

CULTURE AND ECONOMIC PERFORMANCE*

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Abstract

Culture, defined as shared values and beliefs, can influence the performance of an economy in many ways. The culture of a group, whether national, regional or ethnic, may be regarded as a particular type of intangible public good. The chapter summarizes and critiques a positive theory of inter-cultural competition. According to this theory, culture is created by leaders, who specialize in the production of culture, and is shared by their followers. Leaders compete for followers in order to increase the rents that they can extract from their groups. Whilst some of these rents may be pecuniary, most are non-pecuniary, such as the enjoyment of pursuing a public project which glorifies the leader and their group. There are four main dimensions of culture which influence performance, and there are trade-offs between them which are governed by the environment of the social group. The positive theory is useful in interpreting historical evidence on the rise and decline of societies, institutions, and organizations of various kinds.

Keywords

culture, institution, leader, transaction cost

JEL classification: H8, D7, P5

1. Introduction

It is popularly believed that culture has a significant effect on economic performance [Buruna (1999)]. Whilst some economic historians are sympathetic to this hypothesis [Landes (1998)], most economists are skeptical. They question the intellectual rigor of the underlying theory, and the objectivity of the evidence. In *The Wealth of Nations*, Adam Smith downgraded cultural factors from the prominent position they had occupied in his previous work, and subsequent economists have largely followed his lead [Macfie (1967)]. Recently, however, theoretical interest in the economics of culture has revived [Olson (2000)]. This chapter reviews attempts to bring greater rigor to the subject. It is argued that models of rational action, on which conventional neoclassical economics is based, can be extended to allow for cultural influences. Such models suggest that certain cultures promote economic performance better than others.

Culture may be regarded as an economic asset – a form of cultural capital. It is an intangible public good, shared by the members of a social group. The analysis below identifies four major dimensions of culture which influence the performance of a group:

- individualism versus collectivism,
- pragmatism versus proceduralism,
- the degree of trust, and
- the level of tension.

Individualism emphasizes personal autonomy, and echoes the former UK Prime Minister Mrs. Thatcher's dictum that 'there is no such thing as society', whilst collectivism asserts that it is natural for people to be socially embedded in a larger group. Pragmatism favors improvisation and flair in taking decisions, whilst proceduralism emphasizes reliance on rules. High trust reflects a belief that other people are honest and hard-working, whether they are supervised or not, whilst low-trust reflects a belief that people will take every profitable opportunity to shirk and cheat. The level of tension reflects the level of achievement to which people aspire, and their determination to succeed.

The analysis distinguishes between economic performance in a material sense, and overall quality of life. Quality of life depends on emotional as well as material rewards. Culture is not merely instrumental in the pursuit of material rewards, but is a direct source of emotional rewards as well. Boosting emotional rewards can also boost material rewards – as in highly-motivated teams – but there are trade-offs too: for example, a religion that encourages prayer and fasting may reduce material performance even though it improves quality of life. Bias in the measurement of the material living standards adds a further complication. A market economy may appear to out-perform a non-market economy in material terms simply because a higher proportion of its output is recorded in the national income statistics.

It is relatively easy to show that culture can have a positive effect on quality of life. Quality of life depends heavily on the provision of intangible public goods such as visual amenity, safety on the streets, and so on. Culture is not only a public good itself, but is instrumental in creating popular support for investment in other public goods. It is more challenging, however, to show that culture can improve the material output

of private goods, and it is this challenge that is therefore the focus of attention in this chapter. Furthermore, since material performance is easier to measure than quality of life, hypotheses linking culture to material performance are in principle easier to test.

Modern neoclassical economics implicitly endorses a Western culture of 'competitive individualism', which is individualistic and low trust. The collapse of Soviet communism and the 'triumph of the market' was widely interpreted as demonstrating the advantages of an individualistic culture over a collectivist culture. However it said nothing about the advantages or disadvantages of high trust. Until the 1970s, the justification for markets was seen mainly in their ability to adjust to incremental change. Globalization, however, precipitated major changes, and led to the growth of 'enterprise culture', which emphasized the value of pragmatic improvisation over routine procedure when taking key decisions. At the same time, Soviet communism remained wedded to procedural decision-making. Thus Western capitalism was not only individualistic but pragmatic, whilst Soviet communism was both collective and procedural. It is therefore unclear whether the superiority of individualism over collectivism, or pragmatism over proceduralism, was mainly responsible for the revealed superiority of the West.

The success of many newly industrializing countries in pursuing state-led export programs suggests that where government has been pragmatic rather than procedural it has sometimes been able to achieve remarkable results. It may therefore be that excessive reliance on procedure, rather than collectivism *per se*, caused the collapse of communism.

Western capitalism and Soviet communism were both high-tension cultures, whilst developing countries, on the whole, exhibit low-tension cultures. In the third world, high-trust culture seems to perform better than low-trust culture [Sherman (1997)]. Combining the lessons from these various comparisons therefore suggests that the most promising culture is individualistic, pragmatic, high-trust and high-tension. This is entrepreneurial associationism – a culture which encourages people to freely commit themselves to ambitious pragmatic team-based projects. It differs from competitive individualism in having a high level of trust. No country has been able to sustain associationism for very long, however, and so competitive individualism has emerged as a 'second best' solution.

High tension stimulates competition, which tends to undermine trust. It is sometimes suggested that trust arises naturally, through repeated interaction, but it remains the case that selfish individuals have a strong incentive to cheat in the final play of any 'repeated game'. If trust is to prevail generally, it cannot be regarded as natural, but must be engineered [Casson (1991)]. This is achieved by moral leadership, as explained below. From this perspective, lack of trust reflects a scarcity of leadership – indeed, there are grounds for believing that there is a systematic shortage of suitable leaders in most countries. An unfortunate legacy of inter-war Fascism is that the very concept of moral leadership has fallen into disrepute. This has discouraged the systematic production of moral leaders through education. Families and local communities have under-invested in the supply of leaders for future generations. Furthermore, it is argued below that the growth of mass media has distorted competition between potential leaders to favor those who appeal to

narrow self-interest. It is suggested that ineffective moral leadership has impaired the performance of Western economies over the last twenty years. Individualism and high-tension have been pursued to the point where they undermine trust, creating a consumer society marred by crime and anti-social behavior. Undermining trust has raised the costs of coordination, eroded material performance, and caused serious detriment to quality of life.

If this economic theory of culture is correct, and its diagnosis of events is sound, then the policy implication is that nations must improve the supply of moral leadership. Intellectual leaders such as priests, politicians, philosophers and artists all have an important role to play in stimulating the imagination of political and business leaders; in a successful society such intellectual leaders will tend to embrace a high-trust high-tension culture.

The chapter is organized in four sections. Section 2 introduces basic concepts and definitions; Section 3 outlines an economic theory of culture, concerned with competition between groups; Section 4 discusses the key dimensions of culture, whilst the final section examines broader methodological and historical issues.

2. Basic concepts and definitions

2.1. The definition of culture: Culture as a public good

There are many important contemporary economic issues in which culture is a significant factor, such as

- Is a common European currency a symbol of political unification?
- Will contracting out public services such as health to private firms undermine the public service ethic?
- What exactly is ‘consumerism’? Do heavily advertised ‘lifestyle’ consumer brands delude consumers with false hopes, and does it matter if they do?

It is necessary to define culture in a way that captures the common elements in these questions. For the purposes of this chapter, therefore, culture is defined as *shared values and beliefs relating to fundamental issues*, together with the *forms in which they are expressed*. This suggests that there are three main aspects to culture:

- values, which represent the moral aspect of culture,
- beliefs, which represent the technical aspects, and
- forms of expression, which represent the symbolic and artistic aspects.

These values, beliefs and forms of expression are shared within a social group.

It can be seen that this approach to culture is more general than that employed in the economics of the arts. Arts tend to be identified with ‘high culture’, involving the expression of emotion through artifacts (e.g., paintings, books) and performances (e.g., drama, ritual). Culture, as defined above, relates not only to emotional responses, but to quite detached views connected, for example, with scientific topics. Furthermore, it

encompasses more than just expression – it includes the formation and dissemination of views as well.

Culture is an intangible good. Cultural values and beliefs can be shared, which indicates that culture, like knowledge, has the property of a public good [Reisman (1990)]. The fact that one person holds certain beliefs, for example, does not preclude another person from holding these same beliefs too. Thus there is no rivalry in the consumption of culture. Culture may be a good because it has intrinsic value, or because it is instrumental towards some other purpose. People may value certain beliefs because holding these beliefs makes them happy [Layard (1980); Easterlin (1998, Chapter 10, 2001)]. They may value other beliefs because they are purely instrumental – for example, holding correct beliefs eliminates mistakes and so reduces waste, thereby improving the material standard of living. It follows that culture can also be a ‘bad’. Some beliefs make people unhappy – for example, the belief that nobody likes them. Other beliefs may be damaging because they are wrong – mistakes are made when acting on these beliefs, and resources are wasted as a result. From an economic perspective, therefore, the elimination of cultural bads is just as important as investment in cultural goods.

2.2. Cultural diversity

Cultural diversity is a topic which generates considerable controversy. Conventional economic theory suggests that culture is simply a set of beliefs which will ultimately converge on correct beliefs as a result of learning. According to this theory there is a unique set of correct beliefs on which everyone will eventually agree; groups that refuse to learn will fail to survive. The only cultural guarantor of economic success is a correct economic theory and the implementation of policies derived from it. Some economists seem to believe that convergence on the correct theory is almost instantaneous. Adherents of rational expectations theory, for example, maintain that everyone holds correct beliefs because they already know the true model of the economy [Lucas (1981)]. Others allow the process of adjustment to take a little longer; they concede, for example, that the final collapse of authoritarian socialism in the 1990s occurred only after a century of institutional experimentation.

Simple economic models such as rational expectations, assume that information is costless to collect and communicate, and easy to verify. These assumptions about costless information are critical to the prediction that incorrect beliefs will be eliminated, and only correct beliefs survive.¹ However, any plausible economic theory of culture must recognize the significance of information costs. Whilst knowledge is a public good, it is costly to share. No one has complete access to all available knowledge. Costs of collecting information mean that everyone bases their beliefs on only a limited amount of information. Optimal search theory shows that once a certain amount of

¹ The rational expectations approach to economics is a recent innovation which is very much at odds with traditional mainstream writing, even in the Chicago School; see, e.g., Leacock (1998) and Viner (1972, 1978).

information has been collected, it is no longer cost-effective for an individual to refine their beliefs by collecting more. Beliefs are therefore based on a very limited amount of information.² Access to information can be improved by pooling information, but this requires communication between people, which is costly too. It is often more efficient to leave someone to discover something for themselves rather than incur the costs of telling them about it. Information sources are typically localized, which means that when people rely upon their own resources, different groups of people in different localities have different sets of information. Each group generates beliefs on fundamental issues by generalizing from its own experience. This leads to different sets of beliefs, and so to cultural diversity.

Cultural diversity is likely to diminish over time. Much information is a by-product of action – it is acquired through ‘learning by doing’ – and so accumulates over time. Additional information can be captured through scientific experiment. As a result, the information available to each group is likely to become more and more the same. Groups can also compare beliefs, and refine them through a process of criticism. In this way the accumulation of knowledge, combined with critical debate, encourages the emergence of consensus. Diversity cannot be eliminated, however, because there is a lack of decisive information on certain crucial issues. Evidence is decisive when it convinces not only believers but also skeptics. Much of the evidence used in social science is difficult to replicate because it cannot be collected under fully controlled conditions. It therefore lacks the ‘objectivity’ that would convince a skeptic. Lack of objectivity is particularly problematic in the investigation of fundamental issues such as the origin of consciousness, inequality of intelligence, and the relative importance of ‘nature’ and ‘nurture’. Lack of objectivity allows people to remain attached to beliefs which explain their own experience but not the experiences of others.

Disagreements are even more difficult to resolve in the field of values. Some value systems can be criticized for lack of consistency, although not everyone would accept that logical consistency is a requirement of a value system. Religious value systems often appeal to revelation and sacred texts as a source of authority, but secular critics deny their validity. Diversity in values therefore tends to be not only greater, but also more enduring, than diversity in beliefs.³

Overall therefore, fundamental problems in assuring the quality of information mean that despite the increased quantity of information that flows within the world economy, cultural convergence on a true model is unlikely to be attained. The spread of the internet, for example, may well promote convergence on relatively superficial issues such as the consumption of heavily advertised brands, but it is unlikely to promote convergence on more fundamental issues. Indeed, the proliferation of special issue lobbies such as

² Indeed, it is interesting to note that recent research has introduced costs of rationality into rational expectations modeling, which has aligned the approach more closely with that set out in this chapter; see, e.g., Ginsburgh and Michel (1997).

³ For further discussion of the influence of diversity in values see Baxter (1988), Hahnel and Albert (1990) and O’Brien (1988).

anti-globalization protest groups coordinated through the internet suggests that increasing skepticism about the quality and integrity of 'official' information is generating new sources of cultural diversity. Thus while cultural diversity in international consumption patterns may be reduced through greater quantities of information flow, the limitations on information quality mean that intra-national diversity in political and religious beliefs may well increase.

2.3. *Stereotypes*

There is considerable popular awareness of differences between the cultures of particular groups of the same type. These differences are usually expressed in terms of stereotypes. A stereotype is an oversimplified characterization of a social group that ignores diversity within the group. It is a form of group reputation. The members of a group generally view their own group more favorably than do outsiders (which partly explains why they are happy to remain within the group). Indeed, competing groups often adopt negative stereotypes of each other in order to justify their antagonism. For this reason stereotypes are often condemned for promoting distrust between groups. However, different outside groups often hold rather similar views of any given group, which lends support to the idea that there is an objective kernel to the outsider's view. Thus although stereotypes ignore internal diversity and are often hostile, they are still useful because they usually contain significant insights too.⁴

2.4. *Culture as an asset*

Culture is a durable asset: values and beliefs are memorized by individuals, and are transmitted to the next generation through parenting and education. Education is strengthened when culture is recorded in books, embodied in art and artifacts, and embedded in rituals and routines. The durability of culture has encouraged some writers to see it as the 'dead hand of the past'. Culture is acquired from early childhood when critical faculties are undeveloped. People become very attached to their early beliefs for emotional reasons – loyalty to parents, a concern for their 'roots', or fear of change. Beliefs are not revised in the light of new circumstances and hence there develops a disjunction between culture and the real world. This view ignores the fact that people often review their beliefs in adolescence or when they come of age. It also has the misleading implication that a very old culture is likely to be less appropriate than a newer one.

An alternative view is that culture adapts to changing circumstances, but with a lag. It is sometimes suggested that a traumatic set-back such as a military defeat is necessary to undermine confidence in a culture. Defeated groups may sometime adopt their conqueror's culture (or selected aspects of it). On this view cultures which survive do so not because of mere inertia but because the beliefs they embody are more correct or more successful than those they replace.

⁴ For the use of national stereotypes to analyze economic performance see Casson (1990, Chapter 4).

The most efficient way for a culture to cope with change is to adapt its beliefs in an incremental fashion, up-dating them in response to significant events and new discoveries. Monitoring the environment and up-dating beliefs is a complex task, however, and benefits from specialization. It is impossible for everyone within a group to find the time to continually re-examine their beliefs for themselves. To understand how culture changes, therefore, it is necessary to understand the division of labor within social groups.

2.5. A typology of social groups

The basic unit of cultural analysis is the social group: it is the unit within which culture is shared [Newman (1983); Pryor (1977)]. The most significant types of group from a cultural perspective are listed in Table 1. People are born into families and the local community where they live. They also acquire nationality at birth. When they come of age they can take decisions for themselves. They can choose the firm for which they work, the profession (if any) they wish to follow, and the clubs and societies they wish to join. They can also decide whether they wish to be active members of a church or a political party. In taking these decisions they affirm certain values and beliefs they have acquired from family and friends and reject others.

In a high-tension society, belonging to a group involves significant commitments; furthermore, in a high-trust society there are significant emotional penalties for breaking such commitments – disloyalty and lack of perseverance bring guilt and shame. Within a group there are distinctive roles. Roles with greater responsibility generally carry higher

Table 1
Typology of social groups

Type of group	Membership system
Nation state	Citizen by birth or naturalization. Tax-payer by residence.
Market	All buyers and sellers of a product are members of the relevant market – especially competing sellers who locate close to each other.
Network	Member by regular contact with other members – often met through introductions arranged by existing members.
For-profit associations: firm	Member by negotiation. Core members supply services on a regular basis: e.g., shareholders and employees. Customers may be regular, casual, or one-off purchasers.
Non-profit associations: profession, club, church, charity, political party, etc.	Member by application, invitation, qualification or election.
Local community: friends, school, etc.	Member by residential location.
Family	Member by birth or adoption.

status. High-status people can demand deference from other members of the group. In addition, there are differences in status between different groups. Some groups are task-oriented (like the firm) whilst others are support-oriented (like the family), although most types of group combine elements of the two. In a task-oriented group the clients or customers who consume the output are usually different from the workers who produce the output, whereas in a support group the consumers and producers are often the same. In a charity, for example, the donors who supply the funds are quite distinct from the beneficiaries or clients who receive them, whereas in a support group like Alcoholics Anonymous the members support each other [Bolnick (1975)].

Clients usually have low attachment to a task-oriented group. Customers may have only casual contact with a firm, for example, whereas workers are heavily involved on a daily basis. Those who provide finance usually have less attachment than those who provide labor. Shareholders in a large firm can easily sell out for speculative gain whereas employees may serve for life; similarly, donors to a charity are usually less involved than the volunteers. There are also differences amongst workers; whilst some may be permanent full-time staff, others may be casual part-time staff. In a high-trust society commitment from workers and volunteers may be readily forthcoming, but in a low-trust society people will prefer low-commitment involvement instead. People may prefer to give money rather than time to a charity and to take only casual work, while shareholders may be very concerned that their holdings are liquid.

Some groups have formal structures: these are typically large and long-lived groups. Formal structures institutionalize the division of labor, creating posts or offices to which people are appointed; some posts may be filled on a rotating basis, often by election. Other groups are informal. For example, a market consists of all the people who turn up in the market place to trade – whether the market is a physical location, a commercial publication, or a web-site. Although access to the market may be free, traders must abide by the rules for enforcing contracts. A network is even more informal – it is simply a group of people who are in regular contact with each other [Putnam (1993)]. Networks are typically governed by customs which are enforced through reputation effects. A low-trust culture requires formal rules and procedures, whereas a high-trust culture is more versatile: both formal and informal systems can be used. Networks are useful for sharing information, particularly between entrepreneurs. In a high-tension culture networks can foster innovation, but in a low-tension culture they may simply foster collusion instead.

3. Towards an economic theory of culture

Up to this point, the discussion has simply taken existing insights from sociology and social anthropology and reformulated them in economic terms. Further development of an economic approach to culture requires specific analysis of competition between cultures, leading to an explanation of the competitive strategies employed by social groups. This section outlines a set of assumptions on which a formal model of cultural competition can be developed.

3.1. Leadership

Leadership is the most important role within a group. The leader typically manages the external relations of a group. ‘Take me to your leader’ say outsiders who need to negotiate a commitment from a group. The leader demands loyalty from the members in order to guarantee the delivery of commitments and to maintain the reputation of the group. The leader has the power to discipline or expel disloyal people.

The logic of leadership is very simple. In a highly complex and uncertain world, people cannot resolve every issue for themselves. In particular, fundamental questions about the future of the world and the destiny of the individual cannot be easily answered; the costs of collecting and processing all the relevant information would be prohibitively high. Specialist leaders such as priests and politicians are required. Even then their answers cannot be definitive. Different leaders give different answers to the same question, based on different information, and so different cultures prevail. Leaders also provide answers to more specific questions; thus the leader of a firm decides what type of product is most in demand, and the leader of a charity decides what kind of people are most in need of help. The leader is the person deemed to have a comparative advantage in processing the relevant information. He may also claim to have privileged access to information, perhaps through external contacts. Alternatively, he may claim to be able to interpret information in a better way [Casson (2000)].

Leadership styles vary. Some charismatic leaders seek publicity, whereas others are self-effacing. Some leaders even seek to disguise their identity – such as an agitator leading a demonstration or the ‘brain’ at the center of a spy-ring. The common notion that groups can achieve ‘spontaneous order’ without a leader is a myth. It is simply a consequence of failing to identify where leadership really lies.

Leadership requires very scarce talents and as a result many leaders lack appropriate qualifications for the job. Successful leaders must justify the trust that their followers place in them. A leader who has lost the trust of his or her followers is of little value to the group, since members no longer feel secure in following their orders or advice. An alternative leader may emerge ‘from the ranks’ of ordinary members and constitute a rival source of authority – the militant British shop-steward, for example. The rival leader may organize a revolution to depose the incumbent if the incumbent cannot appoint a successor first.

3.2. Competition between groups

In a free society people can choose which leaders they follow. At any given time rival leaders will disagree about fundamental issues and people will have to decide with whom they agree. In particular, different political parties promote different ideologies, based on different theories of the economy and different views of human nature. In principle, only one of the rival leaders can be right. Indeed, the most likely scenario is that none of the leaders is right, since each is promoting an over-simplified and somewhat distorted view of the situation. Disagreements may persist because it is impossible to

find any decisive evidence for or against a particular view. In practice most leaders do not debate upon an abstract level, but rather in terms of strategy and policy. They promote specific projects which embody the values they promote and which, it is claimed, will work because the theory on which they are based is sound. For example, a political leader may promote a project to create a Welfare State, based on the optimistic view that new technology makes 'welfare for all' an affordable proposition. A business leader may motivate their workforce by claiming that their product is the best in the world, and a great benefit to all who consume it.

An articulate leader offers their followers a vision of what the project can achieve. The leader's rhetorical skill in creating 'sound bites' and 'buzz words' may be supported symbolically – perhaps by a launch at a prestigious location. The vision typically ignores the short run constraints under which the project operates, and emphasizes its long run potential instead. A vision will often be deliberately vague. It may be expressed in an artistic form which conveys an overall impression without revealing much key detail. The rationale for this ambiguity lies in the fact that much can change before the project achieves its goal, so that it would be misleading to be too specific about the final outcome. Indeed, the more ambitious the project, the longer it is likely to take to complete and so the vaguer the final outcome will be at the initial stage.

Competition may also induce leaders to scorn their rival's visions – arguing that they represent unworkable delusions. In Western democracies, debate between party leaders sometimes degenerates into mutual scorn. The emergence of negative stereotypes, promoted by leaders who wish to discourage their members from defecting to rival groups, can be explained in similar terms. This negative strategy has its limitations, however – too much emphasis on another leader's faults may suggest to honest followers that a leader is simply distracting attention from their own defects instead.

A key feature of a vision is that it arouses an emotional response in the follower. Such emotions are often described as 'beauty' (in the discovery of a simple theory, for example), 'glory' (as in winning a great team victory) or 'awe' (as in creating a monumental piece of architecture or engineering). The follower is enthused by contemplating the vision; by assessing their own emotional response to the vision, the follower can assess the magnitude of the emotional rewards that they will obtain through participation in the project.

Participation in each project involves a contract – usually an implicit contract assured through trust, but sometimes also a formal contract too, which is backed by law. There is an important psychological dimension to this contract. The leader emphasizes that the reward obtained by contemplating the vision will be strongest for those who make the greatest effort. Each follower will know how much effort they have committed to the project; the greater the sacrifices they have made, the greater the rewards they will obtain. These rewards come from two main sources. The first is the satisfaction from being absorbed in a worthwhile project to the point where the worker is unaware of their surroundings or of the passage of time. The second is a sense of pride and contentment when they rest from their work and reflect not only on what they have already achieved but also on what will be achieved when the project is complete. Followers who

know they have made little effort will experience little reward, whilst those who have deliberately shirked will experience guilt and wish that they had never joined.

An effective leader will show appreciation of followers' efforts. But the leader cannot always monitor individual effort with great accuracy. In certain types of work this agency problem may be overcome by basing rewards on measured output. But output may be only weakly correlated with individual effort, particularly in large teams. The 'psychological contract' is particularly valuable, therefore, in motivating effort in teams. However, team-work is not just a matter of effort. Loyalty is important in any project, and particularly so in teams, where the loss of a member can be very disruptive. Every new member has to learn their role, and the cost of training usually falls on the leader. Loyalty is thus an important element in the psychological contract. The stronger a person's emotional attachment to the project at the outset, the greater their sense of guilt when quitting.

When an individual is deciding whether to follow a particular leader, therefore, they will need to know both how they are likely to respond to the vision, and how they will actually perform. They therefore need to know their own competencies and their own emotional characteristics. If these characteristics are incorrectly assessed then a mis-match will occur between the individual and the project, and thus between the individual and the group. This will in turn lead to a waste of resources, in both material and emotional terms. It is typically assumed in economics that individuals possess full information on their own personal characteristics. In practice, however, it can be argued that they do not. In neoclassical economic theory, asymmetric information is usually construed as meaning that an individual knows their own characteristics, but others do not. It is possible, however, to construe the concept differently, and to suppose that other people know a person's characteristics better than they do themselves. Focusing on emotional characteristics highlights this point. Most parents have a better understanding of their children's emotions than the children do themselves. Many people remain 'child-like' (or even 'childish') in their emotions when grown up, and so not only family but also friends may be better aware of a person's emotional characteristics than the person themselves. Indeed, using biological evidence Frank (1985) has argued that people signal their own emotions to others unselfconsciously through facial expression and posture, and that their inability to control these emotional signals gives a credibility to their statements that they would otherwise lack. In a similar vein Freudian psychoanalysts have argued that people sublimate their emotions in order to disguise their feelings from themselves. People not merely lack self-knowledge and self-awareness – they are also systematically deny the existence of certain emotions too.

It is unnecessary to accept all of these claims in order to agree that many followers may be unaware of their emotional characteristics at the time they take a decision to join a group. Joining a group is therefore not only risky because of uncertainty about the leader and about the behavior of other members of the group, but because of uncertainty about one's own characteristics too. People's uncertainties about their own characteristics provide a significant opportunity for plausible leaders who are a good judge of character. The leader can invite people who in their judgment have the cor-

rect characteristics to join their group. People who feel very uncertain about their own characteristics are likely to respond in a positive fashion to such an invitation. Trusting people are also likely to respond, as they are more likely to accept the leader's judgment. An honest leader pursuing a socially worthwhile project can turn such mechanisms to good advantage, but it is equally obvious that an unscrupulous leader can take advantage of vulnerable followers. The most vulnerable people are those who are unaware that their own uncertainties and trusting nature are very obvious to others. Those whose competencies are obviously limited are particularly vulnerable, because it is obvious that they will receive few offers from other leaders. They may however receive some offers from honest but highly altruistic leaders, who wish to save them from falling under the influence of unscrupulous leaders instead.

3.3. *The changing nature of competition between leaders*

The nature of competition between leaders has been changed fundamentally by the growth of the communications and media industries – from the growth of print journalism in the eighteenth century to the spread of cinema, radio and television in the twentieth. The lower cost of mass communication has intensified competition between the leaders of high-level groups, especially political parties. Most significantly, the technologies of photography, film and video have reduced the cost of pictures relative to words, giving pictorial images an increasing role in propaganda and persuasion. Images liberate arguments from the requirement of a literate readership. They make use of a natural visual language which transcends any specific written language, and therefore reaches a mass multi-lingual audience.⁵

Certain images elicit strong emotional reactions. These reactions are almost instantaneous and are therefore invaluable to leaders in gaining attention for their messages. Indeed these reactions are so strong that the image itself may become the argument. Pictures of starving children or police brutality, for example, make their own political points without any need for verbal interpretation. Competition between leaders for visual attention encourages the pursuit of the outrageous. In any collection of competing images the most outrageous is likely to win. People may be attracted by beauty but surprise and horror have an even greater fascination.

The abstract nature of competition between ideologies does not lend itself readily to visual expression. The loss of media space to more visual subjects may be one reason why vigorous political debate appears to have declined as consumption of media services has increased. Social projects are easier to promote, as visions of better houses, schools and hospitals are easy to project. This encourages politicians to argue less about ideology and more about specific projects – a strategy recently adopted by New Labour in the UK [Protherough and Pick (2002)].

Consumer products are remarkably easy to promote by picturing the consumer as relaxed and self-assured; this works particularly well for simple products which provide

⁵ The links between culture and language are explored further from an economic perspective in Jones (2000).

emotional benefits of a social nature – cosmetics and alcoholic beverages, for example. The multi-lingual nature of a visual proposition benefits multinational consumer brands. Faces attract attention – particularly faces that are instantly recognized. This favors the promotion of ideas through celebrity endorsement. Since sportsmen and entertainers are not generally noted for their political wisdom, celebrity endorsement works best in product promotion, although it has been used with some success in politics too.

Commercial advertisers are unlikely to increase their sales if consumers give money to good causes instead of spending it on themselves. The implicit message of a typical product advertisement is therefore that low-trust is the norm. Similarly, many products are advertised as impulse purchases, which allow the consumer to show off in a social setting. This promotes a low-tension spontaneous lifestyle as the norm, rather than a single-minded high-tension lifestyle which would produce better long-term results.

The optimization of visual image for persuasive purposes requires very scarce skills. Creative workers in advertising and public relations can command substantial economic rents. The financial requirements of major promotional campaigns constitute a significant barrier to entry for many types of leader. A highly visual political campaign may require powerful industry backers who expect rewards if their candidate is elected to office. Thus leadership becomes more like commercial entrepreneurship as the economic requirements converge on the funding of media campaigns.

In most modern societies newspapers, magazines, radio and television rely heavily on advertising revenues rather than sales and subscriptions. They have a strong financial incentive to attract an audience that is susceptible to advertisers' messages. This can induce the 'dumbing down' of content in order to attract the people most likely to be influenced by the visual message that the advertiser plans to use. Some messages are easier to dumb down than others – for example, a blatant appeal to short-term self-interest is easier to communicate than a sophisticated appeal to long-term social concerns.

To summarize, there are many reasons why in a modern society characterized by competitive individualism the role of moral leadership is difficult to carry out. Whilst the power of visual imagery favors the promotion of certain types of charitable project such as child poverty or animal welfare, it discriminates against the promotion of high-trust high-tension political values. Competition for attention in the visual media is on average biased against the promotion of high-trust cultural values.

4. Key dimensions of culture

4.1. Four main dimensions of cultural variation

There are many fundamental issues which cultures must address. Some are very general, such as 'What are people really like?', whilst others are more specific such as 'Whom can you trust?' and 'How do you motivate people?' Other issues include 'What forms of organization are natural?' and 'How far can technological progress advance?' Describing a culture in full can therefore be a very complex task.

A parsimonious theory of culture must identify just a small number of dimensions along which cultures vary. By focusing on those aspects of culture which are likely to influence economic performance, four main dimensions of culture can be derived. These dimensions were introduced at the outset, and are summarized in the first two columns of Table 2. The first column of the table identifies the end of the dimension which is found in a typical Western competitive individualistic society, whilst the second column indicates the dimension which corresponds to ‘Utopian solidarity’ – the kind of culture that would be found in an idyllic closed society of the kind visualized by Rousseau. This four-way classification is a refinement of a classification proposed in Casson (1993).

- (i) *Individualism versus collectivism*: An *individualist* believes that people are autonomous. Everyone is different and each person values personal ‘lifestyle’ projects above others [Earl (1986)]. The information required for coordination is widely distributed – shocks are individual-specific. Ownership and control of resources should be vested in individuals, since only individuals have the information required to take decisions that affect themselves. A *collectivist* believes that we are all part of the community into which we were born. Even as adults we remain dependent on others for our survival. A collectivist also believes in uniformity – everyone is the same, and everyone values large awesome projects. Information required for coordination is centralized – shocks have collective impact. Collectivists believe that ownership and control of resources should be vested in the group [Ekelund and Tollison (1997)].
- (ii) *Pragmatism versus proceduralism*: *Pragmatists* believe that intuitive judgments based on wide personal experience hold the key to successful decisions. Hunches can also be tested through informal conversation with other people. The best de-

Table 2
Four dimensions of culture

Limit of dimension corresponding to competitive individualism	Limit of dimension corresponding to Utopian solidarity	Corresponding dimension in Hofstede	Optimal combination
Individualism	Collectivism	Individualism–collectivism	Voluntarism
Pragmatism	Proceduralism	Low–high uncertainty avoidance	Good judgment
Low-trust	High-trust		Warranted trust
High-tension	Low-tension	Femininity–masculinity	Warranted self-confidence

Note: Only three of the four dimensions identified by Hofstede appear in the table. The missing power–distance dimension in the Hofstede classification may be loosely construed as a hybrid which combines elements of individualism–collectivism with elements of low-trust–high-trust.

decisions are made promptly. A single individual should be ultimately responsible for each decision. *Proceduralists* believe that good decisions are generated by closely following formal procedures, whose design is underpinned by theory, and which involve the systematic collection of objective information. The use of committees may delay decisions, but it is better to ‘get it right’ than to do it quickly.

- (iii) *Low-trust versus high-trust*: *High-trust* individuals believe that others will be honest, work hard, be loyal, and generally keep their promises even when they have little material incentive to do so. *Low-trust* individuals believe that others are guided by material incentives, and will therefore often lie, cheat or shirk. High-trust is particularly important in an individualistic society, because individuals do not have the same power of enforcement as a collective body [Holmes and Sunstein (1999)].
- (iv) *High-tension versus low-tension*: A *high-tension* person is attracted to ambitious projects, while low-tension person prefers easy projects. The high-tension person is stressed because they are aiming high, and will be ashamed of failure.⁶ Conversely, a *low-tension* person is relaxed, because they are aiming low, and they will blame any failure on factors outside their control. Low-tension people like to behave in a spontaneous manner, which often has anti-social consequences [Casson (2002)], although it is a manner of which some economists approve [Scitovsky (1976)].

There are many other classifications of culture which have been devised for a variety of purposes, but there is one particular classification, due to Hofstede, which has been particularly influential in management and organizational studies and is particularly relevant to performance issues [Hofstede (1980); Graham (2001)]. Hofstede’s classification was arrived at empirically by applying factor analysis to a large-scale cross-national study of the employees of a multinational firm. Unlike the classification used here, Hofstede did not deduce his classification from first principles, but nevertheless a comparison is useful. It is interesting that he also focused on four dimensions, some (though not all) of which correspond to the theoretical classification as noted in the third column of Table 2.

Taking the two limits of each of the four key dimensions described above identifies 16 ideal types of culture which are presented in Table 3. Some of these are particularly interesting, especially the high-trust analogues of competitive individualism. These embody the principle of voluntary association for the purpose of pursuing ambitious projects but add the notion that the aims of the project may be altruistic, that competition between the projects is orderly rather than aggressive, and that coordination of projects relies heavy on trust between members of a team. It is known as associationism.

To keep the theory really simple it would be nice to identify just one of these 16 cultures as the best from a performance point of view. It would then be possible to compare

⁶ For an excellent discussion of high-tension in the context of fundamentalist religious sects see Stark and Bainbridge (1987).

Table 3
Typology of cultures

	HG High-tension pragmatic (judgmental)	HD High-tension procedural (administrative)	LG Low-tension pragmatic (spontaneous)	LD Low-tension procedural (bureaucratic)
IS Individualistic low-trust (competitive individualism)	<i>Enterprise culture:</i> Aggressive competition between highly entrepreneurial selfish people.	<i>Big business culture:</i> Aggressive competition between selfish, ambitious but unimaginative people controlling formal organizations.	<i>Libertarianism:</i> Social anarchy constrained only by legal enforcement of market contracts.	<i>Play-the-system culture:</i> Unprincipled competition between formal organizations regulated unsuccessfully by weak and corrupt bureaucracy.
IH Individualistic high-trust (associationism)	<i>Entrepreneurial associationism:</i> Orderly markets allocate resources between ambitious altruistic projects.	<i>Administrative associationism:</i> Orderly competition between ambitious altruistic people running professional organizations.	<i>Good neighbor culture:</i> Social ambitions are limited to relief of current problems such as poverty. Individuals act on impulse to help the needy who are known to them.	<i>Charity culture:</i> Compassionate leaders set up formal organizations to help the needy, and recruit volunteers.
CS Collectivistic low-trust (coercive collectivism)	<i>Revolutionary state:</i> Totalitarian dictator personally promotes prestige projects in which people are forced to participate.	<i>Soviet-style planning:</i> Professional government planners implement ambitious projects using conscripted workers.	<i>Arbitrary dictatorship:</i> Dictator with ambition simply to survive in power improvises strategies to defeat rival bids for power.	<i>Conformist culture:</i> Coercive bureaucracy resists change and demands conformity from apathetic people.
CT Collectivistic high-trust (paternalism)	<i>Charismatic leadership:</i> Paternalistic leader with Utopian vision enthuses population.	<i>Welfare state:</i> Ambitious altruistic programs are devised by a paternalistic leader and administered using public service ethic.	<i>Familism:</i> Paternalistic leader presides over low-productivity economy where socialization is more important than work.	<i>Utopian solitariness:</i> Low-productivity economy is coordinated through compulsory participation in traditional rituals presided over by leader.

the actual culture of any social group with the ideal culture, and measure how many dimensions were in agreement: the closer the actual culture to the ideal culture, the better the economy would perform. Given the advantages of a high-trust culture in reducing agency costs and transaction costs, some form of associationism would be a natural

choice. The form that is closest to classic Western individualism is entrepreneurial associationism, and so this appears to be the natural choice as the ideal.

4.2. Trade-offs involved in a high-performance culture

There are three difficulties associated with identifying entrepreneurial associationism as the unique high-performance culture, however. The first is that a combination of four extreme values is rarely an optimal choice in any problem. There are strong grounds for believing that along each of the four dimensions there is scope for a trade-off.⁷ Typical results of the trade-offs are listed in the right-hand column of Table 2. They may be summarized as follows, taking each dimension in turn:

- (i) *Voluntarism*: Individuals are encouraged to transfer their resources to institutions on a voluntary basis. They are encouraged to identify opportunities for projects which these institutions can carry out. Individuals like group projects, but prefer to choose the type of project with which they are involved
- (ii) *Good judgment*: Procedures work well in dealing with frequent minor shocks of a transitory nature. Improvisation is required in dealing with intermittent major shocks of a persistent nature. Successful improvisation requires good judgment, which is based on wide experience.
- (iii) *Selective warranted trust*: Whilst trust reduces coordination costs, naïve trust is of little value, since naïve people provide easy pickings for cheats. A high-trust equilibrium is what counts, in which the majority of people (who are trustworthy) can identify each other and transact with each other, whilst the minority of people (who are untrustworthy) cannot transact at all. Trust is engineered through moral leadership. Leaders demand loyalty and hard work from those who join their teams.
- (iv) *Warranted self-confidence*: High tension delivers results in task-oriented projects. But high-tension cannot be sustained indefinitely. A high-tension person relaxes in a secure environment where they reflect on their performance and learn from their mistakes. The low-tension person likes to mess around at work, and have lots of fun when relaxing.

A combination of voluntarism, good judgment, selective warranted trust and warranted self-confidence may be termed refined associationism, and may be taken as the most accurate characterization of optimal culture from a performance point of view.

The second difficulty with this choice is that none of the forms of associationism discussed above correspond to the cultures of the most successful Western economies. These tend to be much lower-trust than associationism would imply. It could therefore be argued that the entire theory is a predictive failure. This leads on to the third point, however, which is that the exact position of the trade-off will reflect the local

⁷ The importance of trade-offs in culture is recognized by many writers on culture; see, e.g., Hampden-Turner and Trompenaars (1997).

circumstances with which a culture has to contend. Thus a very large, transient and widely-dispersed group may have to reconcile itself to lower levels of trust than a small, stable and compact group. It is therefore unrealistic to expect every group to conform to the same ideal. In another case, one group may have an outstanding moral leader – a ‘man of the moment’, say – who intervenes at a critical moment when change is required, whereas another group may have to cope without such a leader. Drawing upon a larger number of less able and less trustworthy individuals to do the same job, they may institute a division of powers between the leaders and even endeavor to promote a degree of competition between them.

It is in fact possible to explain the current predominance of competitive individualism in successful Western countries such as the US in terms of adaptation to changing global conditions in the period since World War II. In the post-war period, volatility has increased as a result of accelerated technological change and the globalization of trade, driven by lower transport costs and tariffs. An increase in the volatility favors a switch from collectivism to individualism, and from proceduralism to pragmatism, because of the need for greater flexibility.⁸ Globalization has also reduced trust between trading partners, as local networks of trade have been disrupted by the emergence of foreign competition; social trust has been eroded too, as migration has disrupted the customs of local communities. The globalization of communications has encouraged a switch from low-tension to high-tension culture as people in low-productivity economies have become aware of the opportunities presented by innovation and export-led growth. Countries across the world have therefore switched towards a specific type of competitive individualism, namely an individualistic, pragmatic, low-trust high-tension ‘enterprise culture’, as indicated in the top left-hand cell of [Table 3](#).

The economic theory of culture therefore predicts that culture will adapt to the environment, both across space and over time. This accords with basic economic intuition that despite all the qualifications noted above, a successful culture must correspond closely to the realities of a situation facing a group. As circumstances change, so the optimal culture changes too and forces of adaptation, driven by competition between rival leaders, come into play.

4.3. Refining the dimensions of culture

Sociological writers on culture have between them identified over a hundred different dimensions of culture. Furthermore, cultural analysis of cross-country differences in industrial policy has identified other dimensions besides those mentioned above [[Foreman-Peck and Federico \(1999\)](#)]. Almost all of these additional dimensions can however be subsumed under the four key dimensions; indeed, these key dimensions were developed in part as composite dimensions under which various other dimensions could be subsumed. [Table 4](#) lists 22 dimensions of culture, including many of the most

⁸ For earlier examples of such switching see [Hirschman \(1982\)](#).

Table 4
Sub-dimensions of culture

Characteristic favoring competitive individualism	Characteristic favoring Utopian solidarity
<i>Individualistic (I)</i>	<i>Collectivistic (C)</i>
Atomistic	Organic
Dynamic	Static
Incremental	Radical
Democratic	Elitist
Market-based	Planning-based
Efficiency-oriented	Equity-oriented
Consumer-oriented	Producer-oriented
<i>Pragmatic (G)</i>	<i>Procedural (D)</i>
Empirical	Theoretical
Outcome-based	Process-based
Risk-taking	Risk-averse
Artistic	Scientific
Personal	Impersonal
<i>Low-trust (S)</i>	<i>High-trust (T)</i>
Unprincipled (moral skepticism)	Principled (morally committed)
Secular	Religious
Selfish	Altruistic
Autocratic	Consultative
Aggressive	Orderly
<i>High-tension (H)</i>	<i>Low-tension (L)</i>
Aspirational	Complacent
Deliberative	Spontaneous
Optimistic	Pessimistic
Confident	Unsure
Progressive	Conservative

frequently cited dimensions, and attributes each of them to one of the four key categories.

Where issues relating to political constitutions and national economic policy are concerned, the sub-dimensions associated with the first dimension – individualism versus collectivism – are most important. Where issues of organisational structure and management style are concerned, the sub-dimensions associated with pragmatism versus proceduralism are most important. The quality of personal relationships within organizations, the intensity of competition between organizations, and the general quality of social life are governed by the sub-divisions of the third dimension – the degree of trust. The extent to which people are energized and inspired by visions of better life, either for themselves or others, is governed by the sub-divisions of the fourth dimen-

sion – the degree of tension. Since there is insufficient space to examine each of these sub-dimensions in detail, their principal features are summarized in Tables 5–8. The middle columns of these tables explain the nature of the variation along the dimension concerned, whilst the right-hand column considers the point along the spectrum on which the best results are likely to be obtained. This is described as the ‘high performance mix’. It is important when studying culture to remember that the dimensions of cultural variation do not normally run from ‘good’ to ‘bad’ or *vice versa* but, like ordinary economic variables, express a trade-off in which the optimum is usually at an interior point. Just as in conventional economics, extremes are rarely efficient in cultural life.

An optimum in this context represents a cultural mix which is likely to prove efficient in the long run. In modern parlance, it is ‘sustainable’. However, the optimum along any one dimension cannot be determined without reference to the other dimensions of culture. Thus a culture that promotes a distrustful attitude to other people may have an optimal degree of competitiveness which is quite high, whilst a culture which encourages people to trust each other may have an optimal degree of competitiveness which is much lower. In the long run there will be a tendency for competition between cultures to select the culture that is most efficient in overall terms. The characteristics of an optimal culture are summarized in general terms in the next section. However, as noted above, the optimal culture varies according to environmental constraints, and this means that the optimum is difficult to specify in terms of all the 22 dimensions discussed in Tables 5–8. Furthermore, the process of competition between cultures is so slow and disjointed that for the foreseeable future the detailed predictions of the theory merely identify a sub-set of viable cultures which are likely to remain in competition with each other for a considerable time to come.

Some of the dimensions described in Tables 5–8 are much more relevant at one level of leadership than another. Individualism versus collectivism and the sub-dimensions associated with it are particularly important for high-level leaders of large groups such as the nation state. They influence their attitude to the decentralization of power. A high-level leader must decide how far his or her followers should be allowed to form lower-level groups on their own initiative. Should the emergence of lower leaders be encouraged, as a welcome display of initiative, or discouraged as a potential threat to the leader’s power? Other dimensions apply at every level. The issue of trust, for example, is fundamental at every level. A high-level leader who does not trust lower-level leaders will either discourage the formation of low-level groups or will promote aggressive competition between them, whereas a trusting leader may encourage low-level groups and promote co-operation and orderly competition between them [Knight (1935)]. At the same time leaders of lower level groups must decide whether to monitor their members and offer material rewards for good behavior, or whether to trust the members to monitor themselves and to reward themselves emotionally for good behavior.

Table 5
Detailed analysis of individualism *versus* collectivism

Characteristic: Individualist/ collectivist	Commentary	High-performance mix
Atomistic/ organic	An atomist believes that individuals are autonomous and independent of society. Their personal rewards derive from their own activities and their attitude to others is purely instrumental. Atomists play down emotions as a source of utility and emphasize pleasure from material consumption instead. Organists believe that the most important rewards are emotional and derive from participation in social activity. Activities devoted to improving and strengthening society generate especially large rewards. The more sacrificial effort people put in, the greater the emotional rewards they get out.	Atomism is bad psychology since it underestimates the importance of emotional rewards, particularly those derive from harmonious social interaction. The atomist is correct, however, that ultimately it is individuals that take decisions. A high-performance culture recognizes that economic performance depends on the interaction of numerous individual decisions – decisions taken by people with real concerns about the society in which they live.
Dynamic/ static	A dynamic culture regards the environment as highly volatile. Change is endemic and it is necessary to adapt and evolve in order to survive. Change is exciting and people can thrive on it. A static culture believes that the environment is stable. Change can be neutralized in order to preserve the status quo. Homeostasis provides much-needed security.	The environment is volatile. Major changes usually require adaptation but minor changes can sometimes be neutralized by an appropriate respond. People can only stand so much excitement from change.
Incremental/ radical	An incrementalist believes that changes are typically small and localized. They relate to particular products or places. The people close to the changes are in the best position to respond. A decentralized system that empowers individual decision-making produces the most effective responses. A radical believes that changes affect the entire economy. Radical actions are required to take advantage of new opportunities or respond to emergent threats. This requires a centralization of power.	Volatility in the environment takes different forms. Minor changes occur all the time, whilst major changes occur only intermittently. Minor changes can easily be delegated to individuals to handle; indeed, standard procedures can be developed to deal with the most common types of change. Major changes can take many different forms and require a more consultative and collective response. Leaders have an important role in building consensus where radical change is required.
Democratic/ elitist	A democrat believes that everyone has unique life experiences which make them worth consulting on how to respond to ma-	Leaders are specialists in taking complex decisions. Leaders constitute an elite – but they should be an ‘open elite’ which anyone can

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Table 5
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Characteristic: Individualist/ collectivist	Commentary	High-performance mix
Market-based/ planning-based	<p>major changes. So far as minor changes are concerned, they can be left to handle them themselves.</p> <p>An elitist believes that only a select group of people of high intelligence or 'good breeding', etc. have the ability to form correct opinions and to carry out the appropriate calculations.</p> <p>The atomist recognizes that markets provide the flexibility that allows different people to respond in different ways to similar events. Market-making middlemen adjust prices to match long-run supply and demand; they also hold inventories to buffer short-run fluctuations.</p> <p>From an organic perspective, planning is the most direct means of achieving consistency between individual responses since it uses a single directing mind. A planner may administer prices or ration quantities.</p>	<p>attempt to join. Leaders should consult their followers, but ultimately they must act on their own judgment. Ineffective leaders should be replaced – followers should be able to replace a bad leader, or quit a badly-performing group. Leadership roles require people of exceptional ability, but this ability is difficult to identify in advance.</p> <p>Planning and markets need to be combined. Firms are planning units which coordinate tightly-coupled systems. Households also plan, but on a smaller scale. Markets link these different planning systems in a loosely-coupled way. Factor markets price the labor and capital employed by firms. Firms which attempt to plan activities which are better coordinated by a market will fail to break even. By allocating scarce factor supplies to the most viable firms, the factor markets determine which activities are planned and which are not.</p>
Efficiency-based/ status-based	<p>The atomist exploits market competition to eliminate waste. An inefficient producer cannot match the price of an efficient producer, and so customer switching eliminates wasteful production methods. Consumers who value products most out-bid those who value them least, so outputs are not wasted by consumers who do not value them. The organicist notes that a consumer's ability to pay depends on income. Consumption should reflect basic needs and social status. Since basic needs are similar, necessities should be allocated fairly. Luxuries should reward service to society as a whole and not just wealth derived from scarce factors of production.</p>	<p>People care both about their own consumption and about the kind of society in which they live. Market-based incentives to eliminate wealth can make everyone better off, but only if those who make the savings are prepared to share them with others. If they are forced to share them, then the incentive to make the effort to drive out waste is reduced. An ethic of community solidarity, which provides emotional rewards to those who reduce waste for the benefit of others is the best solution. Thus a market system can usefully be supplemented by a 'honors system', provided that honors are awarded for sacrificial effort and not simply sold to the highest bidder.</p>

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Characteristic: Individualist/collectivist	Commentary	High-performance mix
Consumer-oriented/producer-oriented	<p>The atomist believes that people derive rewards mainly from material consumption. Novelty and fashion, packaging and presentation, are not trivial matters, but sources of serious satisfaction. The proliferation of different product varieties made possible by technology and trade is to be welcomed. So too are the efficiency gains generated by specialization, even though work becomes monotonous. Services are also valuable, even though no tangible artifact is produced.</p> <p>Organicists believe that people derive rewards mainly from producing goods. They value product variation only when it arises from the use of local materials, and from the personal style of the worker. They value tangible product over intangible services, and craft work over mass production. Producer motivation is strengthened by a long-term relationship with the customer which allows the producer to witness the product in use.</p>	<p>Consumer culture promotes the development of new technology. It exploits advances in technology and communication to significantly improve the material living standards of the poor.</p> <p>However, workers ‘alienated’ by mass production will produce poor quality, so ‘job enrichment’, which limits specialization, may actually improve overall efficiency. They may also seek enrichment through trade union activism.</p> <p>Not all workers may require job satisfaction, however. Satisfactions can also be obtained from hobbies and recreations. Boring jobs may indirectly enrich cultural life by encouraging people to seek satisfaction in community activity instead.</p>

Table 6
Detailed analysis of pragmatism *versus* proceduralism

Characteristic: Pragmatic/proceduralist	Commentary	High-performance mix
Empirical/theoretical	<p>A pragmatist believes that the response to change should be based on evidence rather than theory – it should be improvised on the basis of previous experience. Everyone has unique life experiences which help to prepare them for taking decisions. Belief in the uniqueness of personal experience links pragmatism to atomism. A proceduralist believes that decisions should be explicitly ra-</p>	<p>Theory and experience need to be combined. Neither evidence without theory, nor theory without evidence, will produce good decisions on how to respond to change. In some situations there is no relevant theory, whereas in other cases there are multiple theories, and hence confusion. Theories invariably abstract from certain factors, and may therefore distort a decision if the omitted factor is im-</p>

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Characteristic: Commentary	High-performance mix
<p>Pragmatic/proceduralist</p> <p>tional, in the sense of being grounded in some theory. Without the correct theory, evidence cannot be properly interpreted. Decisions should be based on calculation rather than improvisation. Since the mastery of theory often requires intellectual ability, theoretical orientation is often linked to elitism.</p>	<p>portant. On the other hand, ignoring relevant theory can mean that the significance of key evidence is not appreciated.</p>
<p>Outcome-based/process-based</p> <p>Proceduralists believe that a correct theory can suggest a rational procedure which will guarantee a correct decision. A group of people (e.g., a committee) may be involved in taking the decision. Pragmatists believe that procedures normally delay a decision, and make the outcome worse. Disagreements in committees can add to delays; it is better to make one person clearly responsible for a decision, and let them 'get on with it' right away.</p>	<p>Rational procedures may be useful in dealing with transitory volatility – e.g., in recording reservations or managing inventory. But there are few cases where theory is good enough to identify an optimal procedure. Procedures can also be useful in encouraging autocratic individuals to consult with knowledgeable people. Otherwise it is individual experience that is crucial. Selecting the right individual is more important than optimizing the procedure they employ.</p>
<p>Risk-taking/risk-averse</p> <p>A proceduralist believes that risk can be reduced through rational decision-making processes, whereas a pragmatist denies this. The proceduralist worries that correct procedures have not been properly followed, whereas the pragmatist, having improvised their decision, simply sits back and waits for events to unfold.</p>	<p>Large intermittent shocks cannot easily be addressed by routine procedures, and so risk is inescapable. Frequent minor shocks can often be addressed by rational procedures which involve collecting and processing information before a decision is made. The collection of information allows risk to be managed, although it cannot be eliminated altogether. People who are responsible for dealing with large intermittent shocks must be willing to take substantial risks.</p>
<p>Artistic/scientific</p> <p>Science analyzes local situations in terms of timeless universal laws, whereas the artist often expresses surprise and wonder at a situation. The scientist typically values uniformity whereas the artist values diversity. A scientific approach supports the development of a theory and the collection of evidence in a systematic way. It therefore underpins a procedural approach. Art tends to emphasize an emotional or even mystical response to a situation which is not fully un-</p>	<p>Economic theory has employed social scientific principles, such as the division of labor, specialization according to comparative advantage and global competition, with considerable success. Decision-makers who do not understand these principles are at a major disadvantage in business life.</p> <p>Economics has proved much less successful, however, in analyzing the emotional rewards that people derive from work and social activity. A combination of scientific un-</p>

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Characteristic: Pragmatic/ proceduralist	Commentary	High-performance mix
Personal/ impersonal	<p>derstood. It focuses on situations which are difficult, or impossible, to understand in purely scientific terms. It therefore supports a pragmatic approach to decision-making.</p> <p>Pragmatists believe that people know a great deal more than they realize, and so it pays to converse with them rather than wait for them to tell what they know. People can also say more than they can write, because tone and gesture can aid expression. Pragmatists try out their ideas in conversation with other people, provoking others into revealing what they think. This helps them to arrive at a decision quickly. Proceduralists believe that written communication is superior to the spoken word because it is more precise. There is less scope for ambiguity and reason is unlikely to be clouded by emotion. Proceduralists prefer to consult through memoranda, which they study carefully before arriving at their decision.</p>	<p>derstanding of the laws of markets on the one hand, and an artistic appreciation of emotional factors on the other, is therefore the appropriate combination for successful decision-making.</p> <p>Complex arguments benefit from being set out formally, but simple powerful ideas can often be expressed most vividly in conversation. Highly original ideas are difficult to articulate in a formal way. Original solutions to problems are therefore more likely to be generated through personal interaction.</p>
Unprincipled/ principled	<p>Principled persons believe that they are under moral obligation to a higher authority. They are called to play a particular role in society. They can only achieve peace of mind by doing their duty. Their higher nature (conscience, or spirit) recognizes that they need to control their lower nature (body, or passions). Self-control can be exercised through positive emotions, e.g., enthusiasm for a cause, or negative emotions, such as guilt and shame. Principles need to be based on functionally useful moral values: honesty, loyalty, hard work, and so on. These support teamwork on projects and facilitate coordination between different teams. An unprincipled person believes in satiating their biological needs. The only source of authority is their body; their objective is pleasure rather than peace of mind.</p>	<p>People need to respect their bodily requirements for physical survival, but over-indulgence can damage health. People have emotional as well as material needs, and those who realize this will be happier than those who do not. A moral framework enhances emotional rewards derived from participation in socially beneficial projects. Traditional moral principles such as honesty, loyalty and hard work facilitate coordination in complex economies by reducing transaction costs, encouraging investment, and promoting hard work. An effective leader will therefore promote traditional moral principles, even if their ambitions are purely materialistic.</p>

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Characteristic:	Commentary	High-performance mix
Pragmatic/ proceduralist		
Secular/ religious	The secular moralist expects to derive emotional benefits as part of an enhanced quality of life, whereas the religious person expects a dividend in the after-life. Religious people are therefore motivated by deferred rather than immediate emotional rewards. Their moral conduct is therefore more robust to disappointments. On the other hand, their beliefs in the after-life can prove vulnerable to attack from skeptics.	Rivalry between religious groups can promote distrust as well as trust. Religious commitment can make religious conflict very intense. On the other hand, religious commitment can also promote extreme forms of self-sacrifice and heroism, such as those involved in fighting in defense of a country. While both secular morality and religious belief can generate emotional satisfactions (for people of good conduct), religion adds a further dimension to motivation which secularism lacks.

Table 7
Detailed analysis of degree of trust

Characteristic:	Commentary	High-performance mix
Low-trust/ high-trust		
Selfish/ altruistic	Selfish people cannot empathize with others. Their concerns are focused on their own consumption, work and leisure. They may be concerned with status, but only in an instrumental way – as a means of gaining privileged access to resources. They are concerned with the state of society only in so far as it impacts on their own material interests. Altruistic people empathize with others – either personally, e.g., friends – or impersonally, e.g., concern for the poor. They can derive vicarious pleasure from other people's happiness, and share their suffering too. Degrees of altruism differ depending on the weight that people place on other people's interests.	Altruism is important in channeling high-tension people into providing support for others. Self-interested ambition can stimulate high-tension but generates external diseconomies, and leads to under-provision of emotional support. It does nothing to address the income inequality generated by competition between self-interested people, or to support the losers from the competitive process and their dependents.
Autocratic/ consultative	When other people are selfish and cannot be trusted, their opinions will reflect where their own interests lie. Consultation creates a risk of distorting decisions through lobbying from vested interests. If you cannot believe	Consultation is useful not only in improving a decision but in motivating people to implement a decision through participation in the decision process. Opinions received need to be critically examined, however. Where

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Table 7
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Characteristic:	Commentary	High-performance mix
Low-trust/ high-trust		
	<p>what other people say, there is no point in asking their opinion. If other people are honest and their preferences are aligned with those of the decision-maker, their opinions may be valuable since they are likely to have been thinking about similar issues for themselves. Hence consultation is worthwhile.</p>	<p>vested interests are important, conflicting opinions from the different interests will reveal that a problem exists.</p>
Aggressive/ orderly	<p>People naturally respond aggressively when they feel frustrated or threatened. Unanticipated conflicts in congested public spaces often provoke displays of aggression. A low-trust society sees aggression as natural, and may rationalize reprisals as a useful form of deterrence. Aggression is also believed to be useful in strengthening competition. It discourages collusion and stimulates competitive entry into profitable industries. A high-trust society believes that aggression destroys harmony. Provocations often stem from misunderstandings. Disputes should be resolved, not through hasty reprisals, but in a more considered way through intermediaries such as law courts. People must avoid reprisals by exercising self-control. A high-trust society believes in orderly competition, conducted according to 'rules of the game' which maximize benefits such as innovation, and reduce costs from, e.g., dishonest advertising.</p>	<p>The high-trust view is correct. An advanced society is highly complex and the 'law of the jungle', which usually rewards aggression, does not work well. Reprisals can lead to feuds which originate with a simple misunderstanding.</p> <p>Competition is not just about challenging monopoly but about stimulating and diffusing socially useful innovations. Competitors who sabotage each other's activities do not benefit society and so 'rules of the game' are required. Competition works best when rivals can be trusted to abide by the rules.</p> <p>While aggression may sometimes motivate innovation, other motivators such as public recognition are available too. Channeling aggression into competition may be a useful way of controlling a potentially disruptive biological urge, but it still needs to be moderated through self-control.</p>

Table 8
Detailed analysis of the degree of tension

Characteristic:	Commentary	High-performance mix
High-tension/ low-tension		
Aspirational/ complacent	<p>Aspirational people have high norms. These norms may correspond to ideals deduced from moral or theoretical principles. Alter-</p>	<p>The high norms of the aspirational person are indispensable to a high-performance culture.</p>

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Table 8
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Characteristic:	Commentary	High-performance mix
High-tension/ low-tension	natively, people with wide horizons may know that higher standards are being achieved elsewhere. They are dissatisfied with the status quo. They believe that it can and must be changed. Complacent people have low norms. They have narrow horizons due to a parochial outlook. They are satisfied with the status quo, and their chief ambition is to maintain it.	
Deliberative/ spontaneous	A deliberative person concentrates single-mindedly on achieving his objective. He remains focused on it until he has either achieved it or has irretrievably failed. Success is quietly satisfying but failure is mortifying. Spontaneous persons focus on whatever has caught their attention most recently. It is not necessary to finish one task before starting another. Success is a cause for celebration, however minor it may be. Failure is attributed to bad luck or blamed on others.	Deliberation prevents people with high norms from giving up too easily. Spontaneity undermines the value of aspirations, since the aspirations are merely fantasies.
Optimistic/ pessimistic	An optimist believes that the environment is favorable for the successful completion of a project whereas a pessimist believes that it is unfavorable. An optimistic culture promotes general optimism through notions such as 'the time is right' and 'it's all up for grabs'. A pessimistic culture promotes the idea that if something was really a good idea then someone else would already have done it.	Optimism reduces perceived risks and thereby encourages investment and innovation. However, unwarranted optimism can lead to wasteful projects being undertaken. Where the private benefits of investment are less than its public benefits, optimism may induce investors to risk losses for the public good. If private and social benefits are aligned, realism is better than either optimism or pessimism, as it leads to better investment decisions.
Confident/ unsure	When an optimist is confronted by a group of pessimists they may decide that they must be wrong. They need self-confidence to believe that they can be right when everyone else is wrong. A confident culture sustains the idea that people in the group are always right, at least compared with people in other	Most leaders require self-confidence to take the initiative in setting up groups, and take the responsibility if things should go wrong. A combination of optimism and self-confidence is a hall-mark of an entrepreneurial culture.

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Table 8
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Characteristic:	Commentary	High-performance mix
High-tension/ low-tension		
	groups. It may be based on a notion of innate superiority. People who are unsure usually adapt their opinions to conform with the majority view.	
Progressive/ conservative	Progressives regard change as largely benign. They believe it provides opportunities rather than threats, whereas conservatives take the opposite view. Progressives are continually raising their norms in line with new possibilities whereas conservatives are more concerned with ensuring that existing norms are maintained. Being progressive involves innovation rather than conservation. Both are demanding, but innovation tends to be more demanding because the element of novelty increases the risks.	A high-performance culture requires a combination of science-driven innovation with the maintenance of functionally useful traditional morals. It therefore requires both a progressive technical agenda and a conservative moral agenda.

5. Method and history

5.1. Methodological issues in modeling culture

This third and final part of the chapter attempts to draw together the threads of the preceding discussion. It begins by summarizing the principal differences between conventional neoclassical economics and the economic theory of culture outlined above. Five main differences have been identified. Contrary to conventional neoclassical economics, the economic theory of culture put forward above asserts that:

- Information is costly, both to collect and communicate. Where fundamental issues are concerned it is often impossible to collect objective evidence that will discriminate between alternative theories: thus different systems of beliefs can co-exist almost indefinitely. Conflicts between rival value systems are even more difficult to resolve; their authority often derives from tradition or from spiritual experiences whose authenticity it is impossible to assess. Information costs help to explain uncertainty – uncertainty exists because it is prohibitively costly to collect all the relevant information before taking a decision. Many uncertainties are radical and existential, because fundamental issues are peculiarly difficult to resolve. It is not just ‘facts’ that are uncertain – theories are uncertain too.

- The economic environment is volatile. Factual information is therefore continually obsolescing. A steady flow of new information is required to permit the economy to adapt appropriately to changing circumstances. Information sources are localized, so different people have access to different information. Furthermore, since different people use different theories to interpret this information, different people will react to similar events in very different ways. An important advantage of decentralization is that it empowers people to act immediately on their judgment of a situation. Where opinions differ about the advisability of change, competition permits the optimists to bid resources away from the pessimists, and so the weight of opinion as expressed in the market determines whether how much change takes place.
- Because information is a public good, it is inefficient to replicate its collection unless communication costs are high. Furthermore, it is better to concentrate information processing on people with a comparative advantage in interpretation – i.e. those whose beliefs are closest to the truth. These will tend to be the people with a track record of successful decisions. Intermediaries therefore emerge who specialize in processing information of particular kinds. Entrepreneurs intermediate by setting up new firms to sell new products, whilst social leaders intermediate by setting up new clubs and charities.
- Each person's utility depends upon emotional as well as material rewards. Change often elicits a powerful emotional response; some people thrive on the excitement of change, while others fear its consequences. Leaders need to be calm when taking decisions – they have to be confident in their judgments. They also need to understand the anxieties of their followers and provide them with reassurance if they can.
- Emotions are morally framed. Pride and self-esteem on the one-hand, and guilt and shame on the other, are powerful emotions. Leaders can associate positive emotions with actions that promote coordination and negative emotions with actions that undermine coordination. This engineers trust and so reduces agency costs and transactions costs. Improved coordination enhances the performance of the group. The leader can recover costs from this enhanced performance by various means – taxes, membership fees, voluntary donations – depending upon the type of group involved.

These assumptions are perfectly compatible with a rational action approach to modeling. However, the detailed specification of a model is rendered difficult by the fact that both theories and facts are uncertain. Nevertheless, the basic structure of the model can be set out using three propositions:

- Leadership operates at different levels. High-level leaders control nation states, organized religions and international pressure groups. Middle-level leaders manage firms, clubs and charities, whilst low-level leaders manage families and local communities. High-level leaders set a high-level culture within which the other leaders must operate. Lower-level leaders can 'free-ride' on useful values and beliefs inculcated by the high-level leader, but if they disagree with the values promoted at

the higher level they must invest in counteracting them. This issue separates people into those who prefer to assimilate and conform, and those who oppose or resist instead [Jones (1984)].

- Followers have a choice of leader. In a democracy they are free to vote for a political party and to practice their preferred religion; they can also decide which firm to work for, which clubs to join, and which charities to support. People recognize that when they decide to follow the leader of a particular group they must adopt the leader's values and beliefs. Many key decisions regarding choice of leader are made around the time a person comes of age. Using the prior beliefs inculcated in their childhood by their family and community, people decide which leaders they will follow in their adult life. They evaluate the risk that given leader's values and beliefs will turn out to be wrong. They take account of their own personal characteristics, as they perceive them, because these will determine their emotional responses later on. The final choice that an individual makes will reflect not only their beliefs but also their preferences – whether he is selfish or altruistic, material or emotional, and so on.
- Leaders seek to optimize the values and beliefs they promote in order to fulfill their own objectives. Honest leaders will promote their true beliefs – acting on conviction – but dishonest leaders may adapt their values in order to maximize their following. Culture change will occur both through leaders modifying their values to maintain market share, and by followers switching between committed leaders who are unwilling on principle to adjust their values for the sake of expediency.

These propositions show how the basic economic principles of choice and competition can be applied to culture. The economic theory of culture subsumes standard neoclassical economics as a special case. In a simple neoclassical economic model, there is just a single culture which corresponds to the 'true' model of the economy. This 'true' model assumes that people are selfish and materialistic. It is therefore a model of a low-trust society. The high-trust alternative is excluded by assumption. It is also a model of an individualistic society, since people care nothing about the welfare of others and take a purely instrumental view of the kind of society in which they live.⁹

5.2. Historical perspectives

The empirical and historical literature linking culture to economic performance is extremely diffuse. It is possible, however, to identify three specific issues which have had a significant impact on the economic analysis of culture: the Weber thesis, obstacles to development, and the role of freedom.

Economic historians have long debated the Weber thesis that the Protestant Ethic promoted the growth of capitalism [Weber (1930)]. There is broad agreement that the spread of international commerce in Europe coincided with the Reformation (although

⁹ For a comprehensive critique along these lines see Roberts and Holden (1972) and Schoeffler (1955).

pre-reformation origins in Italian city-states must not be overlooked). However causality has been questioned. The Protestant Ethic can also be understood as accommodating Christian beliefs to the requirements of an emerging mercantile middle-class [Schlicht (1995)]. Behind the theological revolution, therefore, a vested business interest may be detected. Protestantism 'dis-intermediated' the Papacy and gave people a direct relationship with God through prayer. It undermined the case for paying the church for indulgences and the upkeep of chantries, and for obeying prohibitions on usury – and thereby reduced the economic burdens on the middle-class.

The theological content had real effects, however. The Protestant convert accepted grace through personal salvation. The sign of grace was not monastic seclusion, as before, but spreading the Gospel through engagement with the world. Business was a 'calling' which could promote missionary work. It supported the expansion of commercial empires into the 'darker corners' of the world. Whilst the origins of Protestantism may be questioned, therefore, its effects appear to be those which Weber predicted. Protestantism replaced the collectivist and procedural culture of the Roman Catholic church with a more individualistic and pragmatic culture, which formed the foundations of the competitive individualism that characterizes the West today.

Jones (1981, 1988) examines the 'take off' of commercialism in Western Europe from a different perspective and arrives at rather similar conclusions. Jones regards entrepreneurship as a natural human behavior which supports survival by encouraging people to show initiative in meeting their material needs. However entrepreneurship can be stifled by political tyrannies, in which collectivism and proceduralism are imposed [Rosenberg and Birdzell (1986)]. The motive is to monopolize the tax-base and use its revenues to support a leisured lifestyle for the elite. From this perspective the Reformation is a protest movement which, by overthrowing a parasitic religious elite, liberates people to follow their natural entrepreneurial inclinations. China and other Asian powers have never liberated themselves in this way; when one elite is deposed, another simply takes its place. Once again, however, the explanation may be cultural – perhaps Western society is intolerant of political oppression in the way that some Asian societies are not.

Development economists have addressed similar issues but from a more secular perspective [Bardhan (2000)]. A drive to 'modernize' post-colonial societies is typically advocated [McClelland and Winter (1969)]. In the 1960s modernization became the secular equivalent of the Protestant ethic. The object was to engineer a high-tension society driven by a desire to catch up with the West, in place of a low-tension society where people are content with low living standards and high mortality. Individualism was a secondary consideration; in the 1960s planned industrialization behind protective tariffs was the recommended strategy, and it was only in the 1990s that privatization and liberalization took over.

A major obstacle to economic development in the poorest countries is weak internal communications which perpetuate a cellular social structure based on local family and tribal loyalties. High levels of local trust are combined with low levels of trust at the national level. National government is too corrupt to intermediate the flow of funds between international agencies and local people. The engineering of trust at the na-

tional level has been accomplished in a number of Asian economies but with one or two notable exceptions there has been little success in Africa. As noted earlier, creating a high-tension high-trust society has proved difficult even in prosperous Western countries.

The disintegration of Soviet communism has led to a resurgence in research dedicated to showing that 'freedom' holds the key to economic performance [Gwartney and Lawson (2003)]. The guarantor of freedom is usually said to be a US-style constitution [Scully (1992)]. A range of freedom indicators has been developed, and cross-country statistical regressions have been reported which confirm the impacts of freedom on living standards and economic growth. On the whole these regressions simply confirm that, other things being equal, Western-style competitive individualism promotes economic growth. The point is not difficult to make if a sufficient number of poor African dictatorships is included in the sample of countries. As in any cross-section regression, there are omitted variables, and much of the sample variation remains unexplained. The apparent significance of some of the variables may be due to the presence of omitted cultural variables, including the legacy of traditional religion [Kohut et al. (2000)]. Whilst these regressions are a significant advance on anecdotal evidence, the range of explanatory variables is too narrow to offer a full account of cultural factors in economic performance.

Advocates of freedom as the critical factor are usually unsympathetic to a cultural interpretation of their findings and this biases the way in which they interpret their results. They typically believe that laws, not morals, reduce agency costs and transaction costs. They believe that a written constitution enforced through impartial courts is better than an unwritten constitution enforced through social sanctions. They believe that the biological drives such as greed and aggression are better guarantors of competition than a genuine desire to benefit the customer. They therefore ignore crucial issues such as why greedy judges do not accept bribes, and how the basic needs of people with low incomes are met.

The historical significance of culture is related to the historical significance of other intangible public goods, such as technological know-how. It is therefore not surprising that modern writers on convergence of national economic growth rates have begun to develop an interest in cultural issues. The traditional way of analyzing the convergence of growth rates focuses on technological diffusion, but there is no reason why the analysis should not include cultural diffusion too. The rapid spread of free-market ideology in the 1990s, with many governments reducing tariffs and privatizing and deregulating their utilities, is a clear example of cultural diffusion. Such cultural diffusion can lead to convergence in institutions as well as in rates of growth. A particularly interesting development has been the incorporation of religion in the convergence model.¹⁰ Whilst the European empires of the nineteenth century are often credited with the spread of Christianity, the US-led Western 'empire' of the late twentieth century is noted chiefly

¹⁰ For a significant step in this direction see Barro and McCleary (2003).

for its spread of secularism. This raises the issue of whether religion or secularism is best for economic growth. If religion is best then the spread of secularism could lead to convergence on a sub-optimal level of growth. The analysis in this chapter suggests that it is the specific content of religious belief that is crucial in this respect, because it is the specific beliefs that determine the emotional incentive structure which motivates people. A simple distinction between religion and secularism is therefore too crude to properly identify the link between religious belief and economic performance. The impact of the spread of religion and culture on the convergence of growth rates is clearly an important topic which warrants further research.

6. Conclusion

This chapter has shown that the influence of culture on the economy extends well beyond the production and consumption of cultural goods in the field of media and the arts. Culture is concerned with the production and distribution of values and beliefs relating to fundamental issues. Cultural products are simply one of the means through which these values and beliefs are expressed. Identifying the fundamental issues addressed by culture is the key to analyzing its impact on economic performance. Values and beliefs of a suitable kind can improve economic performance – both materially, and by enhancing quality of life. Culture is therefore an economic asset. Culture is shared by communication between the members of a social group. It is, in fact, an intangible durable public good. Significant investment is required to create and maintain this public good. Competition between cultures, in terms of relative economic performance, is essentially competition between social groups in investing in appropriate public goods of this type.

By modifying five key assumptions of conventional neoclassical economics, and introducing a theory of leadership, it is possible not only to explain how culture influences performance but also to explain how cultures will adapt to changing local conditions. There are different levels of leadership, corresponding roughly to the size of the group that the leader controls. At any given level the nature of competition is strongly influenced by the media that leaders employ to recruit and retain their followers. The development of mass media disseminating visual images has had a profound effect on ideological competition between political leaders. Changes in the media have made the promotion of high-trust cultures extremely difficult, whilst a skeptical attitude towards leadership in general has diminished the supply of able leaders. Distorted incentives in the market for leadership mean that the most effective culture does not always prevail.

The ideal culture from an economic point of view is individualistic, pragmatic, high-trust and high-tension, though each of these attributes must be moderated to some degree by the need to adapt the culture to local requirements. A simple way of summarizing the advantages of this culture is to note that it is both entrepreneurial and moral. It is entrepreneurial because it encourages innovation and risk-taking, and it is moral because it discourages innovations or risky ventures that cause disproportionate damage to the

interests of others. It is moral because it encourages honesty and loyalty, but it is entrepreneurial because it does so without stipulating rigid conformity to specific practices.

The high-performance culture also encourages both freedom and responsibility. Freedom allows diversity of behavior and thereby facilitates innovation. It also decentralizes power: it allows decisions to be taken by people who have immediate access to relevant information, and so avoids the expense and delay of referring straightforward decisions to higher authority. However responsibility requires people to show consideration for others [Ellickson (1991)]. In respecting other people's freedoms, they accept constraints on their own. They consult with other people before acting in an unexpected way. Consultation is effected both formally and informally. A high-trust culture encourages people to honor informal agreements. A legalistic culture sets out rights and responsibilities, records them and enforces them. People are obliged to negotiate with people who hold the relevant rights before they act. Informal methods work well with members of a tightly-knit social group – friends, relatives and neighbors – whilst formal methods are more appropriate for more impersonal groups. A moral culture will rely on trust as much as possible but will underpin trust by the rule of law.

The high-performance culture respects both tradition and modernity. Embracing modernity promotes scientific research and the practical application of science in engineering and medicine. It also encourages economy through the systematic elimination of waste. Tradition on the other hand underpins many core moral values. Conflict can ensue when scientific discoveries appear to undermine traditional religious beliefs on which conventional morality is based. Some religions are more vulnerable than others on this score, however. An entrepreneurial culture is not devoid of religion, but rather involves religious beliefs which co-exist with a scientific view of the world.

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