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Economic Culture and Economic Performance[*]

KEY MESSAGES

- This paper explores the effects of several cultural values, attitudes, and the like, on some of the main dimensions of economic performance
- It shows a weak correlation between continental countries' relative endowment of some cultural attributes and the relative performance of their national economies
- However, not all of the cultural attributes hypothesized to be important were found to matter for performance
- And not all continental countries were under-endowed in some of the cultural attributes that mattered a lot

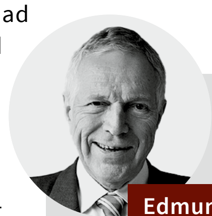
INTRODUCTION

Enlightenment thinkers, from Smith and Hume on to Kant and de Tocqueville, all took it for granted that a society's culture – the people's values, attitudes, morals, and beliefs, many of them learned at their mother's knee – mattered for the effectiveness of business life and, more broadly, for the realization of the society's potential. The Enlightenment is often caricatured as the doctrine that a society eschewing superstition and taboos and embracing reason and individual opportunity will with time attain perfection of its possibilities. Notwithstanding various dissenters, including Marx, who took culture to be a function of the economy's structure rather than the reverse, the Enlightenment view on the influence of a nation's culture remained prevalent right through the "Protestant ethic" in Weber (1905) and the "entrepreneurial spirit" in Schumpeter (1911).

By the middle of the twentieth century, moral relativism had taken over. Most anthropologists and many other social scientists were disinclined to evaluate contrasting national cultures, seemingly believing that every nation finds its way to the culture that is best for it. Hence a society's culture might have a downside in its ill effects on its economy, yet the cost would be compensated by benefits in other directions. Nevertheless, a push back against such relativism soon began. Ruth Benedict wrote that some cultures may be better or worse than others. Several works reestablished culture as a causal force that makes markets work better: Banfield on trust (1958), Titmuss on gifts (1970), the Russell Sage conference on altruism (Phelps 1973), and Putnam on civic virtue (1993).

The debate over economic performance in continental Europe may prove to be a testing ground for the view that culture matters – some elements of it at any rate – for a society's results. As is increasingly admitted, the performance characteristics – one might say the specifications – of the national economy in nearly every continental country are poor compared to most performance characteristics in the United States and a few other comparators. However, the crucial point is not that the Continent's economic systems are inferior to those of some comparators, but rather the nagging sense of falling short – of structural underperformance. In my view, the continental economies had started to be underperformers in the interwar period and remained so, with corrective steps here and further missteps there, from the postwar decades onward. The structural shortfall was masked during the "glorious years," when rapid growth and high employment was stimulated by the low-hanging fruit of unexploited technologies used overseas and further powered by Europeans' efforts to claw back the wealth they had lost in the war years.

Many analyses, looking beyond market forces (e. g., the rather important influence of demographic prospects), attribute the Continent's tendency toward relatively low labor-market participation, if not the lower productivity, to the Continent's social model. Yet this explanation has not had entirely clear sailing. One could as easily bring up the political model. The Continent's historic struggle between left and right may create uncertainty for those investing or innovating on the Continent. The rule of law, or procedural justice, has received much attention from Adam Smith to Douglass North. But the nations on the Continent are not a bunch of banana republics. It is not clear that they are behind



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their comparators in constitutional protections, property rights, antitrust, law enforcement, and judiciary independence.

My thesis for several years has been that it is the economic model that largely accounts for the Continent's inability to match the economic performance of the United States and in some respects that of other comparators. But what is the "economic" model – in other words, what is the "economy"? At first, like others, I meant the economic system, namely the system of economic institutions in the capital, labor, and product markets. In arguing my thesis, I pointed to the strength on the Continent of institutions understood to be bad, such as employment protection legislation and bureaucratic "red tape," and to the weakness of institutions understood to be good, such as a well-functioning stock market and ample liberal arts education.

Why might countries go on with "inefficient" institutions? It may be that countries have differing institutions because they have different economic cultures, causing them to prefer different systems of institutions. Then a country's economic institutions are proxies, to some unknown extent, for the prevailing culture. In that case, the prevailing set of institutions might not be alterable as long as the culture is unchanged.

Of course, any program to explain inter-country differences by appeal to differences in cultural influences would be incomprehensible from the standpoint of neoclassical or neo-neoclassical theory. The Arrow-Debreu equations have no cultural elements – and no economic institutions either, other than private ownership. It follows that a rationale for cultural effects must go outside the neoclassical paradigm to recognize entrepreneurship, management, engaging jobs, learning and personal growth, and team players – thus Knightian uncertainty and creativity as well as imperfect information.

CULTURAL INFLUENCES ON PERFORMANCE – A CONCEPTUAL FRAME

If we are to obtain empirical estimates of the performance effects of national cultural attributes that have any claim to reliability and interpretability, we had better base our investigation on some conceptual framework, however informally formulated it may be – rather than try whatever off-the-shelf variables are at hand. This appears to require some notion of what a system of economic institutions and economic culture is in view of economic change and particularly the processes of innovation, their benefits and drawbacks, and their consequences for the main indicators, economic growth and prosperity. The neoclassical framework, with its premise of perfect knowledge and perfect coordination, is too narrow for much understanding of underperformance and the possible role that institutions and culture may play in it; so we want to go beyond neoclassical economics.

Contrary to myth, what we commonly call the West is not polar with respect to the character of its economies, with the so-called Anglo-Saxon economies all operating on the system called capitalism, with or without an accompanying welfare state, and all the continental economies operating on the system called corporatist, social market, or Rhenish. Denmark's economy is thought to be different in some way, and Italy's is surely more industrious than most of the Anglo-Saxon economies. The Nordic nations, from Finland to Iceland, do not fit neatly into either category. Nevertheless, there is some utility in considering two extremes – two ideal types – each of which resonates somewhat with one or more actual economies in the West.

At one extreme we have a private-ownership system structured for cutting-edge innovation. It is fertile in coming up with innovative ideas with prospects of profitability; shrewd and adept in selecting among these ideas for development; finally, prepared, and venturesome in evaluating and trying the new products and methods that are brought out. A semiclassical theory of innovation began with Schumpeter (1911). Saving is allocated to developing entrepreneurs' proposed "innovations" only to the extent that there are businesspeople around with the initiative to "seize the moment" and the leadership to "get it done." The modern theory of such dynamism – and the case for adopting such a system – began in the mid-1930s with Hayek (1948). First, virtually every employee down to the humblest worker has arcane "know-how," some of it what Michael Polanyi called "personal knowledge," and out of that know-how a new idea may come that few others, if any, would have. With openness to commercial ideas and acceptance of the entrepreneurs who develop them, a plethora of new ideas may be generated. Second, the pluralism of experience and knowledge that the financiers bring to bear in their decisions gives a wide range of entrepreneurial ideas a chance of an informed, insightful evaluation. And, importantly, the financier and the entrepreneur do not need the approval of the state or of social partners. Nor are they accountable later on to such a social body if the project goes badly, not even to the financier's investors. So projects can be undertaken that would be too opaque and uncertain for the state or social partners to endorse. Third, the pluralism of knowledge and experience that managers and consumers bring to bear in deciding which innovations to try and which of those to adopt is crucial in encouraging entrepreneurs to conceive new ideas and financiers to back them.

At the other extreme we have a private-ownership system that has been profoundly modified by the introduction of additional institutions. These include the massive components of the corporatist system of interwar Italy – big employer confederations, big unions, and big banks. The system operates to discourage or bar many entrepreneurial projects, particularly start-ups. For its "innovations" – most of them not world class, not "cutting edge," but rather adaptations of products and methods recently introduced abroad – the system depends more on established companies in cooperation with local and national banks. For what it lacks in entrepreneurship it tries to compensate with technological sophistication and increased coordination. Where the former system allows any number of versions of a new product or method to be developed and launched, this latter system convenes experts to set a product standard before any version is launched. To what end is this system? What is the theory behind it? First, there is the solidarist aim of protecting the "social partners" – communities and regions, business owners, organized labor, and the professions – from disruptive market forces; also the consensualist aim of blocking business initiatives that lack the consent of the "stakeholders" – those with a stake besides the owners, such as employees, customers, and rival companies. Second, elevating community, society, and being over individual engagement and personal growth appeals to anti-materialist and egalitarian strains in Western culture. Third, there is the "scientism" that holds that such a system can be more dynamic than the former system – maybe not more fertile in little ideas, such as might come to petit bourgeois entrepreneurs, but certainly in big ideas. Not having to fear fluid market conditions, an entrenched firm can afford to develop expensive innovations based on current or developable technologies. And with confederations of firms and state mediation available, such firms could arrange to avoid costly duplication of their investments. The state, for its part, could promote technological advances in cooperation with industry by harnessing the society's collective knowledge. The state could indicate new economic directions and favor some investments over others through its instrument, the big banks.

The impetus for this paper has been the intuition that several countries on the Continent – among them Germany, Italy, and France – had and still have a culture that led them to evolve and retain systems of institutions that (in most or all respects) are much closer to the latter extreme than are the systems that the culture of the United States, the United Kingdom, and Canada led them to evolve and retain. It may be that, with their culture attitudes, the former system was abhorrent to them. Or it may be that they thought that their culture would ill equip them to do well with the former system. Or, conceivably, their culture might predispose them against dynamist behavior whatever system they adopted.

CULTURAL INFLUENCES – SOME STATISTICAL TESTS

What are the presumably pertinent cultural values, attitudes, ethics, and beliefs in each economically advanced country in the OECD? And do the inter-country differences among them appear to play a role in causing inter-country differences in economic performance? The cultural data in this paper are limited to those calculated from underlying data (on the individual respondents' answers) contained in World Values Surveys, which, though providing a wealth of data, is not nearly as wide-ranging as we would like.

At first, I found myself defining four dimensions of culture and looking for Survey questions that would serve to characterize each country's culture in every one of the four dimensions.

One dimension has, as I would put it, Stimulation/Engagement/Mastery/Development at one end and at the other, Being/Identity. One national indicator calculable from the underlying Survey data that belongs more clearly in this dimension than in the other dimensions gets at the centrality of jobholding in the culture of the country. This indicator, labeled Importance, measures the response to the question "Is your job the most important thing in your life?". Other national indicators that clearly belonged in this dimension are calculated from responses to questions asking respondents what they look for in a job. One of these indicators, Involvement, measures the respondents' reported pride in their work. A second, Interestingness, measures the preference for an interesting job. A third, Achievement, measures the preference to "achieve something."

The second dimension has at one end Loyalty/Dutifulness/Altruism and at the other end Practicality/Opportunism/Egoism. The sole indicator from the Surveys that appears to belong in this dimension is Willingness to Follow Orders.

The third dimension has at one end Individualism/Pluralism/Tolerance and at the other Solidarity/Conformity/Unanimitarianism/Envy. Here there is an indicator, Acceptance of Competition, calculated from responses to a question of whether the respondent is positive or negative about competition.

The fourth dimension has at one end Initiative/Venturesomeness/Experimentalism and at the other end Passivity/Tradition. Culture indicators in the Surveys that fit here are Desire for Freedom to Make Decisions and thus possibly, freedom to lead – henceforth, Freedom in Decisions, Preference for New Ideas over Old Ideas, Self-confidence, Acceptance of Changes, and Initiative at Work.

We now regress our selected cultural variables on five standard economic indicators: male labor force participation, the employment rate, employment in percent of the labor force, and two measures of labor productivity. Our key findings are the following.[1]

Male Participation Rate

Acceptance of New Ideas, Acceptance of Competition, Importance of Work, and Interestingness of Work are

[1] For details, see Tables 15.1–15.5 in Phelps (2011).

all significant in a GLS regression that controls for "traditional" explanatory variables such as the tax rate. It is also striking that that the degree of explanation of the cultural variables is higher than the explanation provided by the "traditional" explanatory variables.

Economic Activity Rate

Here again, the cultural variables outperform the traditional variables. In a GLS regression model that includes both cultural and traditional variables, especially Acceptance of Change performs well.

Employment Relative to Labor Force

In particular, Initiative at Work and Importance of Work are highly significant with large coefficients.

Labor Productivity

The performance of the cultural variables is generally excellent in explaining labor productivity. A highly interesting result of the analysis there is that neither the cultural group nor the traditional group performs well by itself. Yet when married, the performance of both groups improves – especially that of the cultural variables. Initiative at Work, Willingness to Follow, Freedom in Decisions, Involvement in Work, and Acceptance of Competition are all highly significant with large, positive coefficients.

Productivity Level as a Ratio to the US Level

A potential drawback of the preceding productivity regressions is that that they do not take into account a possible catch-up process going on in which economies are tending to close or narrow the gap between themselves and the productive leader. To allow for this possible effect and to directly evaluate the potential forces leading to the gap, we ran regressions in which the dependent variable is the ratio of a country's productivity level to the level of the leading economy, here that of the United States.

Here, the culture variables appear to perform at least as well as the traditional explanatory variables. In particular, Initiative at Work, Willingness to Follow Orders, Freedom in Decisions, and Acceptance of Competition are highly significant and have the theoretically predicted positive sign.

WHAT ARE THE IMPLICATIONS FOR THE CONTINENTAL NATIONS?

We may reasonably infer from the detailed empirical results here that some particular cultural attributes, namely those with significantly positive regression coefficients, really do matter for economic performance in one or more respects. They are key attributes a deficiency of which in a country would operate to pull down its economic performance in the affected dimensions. If the nations on the Continent are deficient in some or all of the key (and not super-endowed where they are not deficient), that would help explain the widespread perception that the continental economies as structured now are "underperformers." Is the Continent predominantly deficient in these key cultural attributes?

The brief examination that follows is confined to comparing the cultural scores of the Big Three on the Continent with the usual comparators, the US, the UK, and Canada. And the comparison is limited to a few cultural variables. Two culture variables have scored pretty well. Importance of Work, which is so important for participation and unemployment, and Involvement (or Pride) in One's Work, which is important for productivity. In these respects, many of us think of the Europeans as painstaking craftspeople, the Americans as more practical, so we would not be surprised if the Continent's average scores on these two variables were comparable or better than those of the comparators. In fact, according to our survey data, the nationals on the Continent are deficient on these two scores. The data set shows that with respect to Importance of Work, the Americans' score of 0.17 tops Germany's 0.11, Canada's 0.11 tops Italy's 0.08, and Britain's 0.07 tops France's 0.04. With respect to Involvement, America's 2.87 tops Italy's 2.03, Britain's 2.80 tops Germany's 1.79, and Canada's 2.70 tops France's 1.74.

This echoes de Tocqueville's contrast in 1835 between the "tumultuous and boisterous gaiety" in aristocratic societies such as French society and the democratic Americans, who "prefer those more serious and silent amusements which are like business" (de Tocqueville 1835).

Also powerful was another pair of cultural variables, Willingness to Follow Instructions and Freedom in Decisions. The former delivered spectacularly: it raises productivity and even lowers the unemployment rate. On this score, the continentals score decisively below their comparators: America scores 1.47, Canada 1.34, and Britain 1.32; France scores 1.19, Germany 1.13, and Italy 1.04. With respect to the latter, the US scores 0.61, Canada 0.65, and the UK 0.43. Germany has 0.57, France 0.57, and Italy 0.54. The aggregates are about equal, though the Continent loses the competition 2 matches to 1.

Acceptance of Competition appears to have a powerful effect on productivity, as hypothesized, and even on participation and thus, given the unemployment rate, employment. Here the US scores 1.11, Canada 1.01, and the UK 0.57. Germany scores 1.21, thus topping the US, while France has 0.68 and Italy 0.49.

The preference for jobs offering Initiative at Work was also a significant cultural attribute in the productivity estimations and, fitfully, in the participation estimation. On this culture attribute, the Continent's

Big Three is not dominated by the three comparators. Germany scores 0.59, beating Canada's 0.55. Yet America's 0.52 beats Italy's 0.47, and Britain's 0.45 beats France's 0.38. Also, the Big Three's aggregate score is lower than that of its comparators.

CONCLUSIONS AND POLICY IMPLICATIONS

The basic point to carry away, obviously, is that the empirical results lend support to the Enlightenment theme that a nation's culture ultimately makes a difference for the nation's economic performance in all its aspects – activity as well as productivity.

Thus, a country's initiation of a program to reform the institutional machinery with the aim of achieving a major improvement of economic performance – though a much-needed step – would, if undertaken alone, very likely succeed only to a degree and thus cause considerable disappointment. A transformation of the economy to one of dynamism, with the teamwork to implement it and to adapt well to it, can be obtained only if the economic culture and possibly other "background conditions" are conducive, not just the institutional machinery.

An aspect of the results that are of particular interest to me is that every one of the cultural "dimensions" had at least one cultural variable representing it that performed significantly in at least one of the regressions. In the first dimension, Stimulation/Engagement/Development, the (proportionate) number reporting that their job is most important in their lives is significant both in raising male participation and (to a lesser extent) raising employment. In the same dimension, the pride taken in one's work is more mildly labor force raising and more powerfully unemployment lowering. This Pride/Involvement in Work is seen as raising productivity as well.

In the second dimension, Loyalty/Dutifulness/Altruism, the willingness to take a job that requires following instructions was the sole variable entering the regressions. It delivered spectacularly in combination with the Freedom variable.

In the third dimension, Individualism/Pluralism/Tolerance, it appears that Acceptance of Competition had powerful effects on productivity, as hypothesized, and even on participation, possibly through circuitous channels.

Here the continental Big Three makes it a contest but as a group still loses badly to the comparators as a group. On Acceptance of Competition, the US scores 1.11, Canada 1.01, and the UK 0.57. Germany scores 1.21, thus topping the US, while France has 0.68 and Italy 0.49.

In the last dimension, Initiative/Venturesomeness/Experimentalism, two cultural attributes had considerable explanatory power. The preference for Initiative at Work was extremely significant in the productivity equations. It was significant also for the unemployment rate, boosting employment without boosting participation. The desire for Freedom in Decisions, also dubbed here the Willingness to Assume Responsibility, perhaps to lead, was highly significant in the productivity equations.

I would comment that in my previous work I had organized my thinking around the intellectual currents of reaction on the Continent to the Enlightenment and to capitalism in the nineteenth century: the solidarism, consensus, anti-commercialism, and equalitarianism. It would be understandable if such a climate had a dispiriting effect on potential entrepreneurs. But to be candid, I had not imagined that Continental Man might feel less entrepreneurial. It did not occur to me that Continental Man lacked an "entrepreneurial spirit," or intellectual curiosity, or creativity. After all, this is a region that I treasured for the creativity of its Beethoven, Wagner and Picasso. In the early twentieth century, Schumpeter was writing about the entrepreneurial spirit of the Austrians and Weber that of the Germans! Apparently, the Europeans' creativity, once unmatched and perhaps so still, does not translate to business.

Do the data then reflect "two cultures," as argued by Bourguinon (2006)? Or are the inter-country differences here purely random disturbances around the same all-West means? In fact, variances are so low, owing to the large sample sizes, that the differences in scores between the Big Three and their comparators are statistically significant at stringent confidence levels. Such comparisons could easily be misunderstood, however. What is the meaning of the higher score in Germany? Perhaps it only means that the Germans, far more than the Americans, are deprived of opportunities for initiative. They have a craving for additional initiative as a result – far more than the Americans do; thus, initiative is on the mind of the Germans. If so, the Germans' greater interest in those rewards of work does not imply that at the same level of opportunity they would value more initiative than the Americans.

In short, the "value" expressed by the Surveys respondents are apt to be biased by their current conditions: in countries where there is deprivation of supply relative to the mean in the sample, the value attached to more is thereby increased, and as a possible result, respondents place more weight on that value; symmetrically, where there is abundance relative to the mean, there is downward bias. That suggests that the true inter-country differences in reported values, insofar as what is being reported is the value of more, are apt to be much greater than the measured differences.

To sum up this exploration of culture effects on the Continent: there is a loose correspondence between the continental countries' relative endowment of some cultural attributes and the relative performance of their national economies in some, if not all, respects – though it is not yet clear how much of such effects are indirect through the culture's impact on the nation's selection of economic institutions and how much of such effects are direct. Yet not all of the cultural attributes hypothesized to be important were found to matter for performance. And not all continental countries were under-endowed (some were well-endowed) in some of the cultural attributes that matter a lot.

Two caveats: that continental countries tend to differ from comparators with regard to some cultural attributes – the Continent is "different" – does not compel us to agree with the opinion that the continental Europeans have chosen economic institutions that are different yet "optimal" for them, given those values. The values expressed by the continental Europeans do not contrast with those in comparator economies so radically as to suggest that the Continent would reject institutional changes demonstrated to deliver greater innovation and, as a result, higher productivity and a more rewarding workplace – notwithstanding some decrease in job security. The theme that big, even radical, innovations must come from the entry of start-ups (e. g., Schumpeter 1911; Arrow 1962; Bhide 2000) and also, I think, the theme that the Continent's corporatist institutions are inimical to dynamism in all companies, both new and established (Phelps and Zoega 2004), continue to be plausible guides to needed institutional reform on the Continent.

We need not agree either that the continental Europeans have adopted the right values – right for them. It would be appropriate and possibly therapeutic if citizens in nations with unsatisfactory economic performance would compare their attitudes with those in other nations and ask whether they would not benefit from changing some of those values. That may be a long road. To embark on modifications of the economic culture and the economic institutions to implement them would be a voyage of discovery – one having parallels with the "discovery procedure" that is the essence of capitalism.

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