should be the approach towards the governance of ethnolinguistic diversity in order for diversity to realize its positive potential. New evidence from a recent study conducted by the author suggests that in order for ethnic diversity to bring economic benefits, it has to be placed in the right context. The right context elements have been identified based on the research from organizational science, and then transposed to the level of countries. The study conducted on 30 OECD countries revealed that indeed, cultural diversity can constitute a resource of higher innovativeness but it has to be placed in the right context. This paper will present the research conducted by the author and examine its applicability to the level of cities.

**Keywords:** Ethnolinguistic Diversity, Cultural Diversity, Innovation, Creativity, Right Context, Benefits from Diversity

**JEL Classification:** O1, O14, O15, O3, O31, O32, O50, F5, F55, J15

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The world we live in is becoming increasingly diverse in terms of ethnolinguistic differences.<sup>1</sup> The cultural diversity comes from the existence of endogenous minorities in the countries, as well as from the more recent waves of immigration. The existence of different cultures next to each other often can lead to tensions and social conflicts. At the same time, this tension can become a source of increased creativity and innovativeness. The interaction between people from different cultural backgrounds can stimulate creativity and openness to change in the society. The question that arises is what should be the approach towards the governance of ethnolinguistic diversity in order for diversity to realize its positive potential and to bring economic benefits to the society.

A recent study completed by the author aimed at assessing the impact of diversity on the level of innovativeness of countries. The results of the study provided support for the argument that in order for ethnic diversity to bring positive economic outcomes, it has to be placed in the right context. The right context elements have been identified based on the research conducted on the level of small groups and firms, and then transposed to the level of countries. The findings of the study conducted on 30 OECD countries supported the assertion that cultural diversity can constitute a resource of higher innovativeness, creativity and openness but it has to be placed in the right context. The purpose of this paper is to present the research conducted by the author and to examine the applicability of the findings to the level of cities.

First, this paper will put the research into a broader context of International Political Economy. Second, it will present the theoretical discussion of the elements that compose the right context. The right context variables that will be discussed in this paper have been identified based on the research conducted within organizational science and also within cognitive psychology. The main theories which have been used to establish the impact of diversity and to identify the conditioning variables are the '*value-in-diversity*', the '*minority dissent*', and the '*self-verification*' theory.

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<sup>1</sup> The literature of the topic uses interchangeably the terms ethnolinguistic diversity, ethnic diversity, ethnocultural diversity, racial diversity and cultural diversity when it refers to the diversity associated with different sub-national identities based on the kin group, linguistic group, ethnic group, racial group or religious group. This paper will also use those terms interchangeably.

Third, the paper will present the summary of the findings from the study carried out by the author on the level of states. The study has shown that indeed, ethnolinguistic diversity has to be accompanied by the right context variables in order to bring positive economic results. The regressions carried out on 30 OECD countries showed that the positive relationship between cultural diversity and economic performance, measured by innovation, becomes statistically significant only when the right context variable is added to the equation. In its final part, the paper will try to assess in what way the research and the findings from the level of firms and the level of countries could also be relevant for the level of cities.

## **1. Perception of Diversity in the Field of International Political Economy**

The problem tackled by this paper is part of a broader discussion concerning the impact of ethnolinguistic diversity on economic outcomes. There has been a vivid discussion in the field of Political Economy concerning the effects of ethnolinguistic diversity on the economic performance of countries. Most of the studies in the field of International Political Economy have pointed to the negative effects of diversity and have shown that ethnic diversity reduces the rate of economic growth.<sup>2</sup> The negative effects were mainly explained in terms of the hypothesized effects of diversity upon political choices. Other studies, however, have shown that ethnic diversity is not “guilty as charged”<sup>3</sup> and that the argument of ethnic diversity being dysfunctional is not well-founded. The scholars have noticed that there are certain circumstances, such as the existence of democratic institutions and higher income levels, under which the negative impact of diversity is mitigated or even reversed.<sup>4</sup> Moreover, some studies, which were conducted on the level of cities, have proven that ethnic diversity might have productivity enhancing effects.<sup>5</sup>

Therefore, some of the studies conducted in the field of Political Economy imply that there are certain moderating variables that influence the relationship between diversity and economic performance. Those variables determine whether ethnic diversity would have a positive or negative impact on economic performance. This paper departs from that point and it uses the organizational science research to

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<sup>2</sup> Easterly and Levine (1997), La Porta, Lopez de Silanes, Shleifer & Vishny (1999), Alesina & Spolaore (2003), Alesina, Spolaore & Wacziarg (January 2003)

<sup>3</sup> Collier (2001)

<sup>4</sup> Collier (2001), Easterly (2001), Alesina & La Ferrara (2004)

<sup>5</sup> Ottaviano and Peri (2004), Florida (2002) have conducted studies on the effects of ethnic diversity on productivity in American cities and found out empirically that ethnic diversity has a positive impact on productivity.

search for the moderators of the positive relationship between ethnolinguistic diversity and economic outcomes.

## 2. Importance of the Right Context

The studies conducted within organizational science, on the level of groups, firms and organizations, have shown that ethnolinguistic diversity can have both positive and negative effect on economic outcomes. The negative effects are associated with an alleviated level of conflict and the decreases in coherence within groups, which stem from the existence of diverse cultural backgrounds. At the same time, this very conflict can become a valuable resource of increased creativity, openness to change and innovativeness. The extensive studies conducted by the scholars of organizational science have shown that the condition which is necessary for ethnic diversity to bring positive results, in terms of increased creativeness, is the existence of the right context.

It has been observed in the organizational science that, if diversity is placed in the right context, then it can add value and enhance the performance of the firm. However, if the right context is not present, then ethnic diversity can actually impair the performance of the firm. Therefore, ethnic diversity displays the qualities of a *double-edged sword*. The positive properties of ethnic diversity include: increased creativity and innovation, increased problem solving capabilities, increased organizational flexibility, increased human talent and benefits for marketing strategy. The negative qualities of ethnic diversity include: increased potential for conflict, decreased effectiveness of communication and decreased levels of social attraction and commitment within the group.<sup>6</sup>

The scholars of organizational science argue that it is the context in which diversity is placed which decides about the realization of the positive or negative attributes of ethnic diversity. They underline that having diversity is not enough to reap the benefits associated with it because the presence of a resource does not imply its use.<sup>7</sup> What is necessary is the right management of diversity. Therefore, putting the right context in place is essential for being able to seize the benefits of ethnic diversity, as stated by Taylor Cox (2001):

Even though theory and research suggest that diversity can be a resource to enhance organizational performance, there is a crucial distinction

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<sup>6</sup> Cox (2001) pp. 4-5

<sup>7</sup> Hartenian & Gudmundson (2000) p. 216

between merely having diversity in the workforce and developing the organizational capacity to leverage diversity as a resource. The challenge of diversity is not simply to have it but to create conditions in which its potential to be a performance barrier is minimized and its potential to enhance performance is maximized.<sup>8</sup>

### **3. Conditioning Variables on Group and Firm Level**

Having asserted that the relationship between ethnic diversity and innovation is indirect and depends on the existence of the right context, the scholars of organizational science took upon the endeavor of finding out what the right context is. Several studies have been conducted in the last few years in order to identify the elements that pertain in the right context. Different approaches have been used and the topic has been examined from several perspectives, ranging from structural to cognitive and psychological.

The research within the organizational science on identifying the right context for diversity is still under way, and it has not been yet fully solidified into one encompassing theory. However, the scholars have pointed out to several variables that moderate the relationship between cultural diversity and performance of groups, organizations or firms. Until the present, the following elements have been either indicated by the scholars, or can be deduced from the writings of the scholars of organizational science, as being conducive to the translation of ethnic diversity into positive outcomes: valuing diversity; growth and innovation based strategy; and the interaction between diverse individuals. Within the value-in-diversity approach, the cognitive psychologists have identified the following additional conditioning variables: integration-and-learning perspective; verification of personal self-views; simultaneous verification of personal and social self-views.

#### **3.1. Valuing Diversity**

The scholars of organizational science underline that the most important requirement, which lies at the basis of building the right context for ethnic diversity, is to *perceive diversity as a value*. Valuing diversity allows an organization to translate ethnic diversity into innovation and thus, increased performance.

The scholars argue that preparing organizations to have and to leverage diversity requires a fundamental change in thinking about assumptions and relationships concerning ethnic diversity. The organizations have to start perceiving ethnic diversity as

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<sup>8</sup> Cox (2001) pp. 15-16

a resource, which has a potential to add value and not just to disrupt performance. As argued by Cox (2001):

Managing and leveraging diversity requires a process of deep organizational change. [...] The process recognizes that real change in this area will require a systemic approach toward an ultimate goal of institutionalizing a new culture – one that welcomes diversity and allows all members to use their skills and abilities to achieve their full potential in pursuit of business and personal goals.<sup>9</sup>

### ***3.1a. Integration-and-Learning Perspective on Diversity***

The analysis conducted by Ely and Thomas (2001) provided proof for the argument that valuing diversity as a resource is essential for creating the environment in which ethnic/cultural diversity<sup>10</sup> can realize its potential benefits. The authors have conducted a qualitative research in three culturally diverse organizations and have analyzed the impact of different *diversity perspectives* on the functioning of those organizations. They defined the diversity perspective as the “group member’s normative beliefs and expectations about cultural diversity and its role in their workgroup”<sup>11</sup>. They analyzed the impact of three different types of diversity perspectives: integration-and-learning, access-and-legitimacy, and discrimination-and-fairness.

The *integration-and-learning* perspective is essentially the ‘valuing diversity’ approach. It is a perspective where diversity is treated as a resource for learning and adaptive change; where the insights, skills, and experiences employees have developed as members of different cultural identity groups are regarded as potentially valuable resources that the workgroup can use to rethink its primary tasks and redefine its markets, products, strategies, and business practices.<sup>12</sup>

The *access-and-legitimacy* perspective is based on the recognition of the marketing value of the culturally diverse workforce, where diversity is used for gaining access to and legitimacy with the culturally diverse markets. The groups with such approach to diversity do not include the cultural competencies of their diverse workforces into their

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<sup>9</sup> Cox (2001) p. 30

<sup>10</sup> Ely & Thomas (2001) use the term *cultural diversity* which refers to race, p. 236

<sup>11</sup> Ely & Thomas (2001) p. 234

<sup>12</sup> Ely & Thomas (2001) p. 240

main functions, but only use their diversity at the margins, to connect with a more diverse market.<sup>13</sup>

The *discrimination-and-fairness* perspective is an approach where cultural diversity is perceived as an end in itself. Unlike the other two approaches, the discrimination-and-fairness perspective does not connect having a culturally diverse workforce with the enhancement of organization's functioning. The reasons for having a culturally diverse workforce are dictated by the moral imperative to ensure justice and a fair treatment of all members of the society. A diverse workforce serves as an evidence of just and non-discriminatory treatment of employees. An organization with such an approach focuses its efforts on providing equal opportunities in hiring and promotion, suppressing prejudicial attitude, and eliminating discrimination, but it does not try to use diversity to its advantage in terms of functioning and performance.<sup>14</sup>

The results of the analysis conducted by Ely and Thomas (2001) showed that, out of all the three perspectives, only the integration-and-learning perspective gave the right foundation and guidance needed to realize sustained benefits from diversity. The members of diverse groups that embraced this perspective felt valued and respected. They reported feeling that their "whole person" was known, valued and respected by others and that they could express "more of who they were" at work, including those things that differentiated them from others. As a result of the integration-and-learning perspective, the functioning of the organization was "enhanced by the cross-cultural exposure and learning, and by work processes designed to facilitate constructive intergroup conflict and exploration of diverse views".<sup>15</sup>

The other two perspectives did not provide the right foundation and guidance needed to achieve the sustained benefits from diversity. According to the authors, the crucial dimension along which the three diversity perspectives varied was whether and how cultural diversity was linked to the group's work and work processes.<sup>16</sup> They described the impact of the two perspectives on the functioning of groups in their study, in the following way:

In the access-and-legitimacy perspective, cultural diversity is a potentially valuable resource, but only at the organization's margins and

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<sup>13</sup> Ely & Thomas (2001) p. 243

<sup>14</sup> Ely & Thomas (2001) pp. 245-246

<sup>15</sup> Ely & Thomas (2001) pp. 254, 258, 261

<sup>16</sup> Ely & Thomas (2001) p. 265

only to gain access to and legitimacy with a diverse market. [...] this view of the role of racial diversity led to race-based staffing patterns that matched the racial make-up of the markets they served. This fostered perceptions of white-staffed functions as higher status than functions staffed by people of color; racially segregated career tracks and opportunities, which fostered concerns among staff of color about the degree to which they were valued and respected; [...] The resulting interracial/interfunctional tensions appeared to inhibit learning and people's ability to be maximally effective in their work.

Finally, in the discrimination-and-fairness perspective [...] this view of the role of racial diversity restricted the discourse about race to one in which employees negotiated the meaning of all race-related differences on moral grounds. Questions and concerns about fairness led inevitably to strained race relations characterized by competing claims of innocence, with each group assuming a defensive posture in relation to the other.<sup>17</sup>

In the study of Ely and Thomas, the intervening process through which the integration-and-learning perspective enhanced group performance was the creation of the feeling of being valued and respected among the diverse people. That feeling enabled the diverse members of the group to openly voice their ideas and thus, contribute to the creativity and divergent thinking of the group.

There has been a theory developed in the field of social psychology, called the *self-verification theory*, which explicitly focuses on that phenomenon and explains its dynamics on the level of individual cognitive processes. The self-verification theory helps to established further conditioning elements which allow to translate diversity into creativity. The following paragraphs present that theory.

### ***3.1b. Verification of Personal Self-Views***

The *self-verification theory* has been developed in the course of searching for the moderators, on the social psychological level, that would allow one to translate the potential of diversity into reality. The self-verification theory focuses on defining the context, which would create the feeling of being valued and respected among the

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<sup>17</sup> Ely & Thomas (2001) pp. 265-266

members of diverse groups, and thus, ensure the communication of the distinctive ideas and unique perspectives by those individuals. It recognizes that the creation of a social psychological climate that would encourage diverse people to communicate their ideas is essential for translating diversity into innovation:

There are sound reasons to believe that the social psychological climate that prevails in groups will be a powerful determinant of innovation—even more powerful, perhaps, than the abilities of individuals who make up the group.<sup>18</sup>

The self-verification theorists aim at identifying the cognitive individual processes that would moderate the harmful effects of diversity caused by intergroup categorization processes. The self-verification theory has been created as an alternative to the *self-categorization theory*, which also has provided an answer to the question concerning the moderators needed to translate diversity's potential into reality. The answer provided by the self-categorization theory points to the establishment of superordinate goals as moderators of the harmful effects of diversity. It contends that the members of diverse groups must shift their focus from the qualities that make them unique to the superordinate identity of the group in order to avoid harmful categorizations based on demographic differences.<sup>19</sup>

The self-verification theorists argue the contrary and contend that, while evoking a collective categorization may minimize the use of category-based biases and stereotypes, it may also discourage individuals from behaving in ways, which are distinct to their unique identities.<sup>20</sup> Therefore, the self-categorization theory falls short as a strategy for finding value in diversity because it is precisely these unique ways of thinking and acting that constitute the potential benefits of a diverse group. Swann et al. (2004) explain the logic behind that argument in the following way:

Indeed, taken to its logical extreme, self-categorization theory suggests that members of diverse groups should become so single-mindedly committed to the groups' agendas that distinctions among them become blurred. Such blurring of the differences that make a team diverse will

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<sup>18</sup> Swann et al. (2004) p. 23

<sup>19</sup> Chatman et al. (1998)

<sup>20</sup> Polzer et al. (2002)

necessarily thwart efforts to find value in diversity. From this vantage point, although emphasizing superordinate identities may serve to unify members of diverse groups initially, as a strategy for finding value in diversity, it is tantamount to arguing that the best way to exploit a resource (in this case, the unique characteristics of diverse group members) is to minimize and disregard that resource!<sup>21</sup>

The goal of the self-verification theorists, therefore, was to create a strategy for finding value in diversity. They wanted to offer a different solution than the one offered by the self-categorization theory, where the solution implies suppressing diverse identities for the group identity. They argued that there is abundant anecdotal evidence suggesting that diverse groups sometimes do emphasize their differences and still simultaneously become socially integrated.<sup>22</sup> How it happens, however, is still unclear. Therefore, they wanted to provide the answer to the daunting question of how diverse groups interact effectively while remaining cognizant of their differences.

The self-verification theorist contended that, in order for ethnic diversity to be translated into innovation<sup>23</sup>, the diverse people have to attain confirmation of their self-views. Only under such circumstances will the diverse people feel comfortable to actually voice their opinions and thus, contribute to creative thinking. The self-verification theory concludes that the atmosphere of acceptance, understanding and tolerance towards people coming from different groups is essential for ethnic diversity to bring positive results in terms of creativity.<sup>24</sup>

The self-verification scholars have grounded their theory on the processes through which people seek and attain confirmation of their self-views. There is a growing body of research, they argued, that supports the proposition that people want to be known for who they believe they are. It has been observed that when people enter into relationships with others who verify their self-views they will feel more intimate and satisfied with the interaction and they are more inclined to want to continue the relationship.<sup>25</sup>

Furthermore, the scholars of the self-verification theory have discovered through their research that self-verification enhanced the feelings of connection to the group and

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<sup>21</sup> Swann et al. (2004) p. 10

<sup>22</sup> Polzer et al. (2002)

<sup>23</sup> Here innovation is not understood in the full Schumpeterian sense, but it is understood as creativity

<sup>24</sup> Polzer et al. (2002), Swann et al. (2004)

<sup>25</sup> Polzer et al. (2002) p. 297

fostered creative task performance. Swan et al. (2004) summarize the results of their study concerning that discovery in the following way:

Apparently, when group members had their unique attributes and perspectives verified, they felt recognized and understood. Such feelings emboldened them to offer creative ideas and insights they might otherwise have felt too inhibited to share. In addition, feeling known and understood by the group may have increased motivation to cooperate with one another by making members identify more with the group.<sup>26</sup>

The self-verification theorists argue that the effect of greater diversity on group functioning is likely to depend on the level of interpersonal congruence in the group. High interpersonal congruence fosters mutual understanding and appreciation for one another's perspectives and thus, buffers the group from the potentially disruptive effects of diversity coming from negative categorizations. The *interpersonal congruence* is defined as a "the degree of similarity between a person's self-views and others' appraisals of that person".<sup>27</sup> High interpersonal congruence occurs when there is an agreement between people's self-views and the appraisals of their partners. In a situation of high interpersonal congruence, the members of diverse groups feel valued and respected and thus, are more inclined to make higher investments and have a greater willingness to open up and take risks, which all are the qualities that stimulate creativity and divergent thinking in groups.

### ***3.1c. Simultaneous Verification of Personal and Social Self-Views***

Even though the self-verification theory provides an alternative approach to managing diversity than the one offered by the self-categorization theory, nonetheless the self-verification theorists do recognize the validity of the main assertions made by the self-categorization theory.<sup>28</sup> They agree with the contention proposed by Chatman et al. (1998) which states that the superordinate goal can reduce the destructive intergroup categorizations through replacing the negative categorizations with the collective categorizations which encourages group members to unite around their shared social self-views. The self-verification theorists argue that their intention is not to question the

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<sup>26</sup> Swan et al. (2004) p. 16

<sup>27</sup> Polzer et al. (2002) p. 297

<sup>28</sup> Swann et al. (2004)

importance of the verification of social self-views for the well functioning of diverse groups, but to complement the work of the self-categorization scholars with new insights.

The self-verification theorists argue that the problem with the self-categorization theory is that it “captures only a portion of the psychologically significant processes that unfold in groups”<sup>29</sup>. It correctly underlines the importance of the verification of social self-views but it neglects the importance of the verification of personal self-views. Moreover, the principle of *functional antagonism* propagated by the self-categorization scholars states that the verification of social self-views and personal self-views is mutually exclusive.<sup>30</sup> According to the self-categorization scholars, people cannot enjoy verification of distinct personal and social self-views simultaneously, but they have to make a trade-off between the two.

The scholars of the self-verification theory disagree with the assertion of functional antagonism and argue that people can “have it both ways”. They argue that the verification of the personal and social self-views can occur independently and simultaneously. They believe that many social and personal self-views are quite compatible and may even complement one another. According to them, a simultaneous verification of both personal and social self-views is actually necessary for the well functioning of diverse groups engaged in creative tasks.<sup>31</sup>

Swann et al. (2004) note that the configuration where both the personal and social self-views were verified was actually present in the organizations featuring an integration-and-learning perspective in the study of Ely and Thomas (2001). It was possible because the collective goals of the group were compatible with the personal self-views. What made the two goals compatible was the perception of diversity as a value to the group.

The collective goal of the group with the integration-and-learning perspective was to learn from diversity and thus, diversity was perceived as a cherished and desirable characteristic of the group. Therefore, the individuals who were diverse felt that they could verify their personal self-views related to their different cultures because those self-views were totally compatible with the superordinate goal of the group. As a result, the members of the group that followed the integration-and-learning perspective could verify their personal and social views simultaneously. Swann et al. (2004) explain the

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<sup>29</sup> Swann et al. (2004) p. 21

<sup>30</sup> Turner (1985)

<sup>31</sup> Swann et al. (2004) p. 20

psychological dynamics that unravel from the simultaneous verification of the personal and social self-views in the following way:

Verification of their personal self-views will make them feel known and understood, and thus increase their attraction to other group members as well as their commitment to the group. Quite independently, verification of their social self-views will increase their allegiance to and interest in remaining in the group.<sup>32</sup>

The scholars of the self-verification theory argue that the combination where both personal and social self-views are verified is optimal for diverse groups engaged in creative tasks. This combination allows for the development of coherence in the group, and commitment to its collective goals, but at the same time it permits the preservation of diversity of its members, and thus, allows the group to take advantage of its diversity and utilize it as a resource for creativity and divergent thinking.

### **3.2. Growth and Innovation Focused Strategy**

Another conditioning variable that allows to translate diversity into creativity, as identified by the scholars of organizational science, is the *Growth and the Innovation Focused Strategy*. The empirical studies conducted on the firm level have demonstrated that cultural diversity brings positive outcomes in terms of performance for the firms that follow a growth or an innovation-focused business strategy.<sup>33</sup> At the same time however, the studies have revealed that cultural diversity brings negative outcomes to firms that follow a downsizing strategy or a strategy which is low on innovation.<sup>34</sup>

The scholars conducting the studies have concluded that ethnic diversity is a resource that can offer a competitive advantage to some firms, while it may be a performance detriment to others, depending on the business strategy of the firm. Richard McMillan, Chadwick & Dwyer (2003) have found that in association with a growth or innovation-based strategy, racial diversity enhances productivity. Furthermore, the results of their studies show that the positive relationship between diversity and productivity intensifies as strategic growth increases.<sup>35</sup> For the firms, however, which pursue a strategy low on innovation or a downsizing strategy, the relationship between diversity and

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<sup>32</sup> Swann et al. (2004) p. 20

<sup>33</sup> Richard (2000), Richard, McMillan, Chadwick & Dwyer (2003)

<sup>34</sup> Richard (2000), Richard et al. (2003)

<sup>35</sup> Richard (2000) p. 171

productivity becomes negative. Given the results of their studies, the authors concluded that: “Simply put, racial diversity is beneficial to innovators”.<sup>36</sup>

The authors used *the contingency theory* to examine how the innovation-focused strategy may interact with cultural diversity to exert a positive influence on firm performance. The innovation-focused strategy was chosen as a contingency variable because according to the authors, it allows the firm to assume a position in which it can exploit and benefit from cultural diversity. The authors departed from a concept that a firm can take advantage of its resources, only if it is in a position to exploit and benefit from them.<sup>37</sup> They stated that a strategic focus on innovation can allow the firm to assume such a position with respect to the resource of cultural diversity.

A firm whose strategic goal is innovation would be more successful when it possesses the complementary assets, in particular the human resources necessary to develop the innovative processes. Therefore, the authors argue that a firm pursuing an innovation strategy is likely to benefit from the cultural diversity and the creativity and flexibility obtained from a diverse workforce.<sup>38</sup> The authors put forward the following hypothesis, which was empirically proven later in the course of their study:

Racial diversity and innovation strategy will have a positive interaction effect on firm performance, such that the more a firm pursues an innovation strategy, the more it will benefit from a racially diverse workforce.<sup>39</sup>

Richard et al. (2003) argued that the positive interaction effect between racial diversity and innovation strategy on firm performance<sup>40</sup> captured by the study indicates that a racially diverse workforce in conjunction with high levels of innovation can provide a competitive advantage to firms. The results of the study showed that racial diversity is likely to enhance performance for banks pursuing an

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<sup>36</sup> Richard et al. (2003) p. 114

<sup>37</sup> Barney & Wright (1998), Richard (2000)

<sup>38</sup> The variable used by Richard et al. (2003) to measure the Innovation Strategy was a three-item scale where the items were drawn from the Strategic Posture scale developed by Covin and Slevin (1989) of which *innovation* is one facet. “The 7-point, Likert-type items measure the extensiveness and frequency of product innovation and technological leadership used by the firm to develop or maintain a competitive advantage (Covin & Slevin 1989; Miller 1983). The mean rating on these items was used to determine the banks’ degree of innovativeness ( $\alpha=.69$ ); the higher the score, the greater the bank’s tendency to pursue an innovation-focused business strategy” (Richard et al. 2003, p. 116)

<sup>39</sup> Richard et al. (2003)

<sup>40</sup> In Richard et al. (2003) the firms under investigation were from the banking industry

innovation strategy, while it is likely to decline performance for banks low in innovation. Furthermore, for the banks pursuing an innovative business strategy, increasing the level of racial diversity should increase firm performance.

### **3.3. Interaction between Diverse Individuals**

The theoretical concepts developed within the field of organizational science,<sup>41</sup> point to another conditioning variable which is crucial for the positive relationship between diversity and performance to take place, which is the *interaction and communication between diverse individuals*. The *value-in-diversity hypothesis* states that the creation of new quality ideas stems from the interaction between diverse individuals because it exposes the individuals to the diverse ideas and experiences of other people. The interaction between diverse individuals is also stressed as an imperative elemental for the notion of *kaleidoscope thinking*.<sup>42</sup> The most important condition necessary for kaleidoscope thinking to take place is to have contact with people from a variety of perspectives. Finally, the interaction between diverse individuals is also at the basis of the process of *creative synergy*.<sup>43</sup> Creative synergy is only possible when there is an interaction between diverse individuals inside of a group.

As stressed by the scholars of creative synergy and kaleidoscope thinking, the interaction between people with diverse perspectives, experiences and backgrounds “has something to offer over and above the simple combination of individually generated ideas”<sup>44</sup>. In case of the ongoing sharing of ideas, and twisting it over and over again, the interaction of individuals adds an extra value and generates a new product. This new product is a novel idea that was generated exactly thanks to the interpersonal interaction between diverse individuals. Thus, the interaction between diverse individuals is a necessary condition for the ethnic diversity to be translated into creativity, and thus into higher productivity.

## **4. Conditioning Variables on the Country Level**

Based on the insights from the theories of organizational science, we can identify three main conditioning variables which are crucial for translating cultural diversity into positive outcomes on the level of firms. Those three elements create the right context for diversity on the level of firms and they consist of the following: value-in-diversity

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<sup>41</sup> The concepts include of the *value-in-diversity hypothesis*, *kaleidoscope thinking* and *creative synergy*.

<sup>42</sup> Kanter (1968) p.11

<sup>43</sup> Kurtzberg & Amabile (2000-2001)

<sup>44</sup> Kurtzberg & Amabile (2000-2001) p. 289

approach, growth and innovation focused strategy and the interaction between diverse individuals. We argue that those three elements can be translated to the following three elements on the level of countries: democratic pluralism, growth or innovation focused strategy and interaction between diverse individuals. The next paragraphs discuss the three conditioning elements when translated to the level of countries.

#### **4.1. Valuing Diversity on the Country Level - Democratic Pluralism**

We argue that when translated to the state level, a system which provides the best basis for valuing diversity is democratic pluralism. Valuing diversity on the country level would mean that a country is run by rules and policies that cherish and encourage diversity among its citizens. Cherishing and encouraging diversity would mean that a country is supporting the cultivation of diverse ethnocultural identities and practices of its citizens, that the country promotes the attitude of appreciation and tolerance towards diversity among its citizens.

We contend that the system which is most appreciative of ethno-linguistic diversity and thus, provides the best basis for valuing diversity is democratic pluralism because it is based on principles that support the cultivation of diverse ethnocultural identities and practices of its citizens within a single state. Democratic pluralism is understood as “a condition of society in which diverse ethnic, racial, religious, or social groupings ‘maintain their autonomous participation in their traditional culture within the confines of a single civilization’ or state”.<sup>45</sup>

Charles Doran, a scholar who extensively indulges on the topic of democratic pluralism in his recent writings, states that democratic pluralism is the best system to mediate and manage the differences between diverse communal groups. Pluralism protects the culture and identity of respective communities and since the preferences of the communities are secure, the communities are able to participate in the activities of the larger states. Democratic process, on the other hand, helps to mediate the differences in preferences, which usually exist between the different communities, when making a common policy.<sup>46</sup> Thus, it is a united concept of both ‘pluralism’ and ‘democracy’ which makes the system work and makes democratic pluralism successful in managing diversity within a single state.

As argued by Doran (2001) democratic pluralism is based on tolerance towards cultural diversity. Democratic pluralism seeks to harmonize and politically

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<sup>45</sup> Doran (2001) p. 5

<sup>46</sup> Doran (2001) p. 10

integrate the different ethnic groups living within a single state. Doran states that the principles of democratic pluralism ensure that diverse communities can not only live in harmony with each other inside of a single state, but that they can also thrive spiritually, economically, linguistically, and intellectually. Plural democracies, through allowing the diverse groups to retain their traditional cultures, and through endorsing a harmonious coexistence between diverse communal groups, promote the tolerance towards cultural diversity among its citizens.<sup>47</sup>

#### **4.2. Growth and Innovation Based Strategy on the Country Level**

Following the findings and the logic of organizational research, we argue that diversity as a resource needs a special strategy in order for a country to benefit from it. A country that wants to take advantage of diversity has to assume a position to exploit that resource. Otherwise, the country would not be able to use it and benefit from it. We contend that a strategic focus on innovation and growth in the economic strategy is necessary for the country to assume such position with respect to the resource of cultural diversity. Only with such a strategic focus a country can benefit from ethnolinguistic diversity.

Therefore, when translated to the state level, a growth and innovation based strategy is present when a country pursues a strategy that aims at strengthening the competitiveness and the innovativeness of the economy. We argue that a good indication of the existence of a growth based strategy on a country level could be the existence of a good business climate and flexible labor markets; while a good indication of the existence of an innovation based strategy could be the level of spending on innovation, meaning the expenditure on Research and Development (R&D).

#### **4.3. Interaction between Diverse Individuals on the Country Level**

Based on the theory of organizations, the interaction and communication between diverse individuals is necessary for ethnic diversity to be translated into creativity and thus, higher productivity. Only if the diverse individuals interact and communicate with each other, presenting their diverse views on the issues, can the benefits of diversity be realized.

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<sup>47</sup>A way in which plural democracies often encourage the attitudes of tolerance towards diversity, as well as encourage the perception of diversity as a value among its citizens, is through publicizing a positive image of ethnocultural diversity. The propagation of the positive image of diversity is usually conducted through the media, educational system, as well as through the state laws and official government statements (Doran 2001).

We state that, when translated to the country level, the interaction and communication between diverse individuals is possible if they have a contact with each other at various levels of social life, which we can also refer to as *mixing*. Furthermore, we argue that an element that makes the communication among diverse individuals possible is the existence of a common language. It does not have to be only one common language, it could be more than one, however, it is important that a common language exists, in which all the citizens of the country can communicate.

## 5. Empirical Study

The empirical, quantitative study conducted by the author on the impact of ethnolinguistic diversity on the economic performance of countries managed to take into account two of the conditioning elements identified: *democratic pluralism* and the *growth and innovation focused strategy*. The lack of comparable and comprehensive quantitative data did not allow to include the *interaction between diverse individuals* into the empirical study.

Democratic pluralism was incorporated into the quantitative analysis by a specific choice of the sample, which included only the 30-OECD countries, which can be more or less classified as plural democracies. The innovation and growth focused strategy has been divided into two variables: Innovation Focused Strategy and Growth Focused Strategy, which were included into the statistical model as separate right context variables.

The hypothesis stated that, in the presence of the right context, ethnolinguistic diversity leads to higher levels of innovativeness and thus, constitutes an economic benefit for countries. The level of innovativeness was measured by three variables: Creativity, Openness and Innovation. The regression results for the Creativity, Openness and Innovation variables have demonstrated that there is indeed a positive relationship between diversity and innovativeness, but the relationship only becomes really significant when it is moderated by the existence of the right context variables.

Therefore, the statistical analysis, which comprised of factor analyses and simple cross-country regressions, provided support for the hypothesis. The results of the regressions have shown that, for the OECD countries, ethnolinguistic diversity, when accompanied by the right context, indeed leads to higher levels of creativity, openness and innovativeness. The Innovation Focused Strategy and Democratic Pluralism emerged as the main moderators of the positive relationship between diversity and innovativeness. The results have also somewhat supported the Growth Focused Strategy as one of the moderators, however to a lesser extent.

## 6. Implications for the Governance of Ethnolinguistic Diversity in Cities

There are several implications of the results of the study for the governance of ethnolinguistic diversity in cities. First of all, the results have shown that it is crucial to perceive diversity as a value and to cherish and encourage diversity among citizens. On the level of state, democratic pluralism is the system which allows to promote the attitude of appreciation and tolerance towards diversity and the cultivation of diverse ethnocultural identities and practices of its citizens. On the level of cities, the idea of valuing diversity should find application by including the members of diverse cultural groups in the city council, by involving them in the organization of cultural life of the city, by including the symbols of different cultures present in the city in the architectural design<sup>48</sup>, by organizing ethnic/cultural events around the city, by creating a positive image of diversity in the media.<sup>49</sup> Essentially, the application of value-in-diversity approach, or otherwise called the integration-and-learning approach, would include any activities in the city that aim at creating the appreciation of diversity and the common consciousness that diversity constitutes a benefit to the society.

Second, the results of the statistical analysis on the level of states have shown the crucial importance of the innovation and growth focused strategy. On the level of cities, it would mean that diversity would be beneficial for cities which are growth oriented and innovation focused. A growth oriented city would mean a city which puts an effort in creating favorable environment for the development of investment and business. An innovation focused city would mean a city which centers a lot on new knowledge production. Such city would offer a lot of jobs which require creative and divergent thinking. Since diversity is a resource of creative thinking, the cities which possess culturally diverse workforce would have a competitive advantage over the cities which are more homogenous.

An important requirement however, is the actual employment of the diverse workforce in the areas of the economy where the new knowledge is created. It would mean that the culturally diverse individuals should find employment in high-skilled jobs because those are usually the jobs where innovative thinking makes the biggest impact on new knowledge creation. That would imply that in order to take advantage of diversity

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<sup>48</sup> Not only in reference to ethnic districts but most of all in reference to common spaces such as the city centers, city malls etc.

<sup>49</sup> The creation of the positive image of diversity in the media should not be approached in a one sided and tendentious way but it should involve also the discussion about the problems which are related to diversity.

the city should try to attract high-skilled immigration and employ them in the innovation thirsty parts of the economy.

It should be underlined that it does not mean that the low-skilled diverse worker does not carry the benefit of increased creativity related to his diversity, he does. The potential of increased innovativeness coming from the interaction between diverse individuals is also present in the context of low-skilled labor activities. However, the positive impact of increased innovation in the low-skilled areas of the economy is much lower than it is in the high-skilled areas of the economy.<sup>50</sup>

The final comment is owed to the right context element which has not been included in the empirical analysis conducted by the author, but which stems out from the theoretical analysis as being an important part of the right context. It is the imperative of the interaction between diverse individuals. In order for diversity to breed new quality ideas, the diverse individuals have to interact with each other and with the rest of the society. On the level of city, it would imply that the city spaces should be organized in a way which allows for interaction between diverse groups. The interaction is not possible without the existence of a common language that can be used for communication therefore, it is also important that the city offers language trainings for immigrants. If the diverse people can interact and communicate with each other and with the rest of the society they will be able to contribute to the creation of innovative ideas in the society.

To conclude, the study conducted by the author on the level of states, might have some important implications for the governance of diversity in cities. The study shows that diversity, in order to bring positive outcomes, in terms of higher innovativeness, has to be accompanied by the right context. The double-edged qualities of ethnic diversity imply that once you have diversity, you simply have to have the right context in place. Otherwise, not only you will not be able to reap the benefits of it, but you might also experience the negative sides of ethnic diversity such as high level of conflict and communication breakdowns. Therefore, ethnic diversity is a type of resource that cannot be just left idle. If a city wants to take advantage of it they have to manage it and leverage it in the right way. Furthermore, the management of diversity is not something that one can do once and then forget about it. On the contrary, it requires on the part of a city a constant and ongoing commitment which is genuine and serious.

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<sup>50</sup> A city which gives employment to high-skilled immigrants reveals that it has a learning perspective on diversity because it has a willingness to learn from the talent coming from different cultures. A city which gives employment mainly to low-skilled immigrants reveals that it does not recognize the potential benefits of diversity for new idea creation and learning and therefore, it does not value diversity.

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**ANNEX  
REGRESSION RESULTS**

**Abbreviations:**

RCg - Right Context Growth Focused Strategy

RCi - Right Context Innovation Focused Strategy

**CREATIVITY (C)**

**Table 1. Relationship between Diversity (Div) and Creativity (C)  
(Dependent Variable: Creativity C)**

Variable	RCg		RCi
	1	2g	2i
<b>Div</b>	0.43 (2.54)	0.09 (0.36)	-0.27 (-1.44)
<b>DivRCg</b>		0.41 (1.48)	
<b>DivRCi</b>			0.94 (4.91)
No. of observ.	30	30	30
Adj. R-squared	0.16	0.19	<b>0.54</b>

Note: (t-stat in parentheses)

**Table 2. Relationship between Immigration Diversity and Creativity  
(Dependent Variable: Creativity C)**

Variable	RCg		RCi
	1	2g	2i
<b>Imm</b>	0.54 (3.31)	0.34 (1.14)	-0.15 (-0.76)
<b>ImmRCg</b>		0.24 (0.79)	
<b>ImmRCi</b>			0.9 (4.49)
No of observations	29	29	29
Adj. R-squared	0.26	0.25	<b>0.57</b>

Note: (t-stat in parentheses)

**OPENNESS (O)****Table 3. Relationship between Diversity and Openness  
(Dependent variable: Openness O)**

Variable	RCg		RCi
	1	2g	2i
<b>Div</b>	0.3 (1.67)	-0.37 (-1.41)	-0.52 (-2.89)
<b>DivRCg</b>		0.83 (3.2)	
<b>DivRCi</b>			1.09 (6.05)
No of observ.	30	30	30
Adj. R-squared	0.06	0.29	<b>0.59</b>

Note: (t-stat in parentheses)

**Table 4. Relationship between Immigration Diversity and Openness  
(Dependent variable: Openness O)**

Variable	RCg		RCi
	1	2g	2i
<b>Imm</b>	0.41 (2.58)	-0.22 (-0.86)	-0.34 (-1.9)
<b>ImmRCg</b>		0.76 (2.94)	
<b>ImmRCi</b>			0.97 (5.44)
No of observ.	29	29	29
Adj. R-squared	0.17	0.35	<b>0.59</b>

Note: (t-stat in parentheses)

**INNOVATION (I)**

**Table 5. Relationship between Diversity and Innovation  
(Dependent variable: Innovation I)**

Variable	RCg		RCi
	1	2g	2i
<b>Div</b>	0.37 (2.14)	-0.19 (-0.75)	-0.43 (-2.54)
<b>DivRCg</b>		0.71 (2.69)	
<b>DivRCi</b>			1.08 (6.25)
No of observ.	30	30	30
Adj. R-squared	0.11	0.27	<b>0.62</b>

Note: (t-stat in parentheses)

**Table 6. Relationship between Immigration Diversity and Innovation  
(Dependent variable: Innovation I)**

Variable	RCg		RCi
	1	2g	2i
<b>Imm</b>	0.49 (3.0)	0.01 (0.05)	-0.27 (-1.47)
<b>ImmRCg</b>		0.57 (2.01)	
<b>ImmRCi</b>			0.98 (5.35)
No of observ.	30	30	30
Adj. R-squared	0.22	0.30	<b>0.62</b>

Note: (t-stat in parentheses)

## CONTROLLING FOR INCOME

**Table 7. Relationship between Diversity and Innovativeness controlled for Income**

(Dependent Variables: Creativity C, Openness O and Innovation I)

Variable	C	O	I
	2a	2b	2c
<b>Div</b>	-0.12 (-0.64)	-0.40 (-2.24)	-0.30 (-1.84)
<b>DivRCi</b>	0.61 (2.97)	0.84 (4.11)	0.80 (4.24)
<b>Inc</b>	0.39 (2.8)	0.30 (2.2)	0.33 (2.57)
No. of observ.	30	30	30
Adj. R-squared	<b>0.63</b>	<b>0.64</b>	<b>0.69</b>

Note: (t-stat in parentheses)

**Table 8. Relationship between Immigration and Innovativeness controlled for Income**

(Dependent Variables: Creativity C, Openness O and Innovation I)

Variable	C	O	I
	2a	2b	2c
<b>Imm</b>	-0.22 (-1.08)	-0.41 (-2.33)	-0.33 (-1.79)
<b>ImmRCi</b>	0.72 (3.10)	0.78 (3.82)	0.82 (3.83)
<b>Inc</b>	0.29 (1.41)	0.34 (1.77)	0.27 (1.43)
No. of observ.	29	29	29
Adj. R-squared	<b>0.58</b>	<b>0.63</b>	<b>0.63</b>

Note: (t-stat in parentheses)