

Why Culture Matters Most

Presented at

The American Economic Association Meeting
Boston, MA, USA

3 January 2015

David C. Rose
Department of Economics
University of Missouri-St. Louis
rose@umsl.edu

Note: This is a *very* rough draft. Comments and suggestions are most welcome but please do not quote without contacting the author first.

Why Culture Matters Most

Abstract

This paper presents a very brief overview of my forthcoming book, *Why Culture Matters Most*, and then discusses one of the implications the proposed framework has for the role that culture plays in supporting free market democracies.

The paper first briefly explores why culture – not genes, geography, institutions, or policies – is the key to explaining the differential success of societies. This is because only culture can produce high trust societies by overcoming the most fundamental obstacle there is to human flourishing and advancement: rational self-interest undermining the common good.

Prosperity requires large group cooperation but the larger the group, the more likely rational self-interest and tribalism undermine the common good. My central claim is that human flourishing requires a high trust society. This is because a high trust society is required for the development of crucial free market and democratic institutions.

A key element of any high trust society is trust in the system. Trust in the system is having confidence that society's "rules of the game" will not be changed in arbitrary or self-serving ways. I explain why in a free market democracy trust in the system becomes increasingly harder to sustain the more successful a society becomes. This is because the democratic process becomes increasingly prone to facilitating redistributive and regulatory favoritism.

Unfortunately, the larger a society is the more likely institutional safeguards will fail to keep voters from demanding ever more redistribution and regulation. I explain how culture uniquely circumvents this problem by aligning self-interest with the common good through moral beliefs that function pre-rationally and scientific beliefs that suppress tribalism. The earlier in life such beliefs are inculcated, the less susceptible we are to being persuaded by arguments that exploit tribalism for narrow political ends.

Why Culture Matters Most

Introduction

What explains the differential success of societies? This is one of our most enduring questions because its answer has long been relevant to virtually everyone. Nearly everyone understands that the society one lives in powerfully affects one's quality of life no matter how talented one is and no matter how hard one tries. So the key to insuring that most people are able to live happy and successful lives is having successful societies for them to live in.

Going back at least as far as Plato, this question has driven the study of political economy. The reason why is obvious. The better we answer this question, the more successful we'll be attending to the practical business of structuring society so as to maximize human flourishing and advancement.

My goal is to attempt to make progress on answering this question by considering the possibility that culture plays an even more important role in social, political, and economic development than previously understood. My overarching hypothesis is this: just as it is true that the free market system and democratic government rests on institutional foundations, such institutions, in turn, rest on a cultural foundation.

In my forthcoming book, *Why Culture Matters Most*, I explain why culture – not genes, geography, institutions, or policies – is the key to having a high trust society that best supports free market democracy and therefore best explains the differential success of societies. I show how and why culture, in an effective and unique way, addresses the most fundamental of all obstacles to human flourishing and advancement: the problem of individual self-interest undermining the common good. In what follows in this paper, however, I will address a narrower topic, that of the role that culture plays in developing and sustaining free market democracies.

Background

A few countries are wonderful places to live, work, and raise a family. A few are dreadful. Most are somewhere in between. There is very little disagreement about which countries belong in which category. And if you ask why these countries are so different, most people will say it is largely because of their differences in culture.

The theories people offer for why culture matters are varied and often wanting. Their theories range from banal to bizarre, from innocuous to disturbing. But their powers of observation are in good working order. The big difference is indeed culture. And they are in good company. As the great Harvard economic historian, David Landes, famously stated:

If we learn anything from the history of economic development, it is that culture makes almost all the difference. [Landes, 2000, p. 2]

This was a very controversial view not so long ago. Consider the reaction to Lawrence Harrison's *Underdevelopment is a State of Mind* (1985). But over the last decade in special issues of the *Journal of Economic Perspectives* (Spring 2006) and the *Journal of Economic Behavior and Organization* (September 2009), and in even more recent work by Algan and Cahuc (2010), Tabellini (2010), Gorodnichenko and Gerard (2011), and Luttmer and Singhal (2011), it is evident that there is an increasing awareness that culture matters even more than previously thought. It is also becoming increasingly clear that it is imperative that we investigate why some cultures produce a better general quality of life than others.

A natural way to explore the nature of the connection between economics and culture is to examine the historical record. If culture matters, then there should be economic phenomena that change in response to changes in moral concepts like virtues that are transmitted through culture. Max Weber's (1958[1904]) famous argument that Protestant emphasis on industriousness helped launch the rise of capitalism is, of course, the most well known example of such efforts.

Deirdre McCloskey (2006, 2010) shed important light on the role of culture by examining the relationship between the development of free market societies and the virtues. McCloskey provides a compelling account for how the development of free market societies in the West was catalyzed by the spread of *The Bourgeois Virtues*. Economic development took off when these virtues appeared in sufficient measure, presumably by becoming fully ensconced in the culture.

Yet despite all of this work most academics and intellectuals continue to believe Landes' claim to be incorrect and offensive. For many academics and intellectuals, accepting that culture might matter most changes nearly everything they thought they knew about how the world works. Saying culture matters most remains politically incorrect because it appears to rob us of any hope for improving the quality of life of those who live in impoverished societies. It also appears to provide too easy an excuse for the rich to ignore the poor.

The story of the role culture plays in shaping human societies begins in prehistory. Our immediate pre-human ancestors did not dominate the planet, but we do. Why? Path breaking books such as Boyd and Richerson's *Culture and the Evolutionary Process* (1985), Richerson and Boyd's *Not by Genes Alone* (2005), and Bowles and Gintis' *A Cooperative Species* (2011) strongly suggest that it was not simply because our genes made us smarter. Also important was our extraordinary ability to create and sustain culture. This is because culture dramatically sped up our ability to adapt to the world around us. That's the trick to populating the planet from equator to the arctic.

This work also suggests that culture isn't just a uniquely powerful product of human genes. Culture also feeds back on genetic evolution. When we do new things that just so happen to improve our chances for survival, genes that support such activities become reinforced in the population. It is therefore becoming increasingly clear that culture is not just a product of, but is also a writer of, the human genetic recipe.

An inevitable byproduct of our success over other species was increasing competition with other humans. It is well known that this likely contributed to a cognitive arms race that increased our intelligence beyond what was needed to dominate other species. But it also likely contributed to a cultural arms race as a new margin of group level competition through culture emerged: the evolution of cultural beliefs to facilitate ever more effective cooperation within groups. This, of course, increased our ability to compete with other humans living in other groups. Because speed of adaptation became so crucial in this competition, memes (ideas that function evolutionarily like genes but that change faster than genes) became increasingly important relative to genes in deciding which groups were the most successful.

After humans filled the world, the rise of agriculture allowed us to build entire societies. Just as bands and tribes competed with one another, now entire societies did. Competition between societies induced further changes in institutions and culture. Improved modes of transportation also increased competition between societies and thereby sped up the evolutionary process even more. Speed of change itself became a margin of competition, so memes became ever more important relative to genes in explaining the differential success of societies.

This account comports with our relatively low level of intra-species genetic variation. If only genes accounted for the differential success of societies, then our intra-species genetic differences would have to be relatively large to adequately explain the relatively large

differences in success across societies. But nearly every other mammal has less variation in how they live across different groups but significantly more variation in their genes. So whereas genetic differences are not likely to provide a good explanation the differential success of societies, our unique capacity for culture might.

The societies that were the winners in this competition were, by definition, the most successful societies. But that does not necessarily mean they were the best societies to live in or the societies that would do the best job advancing humans generally. For a very long time societal success benefitted a minority elite largely at the expense of terrible misery endured by the vast majority of people in any given society.

Over time, however, it became increasingly the case that societies that best supported general human flourishing were also the most likely to become the most successful in the long-run. It also became increasingly clear that humans are most likely to flourish, both individually and collectively, when they live in free market democracies. All other societies were (and are) simply no match for their creativity and vitality. Fifty years ago one could have quibbled with this claim, but no longer. It is just too difficult for a society to dominate or conquer another society if it is always playing catch-up with that society.

So why, then, haven't all societies become free market democracies? Even more perplexing, why are free market democracies so prone to unwinding the very institutions and policies that made them successful in the first place?

One reason why these questions have proven so hard to answer is that the study of institutions has dominated the discussion. It is hard to overstate the importance of institutions to the process of development, of course, but the study of institutions has tended to either subsume or crowd out the study of culture. As one example of the continuing emphasis on institutions, in *Why Nations Fail* (2012), Daron Acemoglu and James Robinson explain the differential success of societies by arguing that it is the absence of “institutions, institutions, institutions” that explains the existence of poorly performing societies.

Most social scientists now agree that having the right institutions is a necessary condition for developing and operating a thriving free market economic system (Grief 2006; North 1990; 1991; 1994). They are right, of course. But a necessary condition does not a sufficient condition make. We have learned the hard way that institutions cannot be simply dropped into any given

society. Of particular relevance here is that institutions that evolved in high trust societies but are absent in low trust societies nearly always fail when implemented into low trust societies.

Moreover, in nearly all free market democracies today crucial market institutions are being unwound. At the same time, highly successful free market democracies are showing signs of faltering. Over the last half century the problem hasn't been unwillingness or inability to adopt market institutions and policies so much as it has been inability to sustain them after they have produced success.

I contend that the problem is that many institutions are high trust dependent and since a high trust society is a cultural phenomenon, by extension they are culturally dependent. As such, I contend that culture is what ultimately explains the differential success of societies. It is inadequate culture that explains why most societies do not flourish and it is the erosion of culture that explains why successful societies so frequently falter from largely self-inflicted wounds.

The reason why culture is so important is that it addresses, in a unique way, a deep and ubiquitous problem faced by all societies. The problem is that what's best for the individual is often not what's best for society. In other words, rational self-interest often undermines the common good. This is hardly news. It has been a part of accepted wisdom of nearly all societies dating back to the ancient Greeks. It is the crux of innumerable parables, plays, books, and movies. It is also a key issue in group selection models in evolutionary biology.

But it's worse than that.

This problem becomes far worse the larger are the groups within which we live. This is unfortunate because the key to having general prosperity is reaping the maximum gains from specialization, and gains from specialization rise dramatically with group size. This is not a controversial claim by any means. It quickly became one of the most universally accepted propositions in social science since Adam Smith introduced it in 1776.

So humans have a dilemma. The good life requires cooperating in large groups, the larger the better, but the larger the group, the more likely that what is individually rational works against the common good. This is because the commons dilemma associated with untrustworthy action is worsened by group size like all commons dilemmas are by construction. Put another way, the larger the group, the greater is the wedge between that which best promotes individual welfare and that which best promotes the collective welfare. Because of this, the larger the group, the

harder it is to trust that nearly all individuals will abide by rules that they and everyone else agree to so as to avoid this problem.

This point is not entirely original. Mancur Olson's classic *The Logic of Collective Action* (1965) worked out some of this argument with respect to special interest politics almost a half century ago. Some readers will also recognize this as a commons dilemma problem from the field of game theory. This kind of problem became part of the Western lexicon with Garrett Hardin's famous essay "The Tragedy of the Commons" (1968).

In my view, the most successful societies are those that have figured out how to overcome these kinds of dilemmas. In such societies people can trust each other to follow rules that exist keep self-interest from undermining the common good. I will explain why the key to overcoming such dilemmas is to eliminate them altogether by changing the payoffs to individuals through their own moral tastes. In doing so, individually rational behavior that is problematic for society as a whole can be rendered moot by making it irrational. This is achieved by inculcating internalized moral beliefs that produce involuntary feelings of guilt for behaving as an individual opportunist at the expense of society as a whole.

Human Flourishing

Obviously a number of factors explain the differential success of societies. There is a long list of requirements for best supporting human flourishing, but two factors would be widely regarded as necessary conditions are these: general prosperity and freedom. I shall now briefly argue that the key to producing a condition of general prosperity and freedom is being a full-fledged free market democracy.

Free markets produce general prosperity by unleashing the full power of large group cooperation. The price system is nothing if not a mechanism for effectuating efficient cooperation across entire societies by assuring all resource users bear the social opportunity cost of resource use. This facilitates very large scale production, which is the key to effectuating increasing returns to production and having more goods per capita. There is more to achieving a condition general prosperity than Hayek's point about the price system solving the local knowledge problem and Adam Smith's point about increasing returns, but together Smith and Hayek's framework nevertheless established the following iron law of economics: if all economic activity is limited to small groups, poverty is guaranteed.

Conversely, the larger the group within which economic activity occurs the more prosperous the group as a whole will be. This is almost true by definition. One hallmark of free markets is voluntary transacting. Voluntary transactions must be expected to be mutually beneficial in nature and therefore positive sum. Virtually any positive sum activity satisfies the definition of cooperation.

Democracy is also important because free market activity is meaningless without freedom, and democracy protects freedom by serving as a check on government power. We need government for contract and property rights enforcement for strong incentives for cooperation, but a government with enough power to do this has enough power to deny citizens their freedom. Democracy gives citizens the power to vote those in government out before things go too far.

I submit that the key to creating and sustaining a free market democracy is having a high trust society. This is because many free market institutions and democratic institutions are highly trust dependent.

For free markets to most fully support the voluntary transactions through which cooperation occurs, a society must have the lowest possible transaction costs. This requires trustworthy transaction partners and a trustworthy government to enforce contracts and property rights.

For democracy to adequately check government power, citizens must be able to trust that the democratic process will be honestly administered. They must also trust that the democratic process will not be used as mechanism for engaging in political favoritism at their expense.

A society filled with trustworthy individuals and a trustworthy government – what I call a high trust society – is therefore a necessary condition for most fully enjoying the benefits of general prosperity and freedom. So it's all about having a high trust society. My big claim today is that culture is the key to producing a high trust society, which is why I contend that culture matters most. Just as a free market democracy rests on an institutional foundation that institutional foundation rests on a cultural foundation.

As noted above, economists are normally reluctant to make these kinds of arguments. Oliver Williamson famously quipped that the study of trust was a distraction. Robert Solow argued that social capital – an area that has one foot in trust and the other in culture – is also likely to be unfruitful. At the same time, culture is hard to define, hard to measure, and hard to model. Cultures vary greatly from society to society, but we prefer explanations that are highly general. And for rather obvious reasons, we also try to avoid touchy subjects like morality.

Moral Beliefs, Moral Tastes, and Trust

A high trust society arises from a norm of trustworthiness. Without it extending trust to most people in most circumstances would be irrational so a high trust society would be impossible to sustain. In 1988 Robert Frank argued that if one's reluctance to behave in an untrustworthy way is derived solely from rational calculation, one will always behave in an untrustworthy way if there is no chance of detection. Frank called such circumstances "golden opportunities" and they are precisely the kind of circumstances in which trustworthiness is meaningful and makes a difference.

How do we get around this problem? Frank reasoned that the key was people experiencing involuntary feelings of guilt when they behave in an untrustworthy way because they'll feel guilty whether detected or not, and they know it.

The key word is "involuntary." If people consciously choose to feel guilty it won't work. Guilt must arise from a sincere belief that behaving in an untrustworthy way is wrong so it will manifest itself at a pre-rational stage of decision making.

The key, then, is for people to have moral tastes that exert their influence at a pre-rational stage of decision making. If the disutility from experiencing involuntary feelings of guilt is high enough then the net payoff to behaving in an untrustworthy way will be negative, making such behavior irrational even when the individual believes that there is no chance of detection. This beats the commons dilemma because it is the rationality of the individual doing what harms society as a whole that is the crux of the problem.

In *The Moral Foundation of Economic Behavior* (2011) I explained why the psychological mechanisms that support small group trust cannot be scaled up to produce large group trust. Large group trust must therefore be based on something else. I explained why maximizing the breadth and depth of trustworthiness requires moral tastes with a particular logical structure. I argued that such moral tastes are necessarily instantiated through moral beliefs that, not surprisingly, possess particular characteristics. The required characteristics for making large group trust possible turned out to be abstract and often contrary to our instinctive moral intuitions.

Others have advanced the cheerful argument that the basis for human morality and trust is deeply hardwired. I don't disagree with this notion with respect to small groups since we evolved

in small groups. But there is no reason to expect our genes to support large group trustworthiness and there is no evidence that they do. If they did, we'd expect all large societies to be high trust societies and therefore prosperous societies. But most are neither.

This makes sense. Most of the world is filled with people in low trust societies, but there is no shortage of trust behavior in those societies. I submit that what we are observing is largely small group trust, which our genes do a good job supporting for obvious reasons. The problem is that a great deal of small group trust is not an adequate substitute for large group trust. But we need large group trust to unlock the power of large group cooperation. At the same time, unlike hardwired moral intuitions, invented moral beliefs can vary greatly across societies, which is a good thing when you are trying to explain the differential success of societies.

I contend that culture is so important because it is the only known mechanism for conveying the right kind of moral beliefs. If people choose moral beliefs for themselves because they believe it is prudent to do so, then as soon as a “golden” opportunity to promote their welfare at the expense of society presents itself, it will be prudent for them to act on it.

Only culture gets around this problem by separating the decision to have moral beliefs from the costs of abiding by them later. This, I believe, is one why religion has been such an important part of the human story. Religions can provide a compelling narrative to convey moral beliefs and moral tastes. For a more general argument that comports with this claim, see David Sloan Wilson's book *Darwin's Cathedral* (2002), which contends that religion likely evolved to facilitate greater cooperation.

Implications for Free Market Democracies

Although there are many well-known arguments for why capitalism and freedom are mutually reinforcing, I submit that free market democracies are inherently unstable and that only culture can ultimately address this problem – constitutions, laws, institutions, and policies aren't enough.

Here's the problem. The larger a society is, the more likely the democratic process will become a mechanism for redistributive and regulatory favoritism. The crux of this problem was worked out long ago in one of the most influential books ever written in political economy, Mancur Olson's *The Logic of Collective Action*.

Favoritism doesn't create wealth; it only moves it around in zero-sum fashion. So the winners in Olson's story required losers. But we can't all benefit from being zero-sum parasites

at the same time. And those who don't even try – members of acquiescing majority that effectively serve as host – end up being the biggest losers of all.

My point is not to belabor what you already know, which is that commons dilemma problems produce Nash equilibriums that are inefficient. My point today is that this kind of behavior inevitably destroys what I call *trust in the system*. Trust in the system goes beyond generalized and presumptive trust that individuals – even strangers – have for others in their society. Trust in the system is having confidence that laws, policies, or their patterns of enforcement will not be changed from the top down in silly, arbitrary, or self-serving ways.

The only way to have all special interest groups get more money from the public sector is for the public sector to take more money from the private sector. This reduces the return to cooperation thereby reduces output per person, further increasing pressure for redistribution, and so on. Unexpected changes in policies to effectuate redistributive and regulatory favoritism are viewed by those who actually create wealth as endless “baits and switches” that ultimately destroy trust in the system.

Such unexpected changes are analogous to the Robert E. Lucas's surprise aggregate supply function. Recall that in Lucas's framework unexpected monetary shocks can produce desired results in the short-run. But if used repeatedly, people increasingly catch on to the game. Whether it is unexpected changes to money growth or unexpected changes in policies associated with redistribution and regulation, trust in the system is increasingly destroyed so the net social gains are penny-wise, pound-foolish at best.

This process does not merely reduce the strength of incentives for effective large group cooperation by reducing trust in the system. It can also erode trust in the democratic process itself. Political favoritism is inherently zero-sum. As the stakes of political favoritism rises, the fear of being on the losing side rises so the temptation to engage in electoral fraud rises. At some point cartel problem incentives may induce pre-emptive fraud, making electoral fraud a self-fulfilling prophecy. This destroys trust in the democratic process and ultimately trust in the system.

It is important to not lose sight of the fact that group size is an important factor in all of this. The key to maximizing general prosperity is large group cooperation. But the larger a society is, the longer redistributive and regulatory favoritism produces significant marginal gains to favored groups without producing perceptible costs to the majority. Because of this, trust in the system –

including trust in democracy itself – is prone to a death by thousand cuts in the long-run. For a free market democracy to be sustainable, the democratic process must be kept from undermining trust in the system via political favoritism.

So the closer we come to having it all – large group size and strong trust – the harder it is to keep it up. This makes perfect sense. If all there was to the story was the mutually reinforcing effects of capitalism and freedom, then our efforts to kick start economic development around the world would have already produced free market democracies nearly everywhere that support widespread human flourishing.

This contrasts with another cheerful position, one associated with Jeffrey Sachs's view of economic development. Sachs contends that once economic development gets going in earnest, it tends to proceed under its own steam. The key problem, then, is getting impoverished societies up to the first rung of the ladder.

But in this case the earliest commercial societies should now be the most prosperous, and they aren't. At the same time, there has been a strong effort over the last century to get many societies up the first rung, as it were, and many of these societies are no better off. Finally, this account does not explain why so many highly successful societies settle into policies that dramatically slow their growth and worsen their quality of life (e.g., post-war Great Britain).

Economic history is not replete with first mover advantage. Economic history is replete with the rise and fall of dominant societies. Any explanation for the differential success of societies must comport with this. An underlying commons dilemma associated with trust in the system that is worsened by increased development and growth is at least potentially consistent with the tendency for societies to rise and fall.

In my view we must recognize that democracy is neither new nor special. Democracy is a very old and ubiquitous small group collective choice mechanism that works well in the kind of small group contexts within which it evolved. But as group size increases the returns to political opportunism via Olson's interest group dynamics increases dramatically. As democracy increasingly facilitates political favoritism, citizens are increasingly faced with a choice to act as political opportunists or serve as fools.

Going back at least as far as Plato, scholars have warned us about democratic mob rule. But not enough attention was paid to group size and trust in the system. Even so, at some level many

very smart people understand all of this and some have questioned whether democracy is really such a good idea after all.

I think this is too pessimistic. I think it underestimates the value of democracy in protecting freedom from tyranny. In my view the real problem is not democracy *per se*, it is unbridled democracy. Unbridled democracy is not a big problem in very small group contexts because Olson story can't get off the ground. But if democracy is to be employed in large group societies required for general prosperity, democracy must be bridled so the kind of political opportunism Olson described is held in check.

One solution is to bridle the democratic process through institutional constraints. Institutional constraints are certainly better than no constraints. But in a genuine democracy such constraints can be altered by the democratic process. We can even vote to amend the constitution itself. We have, of course, already done so precisely to remove prior constraints. Institutional solutions that avoid *that* problem by not being amendable via the democratic process *ex post* are obviously inconsistent with freedom.

Contrary to what many now claim, our problems in the West are not the result of institutional or policy shortcomings, or of the government not being willing to give voters what they want. In reality government has been doing an outstanding job giving voters what they want. In reality the problem, and therefore the solution, lies with the voters themselves.

In my view it is now clear that maximizing human flourishing by most fully supporting free market democracy requires that voting behavior be *morally* constrained. Specifically, it requires that voters refuse to use the democratic process as a means of redistributive or regulatory favoritism because they believe doing so to be wrong regardless of how noble the ultimate ends are. Only restraint manifested through the moral tastes of the voters themselves can avoid democracy becoming such a self-defeating mechanism, on the one hand, while remaining perfectly consistent with individual freedom, on the other. Culture is so important because such moral tastes will not be rationally chosen by the actors themselves. To constitute a prevailing ethic that sustains a truly high trust society, they must be culturally transmitted – they must be taught to children as early and as often as possible.

So to have a sustainable and prosperous democracy, a society must have the right kind of culture, because only moral beliefs that preclude using the democratic process to promote any individual's or any group's welfare at the expense of society as a whole can check such political

opportunism without curtailing freedom at the same time. In this way market and democratic institutions rest on a cultural foundation. And in this way the paradox of free market democracies unwinding the very institutions and policies that made them so successful in the first place is explained by democracy unbridled by culture.

I want to stress that solving genuine market failure problems to promote the common good is not an exercise in favoritism. There is, therefore, nothing about what I've said today that conflicts with having social safety nets that address problems of market failure. Recall that even F.A. Hayek, a champion of free markets and the free society, supported social safety nets.

In summary, the good life requires cooperating in very large groups, but the larger the group, the more likely it is that what choices that are individually rational work against the common good. This is a devastating fact of life for human societies, because the best possible sustainable outcome for everyone is one that is almost inevitably undermined by our individual rationality. The trick to solving the problem isn't to try to overcome this rationality but, instead, to change what is rational through moral beliefs that function as tastes in the decision making process. Culture is a unique process by which such moral beliefs can be credibly and consistently instantiated in the minds of the vast majority of citizens to produce such a result.