



Cultural dimensions, collective values and their importance for institutions



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ABSTRACT

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This paper critically assesses the role of culture in determining the quality of institutions. Employing various measures of cultural differences, I find that only differences related to the degree of individualism in society and the extent to which inequality in the distribution of power is tolerated are strong and statistically significant predictors of the observed differences in institutional quality. This finding is robust to the inclusion of various other determinants of institutional differences across countries discussed in the literature and it holds for a variety of measures of institutional quality. Moreover, the strong link between these two cultural dimensions and the quality of institutions is also confirmed in instrumental variables regressions where a novel instruments for culture based on a weighted average of the cultural attitudes present in neighboring countries is employed. *Journal of Comparative Economics* 41 (2)(2013) 447–467. Carleton University, 1125 Colonel By Drive, Ottawa, ON, Canada K1S 5B6. © 2012 Association for Comparative Economic Studies Published by Elsevier Inc. All rights reserved.

1. Introduction

Within the broader social science literature on the determinants of economic development both the cultural background of different societies and the quality of their institutions have attracted substantial attention.¹ Yet, when thinking about the process of long-run economic development it is hard to think of a country's culture, reflected in its shared values and beliefs, as something distinct from its institutions, namely the formal rules that regulate human interaction.² This is because, as [Williamson, 2000](#) indicates, cultural norms impose constraints on the development of more formal institutions, or, as [Roland, 2004](#) argues, the slow-moving nature of culture limits the possibilities of radical institutional change.

Such observations have triggered a growing empirical literature attempting to assess whether and to what extent cultural norms influence institutional development, which has produced important positive results.³ Yet, one of the questions that the existing literature has to this point not systematically addressed is which particular aspects of a country's or nation's culture matter most for the development of its institutions. This question is both natural and important, given the apparent multidimensionality of culture with its complex values system, and it will be the focus of the present paper.

To address this question, in what follows, I will consider an extensive set of measures of cultural differences across countries and investigate the extent to which they are able to explain the corresponding differences in the quality of institutions.

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¹ Cultural theories of economic development go back to [Weber, 1905](#) and have been revived, among others, by [Landes, 1998](#) and [Clark, 2007](#). The role of institutions has, for example, been emphasized by [North, 1990](#) and [Acemoglu et al., 2005](#).

² See, for example, the seminal work of [Almond and Verba, 1963](#) in this context.

³ Prominent contributions in this strand of literature include [La Porta et al., 1997](#), [La Porta et al., 1999](#), [Licht et al., 2007](#), and [Tabellini, 2008](#).

This approach differs from the ones followed in existing studies that have sought to investigate the link between culture and institutions in the following important respect. Existing studies, as I further explain below, have either focused on the predictive power of one particular measure of cultural differences or on just a small subset of such measures. Hence, the results of existing studies may point to the importance of culture for institutional development, but they say little about the relative importance of different dimensions of culture.

To assess this latter point, in the context of the present paper, I will thoroughly investigate the extent to which a country's level of institutional quality – measured in various ways – can be accounted for by different dimensions of its culture. These include the religious composition of the population, the prevalence of particular cultural attitudes – such as the level of trust and generalized morality, which the existing literature has underscored as important determinants of economic outcomes⁴ – several composite indices of cultural values from the World Values Survey, as well as, various fundamental cultural dimensions from the cross-cultural psychology literature, namely those of Hofstede, 1980 and Schwartz, 1994.

Furthermore, to carefully assess the strength of the relationship between institutions and culture, at all stages of my empirical investigation I will be controlling for the effect of other important determinants of a country's institutional framework, such as its level of economic development, the origin of its legal system, or its ethno-linguistic background. Particularly, in my analysis I will be carefully taking into account the early institutional history of each country, given the apparent persistence of various institutional arrangements.⁵ This is an important novelty over existing empirical studies on this topic, which have paid little attention to this persistent channel.

Finally, in order to eliminate potential endogeneity biases that could affect the estimated relationship between culture and institutions and render statistical inference invalid, I will also be documenting results from instrumental variables regressions based on a novel instrument for cultural differences. Specifically, in line with the idea of continuity of culture across national borders, I will be employing an appropriately weighted average of the cultural values in the neighboring countries as an instrument for the cultural values of a given country. This instrumentation strategy – the validity of which will be assessed through overidentifying restrictions tests – has the attractive feature that it is not restricted to the context of the present paper, but it can also be applied in other empirical exercises that aim at identifying the effect of culture on economic outcomes.

The results of the present analysis indicate that cultural values associated with the degree of individualism in society and the acceptable degree of inequality in the distribution of power are the sole important cultural determinants of a society's quality of institutions. Specifically, a one standard deviation change in these two cultural dimensions is shown to be associated with a change in institutional quality by 35% of a standard deviation. This effect is robust to the inclusion of various control variables, holds for various indicators of institutional quality and also survives in instrumental variables regressions, while the effects of other dimensions of culture were found to be substantially smaller and not robust.

This finding from the present cross-country investigation confirms those of Greif, 1994 whose historical analysis of Medieval trader networks suggests that different cultural beliefs regarding the relationship between the individual and the group and regarding society's optimal distribution of power present in Muslim and Latin Medieval societies led to very different forms of societal organization and distinct trajectories of institutional development. It is also in line with Banfield, 1958 explanation of the malfunctioning of institutions in Southern Italy, which he associates with its collectivistic culture, but less in line with Putnam et al., 1993 who highlight the role of social capital for the functioning of institutions. In addition, the results parallel those of Gorodnichenko and Roland, 2011, who demonstrate that among a variety of cultural variables the degree of individualism in a society is the most important determinant of long-run economic development.

The rest of the paper is organized as follows. Section 2 describes the empirical strategy and the employed data. Section 3.1 presents the baseline regression results, while Section 3.2 shows the results from a battery of robustness tests. Section 4 concludes the analysis with a few additional remarks.

2. Data and measurement

The typical approach through which the literature seeks to assess the role played by a country's cultural orientation on the quality of its institutions is by estimating a specification of the form,

$$Institutions_i = \alpha + \beta Culture_i + \delta X_i + \varepsilon_i,$$

where the index i indicates the country and X_i is a vector of control variables. This approach has, for example, been followed by La Porta et al., 1999, La Porta et al., 1997 who have shown that the religious orientation of societies and its overall level of trust are correlated with the quality of its institutions. Likewise, it has been used by Tabellini, 2008, who has provided evidence relating the quality of institutions with the degree of generalized morality in society, and by Licht et al., 2007, who have documented that the quality of governance is higher in societies that place greater emphasis on the autonomy of individuals.

Here I will be following a similar approach, but with the important difference being that I will be considering an extensive set of measures of cultural differences and various indicators of institutional quality as dependent variables, while taking

⁴ Trust has, for example been shown to be linked with economic growth (Tabellini and Guido, 2010; Knack and Keefer, 1997; Algan and Cahuc, 2010), financial development (Guiso et al., 2004), trade (Guiso et al., 2009) as well as to institutions (La Porta et al., 1999; Tabellini, 2008). Similarly, religious adherence has been linked to economic growth (Barro and McCleary, 2003; Guiso et al., 2003) and institutions (La Porta et al., 1997).

⁵ See Greif (2006, chapter 7) for a discussion of the persistence of institutions and the "long shadows of history."

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