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Culture in Economics

History, Methodological Reflections, and Contemporary Applications

Many economists now accept that informal institutions and culture play a crucial role in economic outcomes. Driven by the work of economists such as Nobel laureates Douglass North and Gary Becker, there is an important body of work that invokes cultural and institutional factors to build a more comprehensive and realistic theory of economic behavior. This book provides a comprehensive overview of research in this area, sketching the main promises and challenges faced by the field. The first part introduces and explains the various theoretical approaches to studying culture in economics, going back to Smith and Weber, and addresses the methodological issues that need to be considered when including culture in economics. The second part of the book then provides readers with a series of examples that shows how the cultural approach can be used to explain economic phenomena in four different areas: entrepreneurship, trust, international business, and comparative corporate governance.

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Prologue

"Well, culture counts. In the first two chapters, I speak about geography, which I think is terribly important. But once you get past geography and want to know why certain areas have done better than others within the same geographical context, then you have to recognize that culture counts."

(David Landes, interview in *Challenge* 1998)

"*We do have a great deal of recent research modeling specific norms and their impact set in a game-theoretical framework, but examining the overall consequences of culture for economic performance is still in its infancy.*"

(Douglass North 2005: 57)

Why a book on culture in economics?

Culture matters! If there is a one-liner summarizing the rationale for this book, it is this one. Recently many economists have turned their attention to the role of culture and have included culture in their economic theories. This interest is also reflected in books by prominent scholars who have argued that a closer study of the role of culture in economics is required. For example, Nobel Prize winner Douglass North argues that culture is fundamentally related to economic outcomes. As North puts it in his most recent book on economic change: "Our task is to explain the diverse belief systems that have evolved historically and in the present, which have very different implications for structure, organization, and economic success of societies" (North 2005: 69). A similar plea for a closer analysis of culture can be found in Greif's 2006 seminal work on institutions and economic development (Greif 2006). According to Greif, insufficient attention is paid to the fact that unobserved institutional elements, i.e. culture, can vary systematically across societies and directly influence the effectiveness

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of institutions. Two societies with the same formal rules specifying property rights will experience very different levels of investment if different beliefs about the enforcement of these rights prevail in each (Greif 2006: 20–21). Such statements by Greif and North reflect a broader consensus among many economists that culture matters and deserves scholarly attention. The fact that Tabellini's presidential lecture at the 2007 meeting of the European Economic Association was entitled "Institutions and culture" sends a clear signal to the community of economists: we need to incorporate culture in our economic framework (Tabellini 2008b). This book is an attempt to put this discussion on culture in economics into a broader perspective and sketch the added value of including culture in economics along with questions that arise when doing so.

This said, scholarly work about culture remains highly scattered and diverse. Contributions are spread thinly not only over various areas of economics but also over neighboring disciplines such as sociology, anthropology, political science and management. In this book, we have attempted to bring together these scattered contributions in a single volume. We discuss the ways in which economists have incorporated informal norms, values and culture in their work, contrasting and complementing these with perspectives from other disciplines. Assessing these contributions critically and from an historical perspective allows us to discuss our achievements thus far and also point out some of the main difficulties and challenges lying ahead of us. In doing so, we have written a book that is unique in the sense that we bring together several streams of research that would normally be found in an array of journals, conferences and workshops in economics, sociology, political science, anthropology and management.

Finally, although this book is not intended to be a classical textbook with supporting case material and assignments, we do think it is a valuable resource for economics professors teaching courses on culture and institutions as well as graduate students in economics. As we have previously taught courses on institutional economics, culture and economic behavior and international political economy, we have experienced the need for a book summarizing the culture debate and putting it into broader perspective. As far as we know, only David Weil's most recent textbook (2009) on economic growth contains a separate chapter on culture. Although he provides an informed and succinct overview of the reason why culture is important to economics,

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our ambitions go beyond arguing that culture matters. We wish to show where this interest in culture comes from and discuss the history of culture in economics to understand contemporary developments. Even more so, we wish to push the methodological and theoretical research frontier in this field. For econ-students, our book is a useful resource for evaluating the recent cultural turn in the economics discipline. By providing such an historically embedded analysis of the way economists have dealt with culture, we also aim to counter recent criticism indicating that many economists are trained as mathematicians and have forgotten the broader societal context in which economic activity takes place (*see* Paul Krugman, *The New York Times*, September 2, 2009). Because we have made great efforts to not turn a blind eye toward developments in other social sciences, social scientists from any discipline will recognize many of the themes discussed. For non-econ-students this book may, therefore, serve as a relatively simple introduction to the way culture has been included in economics.

Overall structure

The book has two main parts and a conclusion. The first part is mainly concerned with historical and methodological issues that need to be considered when including culture in economics. We structure the various approaches to "culture" by sketching the historical and methodological context in which the discussion on culture has evolved. Also, we point out some non-economic contributions to culture and economy, in so far as they seem useful to economists interested in culture. This is the task of the first part of the book, which constructs a framework from which to assess the various contemporary contributions to the field of cultural economics. The second part contains four contemporary applications.

We center the discussion in the first part on three closely related key challenges or tensions. The first relates to the fact that whereas culture deals with structures that are deemed given to the individual, economists start from a model of reality in which behavioral patterns and outcomes are retraceable to individual, purposeful decision-making. As a result, economists studying culture face a challenge of aligning cultural (exogenous) *structures* to economic *agency*. Second, we note that the concept of culture refers to properties at the *collective*, macro-level while most economic theory operates at the level of the

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individual or is derived from the micro-economic behaviour of individual agents. Hence, culture research in economics encounters a problem of realigning the collective and the individual, or more practically has to find a solution for the problems associated with the aggregation from micro to macro and vice versa. The third theme concerns the tension between economists' focus on establishing *universal* insights and principles on the one hand and the presence of a diversity in cultural logics and perceptions of reality on the other. This *context specificity* is hard to align with this basic assumption of universalistic behavior. This tension between universalistic and particularistic is related to the phenomenon of a cultural bias.

These three themes return in the second part of the book when we discuss contemporary applications of cultural economics. We have chosen to discuss entrepreneurial culture, trust, international business and comparative corporate governance for two main reasons. First, they are highly topical in the sense that they can be found on the agenda of many economists interested in culture. This is reflected in the choice of panel sessions at conferences and the popularity of these topics among Ph.D. students. Second, by limiting ourselves to these four different topics that we consider to be representative, we intend to cover the broad scope of culture studies in economics. Despite the shared focus on culture, the four topics show minimal overlapping, thereby maximizing the lessons that can be learned from these specific topics. Each of these chapters deals with different practical issues that arise when incorporating culture in economics and serves to illustrate the abstract themes discussed in the first part.

The final part of the book, Chapter 10, concludes and provides several main methodological concerns, theoretical challenges and empirical opportunities for further work on culture in economics. The book has a common denominator, but we have tried to write it in such a way that the chapters can also be read as stand-alone contributions.

Chapter overview

In the first chapter we seek to define culture. Given the variety of methodological perspectives and scholarly and disciplinary differences, it is impossible to come up with one (new) all-encompassing definition. Kroeber and Kluckhohn (1963) have already counted more than 170 definitions of culture in the literature. In reviewing the literature, we

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are, however, still able to compile a list of defining and recurring characteristics of many definitions of culture. After having established these key characteristics of a definition of culture, we describe the difference between culture and closely related concepts such as nationality, ideology, institutions and ethnicity.

In Chapter 2 we provide an historical overview of thought about culture in economics, putting the removal of culture from economic thought after the Second World War in its historical context. This history is meant to show that, in spite of the renewed interest in linking culture and economy, the way in which the two concepts have grown apart over time continues to frame the current debate about culture in economics. It is argued that the status of the debate in the 1950s should be seen not so much as a starting point of the debate about culture and economy but as the culmination of a longer development in which conceptions of culture and "the economic" had gradually evolved in opposite directions. Culture, or better, perhaps, morality, which was the more common term in early days, had been an inherent part of economic studies since the early work of Adam Smith but was, however, outsourced to sociology and anthropology in the early twentieth century.

Chapter 3 follows up on this historical overview by putting into context the recent surge in studies on culture. We do this by analyzing the specific reasons for the current inclusion of culture in the economic framework. We describe the role of failing World Bank policies, the break-up of the Soviet Union, increased data availability, the Asian Values debate, and the rise of New Institutional Economics.

Having described both the time-line of culture's inclusion, exclusion and inclusion again, and the underlying rationale for this development, we put the relation between culture and "the economy" in theoretical perspective in Chapter 4. We distinguish between three broad approaches: culture and economy, culture as economy/economy as culture, and a third, more meta, perspective focusing on the culture of economics. The first approach, labeled culture and economy for lack of anything better, conceptualizes culture as an exogenous factor. It can be included in economic models as a source of preferences, as a source of constraints or as deviations from the model. Each of these options is elaborated upon in this chapter.

Parallel to this approach whereby culture is perceived as an exogenous factor, more inclusive approaches exist as well. Some authors

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have sought to extend the economic framework to cover all social and cultural phenomena, viewing culture as economy. Gary Becker and the Chicago School are examples of this, as is the cultural materialism of anthropologist Marvin Harris. Alternatively, ethnographers and economic historicists have developed analyses in which culture is studied as an encompassing whole covering every sphere of life. In this line of work, economic behavior enters as a cultural phenomenon that is subject to cultural studies. These approaches we classify as *culture as economy/economy as culture*.

The final and more meta-analytical approach addressing the role of culture in economics concerns those who study the ideas of economists from a cultural perspective. It deals with the *culture of economics*. Whereas the first approach (culture and economy) is especially most familiar to and most popular among economists, the second and certainly the third approach are less well known. In order to provide a full sketch of the landscape of studies addressing the link between culture and "the economic," we do, however, consider it necessary to discuss these approaches as well.

Chapter 5 concludes the first part of the book. Given the landscape sketched in Chapter 4, we focus on the methodical side of the "cultural economics." We discuss the variety of (empirical) approaches that can each be associated with the theoretical streams of research as described in Chapter 4. Because of its popularity in economics, we concentrate on those approaches associated with the "culture and economy" strand. This implies that we discuss cross-cultural experimental approaches and contributions from cross-cultural psychologists who have operationalized culture by means of large-scale, cross-societal value surveys. We discuss well-known databases such as the World or European Values Survey and Hofstede's and Schwartz's work on culture dimensions. The availability of these databases yields new possibilities for empirical research.

Part II consists of four chapters dealing with topics which contemporary economists are interested in and are still working on. In the first application in Chapter 6, we discuss the role of entrepreneurial culture. Many economists, ranging from entrepreneurship and innovation economists to growth economists, have referred to such an ideal of entrepreneurial culture. Entrepreneurial culture is often the residual in economic explanations, but, beginning with the work by McClelland (1961), entrepreneurial trait research has provided a renewed impetus

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to the (empirical) study of entrepreneurial culture. As we discuss in this chapter, the discussion on entrepreneurial culture centers around the tension between structure and agency and the difficulty in translating insights from entrepreneurial trait research at the individual level to the notion of an entrepreneurial culture at the collective level.

The highly topical issue of trust is discussed in Chapter 7. Economists frequently operationalize culture in terms of generalized trust, as, for example, in Tabellini's 2007 presidential lecture at the European Economic Association referred to previously (also in Fehr's 2008 presidential lecture on trust at the same meeting (Fehr 2008) and Dixit's presidential lecture at the 2009 meeting of the *American Economic Association* (Dixit 2009)). We provide an overview of the studies using trust as an indicator of culture and discuss the strengths and weaknesses of such an interpretation of culture. We also discuss the (economic) consequences and the antecedents of societies characterized by high or low trust levels. In doing so, we show how economists struggle to trace the origin of trust and the associated problem of infinite regress. Moreover, we discuss the difficulty in coming up with a universal measure of trust because trust has been argued to be (partly) context specific.

In Chapter 8, we turn toward a more business-oriented approach, i.e. we enter the field of international business. Logically, culture has traditionally played a major role in understanding the patterns of international investment and cooperation across borders. The field of international business deals with the challenges arising from these cultural differences. More specifically, we discuss the relation between cultural differences and investment behavior of multinationals and the influence of (differences in) value patterns of managers working across borders. The tension between universal approaches and context-specific rationality is an important part of the discussion in this chapter.

The final application in Chapter 9 deals with the relatively recent literature addressing the reasons for international differences in corporate governance regimes. Contemporary studies of differences in investor protection regimes explicitly mention the role of legal origin in explaining differences in degree of investor protection. Similar to the literature on trust, studies in the field of comparative corporate governance and legal origin have embedded their explanation in the broader cultural or institutional turn in economics. We discuss the different concepts associated with this literature and draw implications

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for our broader research agenda on the inclusion of culture in economics. More specifically, we focus on the optimality of culture or, in other words, the question of whether there is one unique best culture (from an economic point of view) or whether multiple equilibria exist that perform similarly.

The book concludes with a discussion of what we have learned so far and what roads we need to follow if "cultural economics" is to make a meaningful and lasting contribution to economic thought. Given the enormous amount of work on culture, both in the past and by our contemporaries, this book is by definition a far from exhaustive overview of conceptualizations of culture and the way economists have dealt with culture. On the basis of this limited overview, we do, however, feel that (i) we provide a general insight into the various trends in cultural economic research that exist, (ii) we indicate where they are coming from and where they are heading and (iii) we highlight the important challenges and possibilities confronting research into culture in economics.

The book's message

We intend to provide an overview of the literature addressing the role of culture in economics and, at the same time, take a position in this broader debate. Our critical reflection on how culture made its way back into economics and how contemporary debates in economics are shaped by the interest in culture should not be mistaken for a negative evaluation of this literature. In fact, we are optimistic about the future development of economics. The current attention devoted to culture in economics (and context in general) is a sign of the strength and maturity of the economic discipline. Economists today are incorporating insights from other disciplines, reflecting upon their assumptions, reaching out to critics in a constructive dialog and amending their theoretical premises in order to develop more meaningful and precise insights. All this bodes very well for the future. At the same time, we are not naïve. As economics has moved beyond its traditional limits, many latent discussions buried for decades underneath a blanket of consensus over how to do proper economics have suddenly started to re-emerge. Whereas "as in most other sciences, the majority of the economists do their work with little explicit reflection on the philosophical assumptions that underlie their research" (Hodgson 2007:

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211), the inclusion of culture in economics forces us to (re)think some of these pillars. It puts old questions, such as those about structure and agency, collectivism and individualism, and universalism versus particularism, back on the agenda while also triggering a couple of new ones. Up until now, unfortunately, contributions to the debate about culture in economics have, generally speaking, not taken up these challenges very well. The deeper methodological and theoretical implications of incorporating culture in economic thought have not generally been acknowledged, let alone adequately responded to. The immediate danger is that, as a result, the discussion about culture in economics will not be able to move beyond the level of platitudes such as "culture matters" and push economic theory forward in a meaningful way. In this case, people are likely to lose their interest in the issue sooner or later and write off the newly re-emerged field as a theoretical dead-end. Such a fate is avoidable and should be avoided. Beyond the conceptual and methodological difficulties lies a potentially blossoming field of inquiry. In order to reach that point, this book seeks to dissect the current debate and expose those challenges that have to be addressed in order for the new cultural economics to flourish.

Acknowledgments

Parts of this book have been presented at numerous places and we are grateful for all the comments we have received over the last couple of years. We thank the Netherlands Organization for Scientific Research (NWO) and the Royal Dutch Academy of Sciences (KNAW) for providing funds that have given us both the opportunity to concentrate on writing this book. We also thank our colleagues at Nijmegen University and the University of Groningen. Extensive discussions over lunch with André van Hoorn, Floris Heukelom, Eelke de Jong, Jan Peil, Harry Garretsen, Roger Smeets, Remco Zwinkels, Bart Frijns and Albert de Vaal have definitely contributed to the quality of the book. We also thank Arjen Slangen of the University of Amsterdam for sharing his useful and critical insights on the role of culture in international business. Of the many people at various conferences with whom we have discussed the contents of this book, we would like to specifically thank the organizers and attendants of the workshop on culture and economy at the EAEPE Conference in Bremen, 2006. Of course, any errors are ours, and interpretations of general developments in the field

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are even more ours, but the opportunity to use you as sparring partners is greatly appreciated.

Although it has already been some years, the working group on European Values at Tilburg University was probably the first group to exhibit the ambition to write a book like this. We are still grateful for the discussions with the members of that pioneering group, consisting of sociologists, management scholars, political scientists and economists. More specifically, we would like to thank Wil Arts, Paul Dekker, Loek Halman, Sjak Smulders, Jaques Hagenaars, Lans Bovenberg, Niels Noorderhaven and Wim van der Donk. We have all gone our separate ways, but the seed for this initiative was planted in those meetings in 2002 and 2003.

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Final remark

The title of the book reflects our ambition to discuss the role of culture in economics and the way in which scholars have attempted to (re-)align the premise of economic rationality with the foundations of social behavior. The title is deliberately chosen. We do not wish to suggest that we provide *the* framework on culture and economic behavior, nor do we describe the foundations of a new field called cultural economics. However, for reasons of readability, we will occasionally refer to the broader field of studies on culture in economics as "cultural economics."

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