

**PROXIMATE AND FUNDAMENTAL FACTORS OF GROWTH:  
CULTURE AND INSTITUTIONS**

**NEPOSREDNI I FUNDAMNENTALNI FAKTORI RASTA:  
KULTURA I INSTITUCIJA**

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**Abstract**

*Political macroeconomy demonstrates that no single factor (market economy) is sufficient for the emergence of democracy. Reforms in post-socialist countries were based on misleading assumption of causality running from market economy towards consolidated democracy. Good institutions are characterized with three attributes: first, they establish and protect property rights; second, they restrict social elites which strive to expropriate income and property of others members of society; third, they provide equal chances for employment, social security and civil rights to all individuals. Good institutions contribute to political stability, succesfull macroeconomic policy and enhance initiatives. Key role of institutions is in securing stability and continuity. Institutional inovativeness is confirmed in great historical events as transition to capitalism, Great Depression, postwar reconstruction, ongoing Great economic 2008. crisis. Authors demonstrate the importance of values - culture and governance for economic growth comparing Asian and European countries (China, Japan, Germany, Russia) and South-Eastern countries (Serbia, Slovenia, Croatia). Authors conclude that fundamental factors of growth (culture and governance) are of much more importance for economic growth and were greatly neglected during social and economic development of post-socialist contries.*

**Key words:** *political macroeconomy, institutions, culture, democracy, good governance.*

**Apstrakt**

*Politička makroekonomija pokazuje da samo jedna faktor (tržišna ekonomija) nije dovoljan za razvoj demokratije. Reforme u postsocijalističkim zemljama temelje se na pogrešnoj pretpostavci da je tržišna ekonomija dovoljna za ostvarenje konsolidovane demokratije. Razvoj institucija je bio uveliko zanemaren. Dobre institucije su one koje imaju sledeće atribute: da uspostave i zaštite prava vlasništva; one ograničavaju društvene elite koji nastoje redistribuirati prihode i imovinu drugih članova društva; one pružaju jednake šanse za zapošljavanje, socijalna sigurnost i građanskih prava svih pojedinaca.*

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*Dobre institucije doprinose političkoj stabilnosti, uspješnoj makroekonomskoj politici i jačanju podsticaja. Ključna je uloga institucija u osiguranju stabilnosti i kontinuiteta. Institucionalna inovativnost je potvrđena u velikim istorijskim događajima kao što su: tranzicija u kapitalizam, Velika depresiji i zadnje finansijska kriza. Autori pokazuju važnost vrijednosti - kulture i upravljanja - za ekonomski rast upoređujući azijske i evropske zemlje (Kina, Japan, Njemačka, Rusija) i zemlje Jugoistočne Evrope (Srbija, Slovenija, Hrvatska). Autori zaključuju da su temeljni faktori rasta (kultura i upravljanja) mnogo važniji za ekonomski rast i da su bili veoma zanemareni u društvenom i ekonomskom razvoju post-socijalističkih zemalja.*

**Ključne riječi:** *politička makroekonomija, institucije, kultura, demokratija, upravljanje.*

## 1. GROWTH AND INCLUSIVE INSTITUTIONS

In recent two decades, due to contributions of Political macroeconomy, focus of macroeconomy turned away from narrow perspective based on market and privatisation (market fundamentalism) towards broader perspective based on institutions and values (institutionalism). Instead of normative economics this approach - art of economics - proves more fruitful in explanation diversities of social and economic development, and lower than expected results of development in undeveloped countries. "Human and physical capital are proximate causes of economic growth. Why do some countries have better technologies and more human capital?"<sup>3</sup> Which factors are fundamental factors of growth? Not as predicted and expected, market alone, but network of institutions, values strongly intertwined with very different conditions in each country alone. Market fundamentalism that predicted the same and obligatory model of development for all countries irrespective of their historical heritage is similar to Marxist/Leninist five-stage unilinear model of development (from primitive community to socialism). In essence, both are fundamentalism, alike religious one.

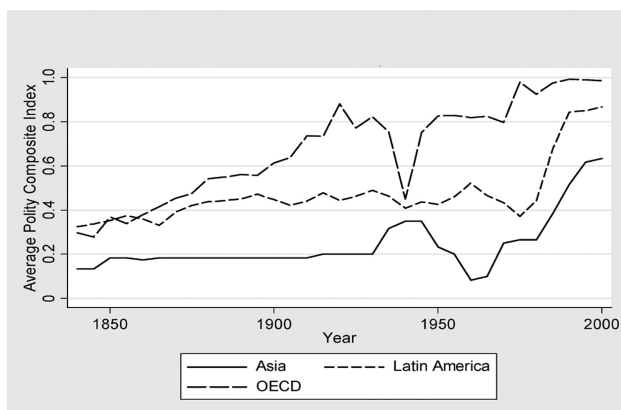
Main thesis of one of leading proponents of Political macroeconomy, D. Acemoglu, is: "growth is much more likely under inclusive (economic and political) institutions than extractive institutions. Inclusive economic institutions: Secure property rights, law and order, markets and state support (public services and regulation) for markets; open to relatively free entry of new businesses; uphold contracts; access to education and opportunity for the great majority of citizens, i.e., create incentives for investment and innovation and a level playing field. But most societies throughout history and today ruled by Extractive economic institutions: they are designed by the politically powerful elites to extract resources from the rest of society."<sup>4</sup>

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<sup>3</sup> Acemoglu, D., *Political regimes, institutions and growth*, June 2005, Tüsiad-koç university economic research forum.

<sup>4</sup> Acemoglu, D., *State Building: A Political Economy Perspective*, Nemmers Lecture. Acemoglu, D., Robinson, J., *Why Nations Fail*, FBBVA Lecture, May 21, 2012.

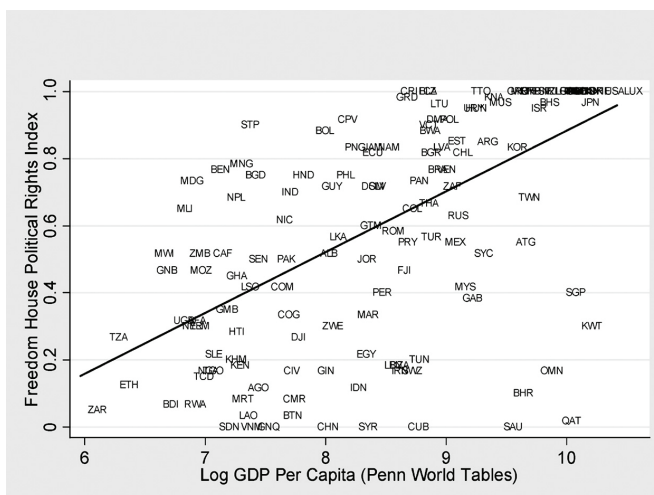
Graph 1: Average polity composite index (Asia, Latin America, OECD)



Source: Freedom House, Polity score

OECD countries in the whole period since 1840 were democratic, while democracy declined in other parts of the world. Graph 1 shows Average polity composite index for OECD, Asia, and Latin America. According to Polity score first wave of democratization happened during the First World War, and second one during Second World War.<sup>5</sup>

Graph 2: Log GDP Per Capita

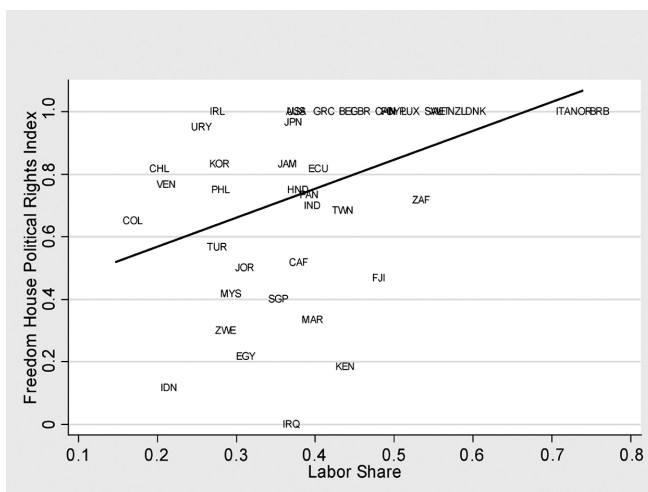


Source: Freedom house, Polity score

<sup>5</sup> Acemoglu, D., Robinson, J., *Economic Origins of Dictatorship and Democracy*, Cambridge University press, 2006., p. 52. Serbian edition, Zavod za udžbenike, Beograd, 2012, translators dr Milica Jakšić i dr Miomir Jakšić.



Graph 4: Labor share



Source: Freedom house, Polity score

Importance of institutions, culture and values lies in the fact that, contrary to previously dominant market fundamentalism, there exist correlation between GDP and democracy, but not oneway unilinear causation, either from side of GDP or democracy. "If institutions matter (so much) for economic performance, why do societies choose or end up with institutions that do not maximize economic growth or aggregate economic welfare."<sup>8</sup>

"Recent research demonstrates that cultural variables determine many economic choices they even affect the speed of development and the wealth of nations. Culture and institutions are endogenous variables, determined, possibly, by geography, technology, epidemics, wars, and other historical shocks. Can any causal link between the two be established? How do culture and institutions interact?."<sup>9</sup> Guiso, Sapienza, and Zingales (2006), defined culture as "those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to generation."<sup>10</sup>

The term culture, refers both to values and beliefs, and both are in decisive manner influenced by institutions which forms socio/economic framework for their emergence and evolution in complex and uncertain environments. North (1990) defines institutions as "the humanly devised constraints that structure human inte-

<sup>8</sup> Acemoglu, D., Modeling Inefficient Institutions, *Ekonomске ideje i praksa*, no. 12, march 2014., thematic issues Political macroeconomy and contribution of Daron Acemoglu.

<sup>9</sup> Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014., accessed 23.12.2014.

<sup>10</sup> Guiso, L., Sapienza, P., and L. Zingales, 2006, "Does Culture Affect Economic Outcomes?", *Journal of Economic Perspectives*, 20(2): 23-48, according to Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.

reactions. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, convention, and self-imposed codes of conduct), and their enforcement characteristics." In North's theory, formal rules are created by the polity, whereas informal norms are "part of the heritage that we call culture."<sup>11</sup>

Alesina and Guiliano conclude: "culture (or informal institutions) and formal institutions are interrelated, but the label "informal institutions" implies that formal institutions determine informal ones and that the latter are of secondary importance. Once we agree that formal and informal institutions interact, and that either one may cause the other, then identifying certain values and beliefs as culture or informal institutions becomes merely a matter of semantics."<sup>12</sup>

## 2. HOFSTEDE DIMENSIONS AND WORLD VALUES SURVEY

The most common tool for measuring institutions and culture is through indices and surveys questions. In this paper we used Hofstede dimension indice and The World Values Survey (WVS) for culture and compared different countreis.

Classical work of G. Hofstede was basis for inclusion of culture in the field economics, and nowadays contributions made by international human resource management and organizational culture.<sup>13</sup> In recent period Hofstede dimensions added new dimension to such explorations. Six dimensions were investigated:

### "1. Power Distance (PD)

People in societies exhibiting a large degree of power distance accept a hierarchical order in which everybody has a place and which needs no further justification.

### 2. Individualism versus collectivism (IDV)

Individualism, can be defined as a preference for a loosely-knit social framework in which individuals are expected to take care of only themselves and their immediate families. Its opposite, collectivism, represents a preference for a tightly-knit framework in society in which individuals can expect their relatives or members of a particular in-group to look after them in exchange for unquestioning loyalty.

### 3. Masculinity versus femininity MAS

The masculinity side of this dimension represents a preference in society for achievement, heroism, assertiveness and material rewards for success. Its opposite,

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<sup>11</sup> North, D., 1990, *Institutions, Institutional Change, and Economic Performance*, Cambridge University Press, Cambridge, according to Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.

<sup>12</sup> Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.

<sup>13</sup> Hofstede, G., 2001, *Culture's Consequences: Comparing Values, Behavior, and Organizations Across Nations*, second edition. Sage Publications.

femininity, stands for a preference for cooperation, modesty, caring for the weak and quality of life. Society at large is more consensus-oriented.

#### 4. Uncertainty avoidance index (UAI)

Countries exhibiting strong UAI maintain rigid codes of belief and behaviour and are intolerant of unorthodox behaviour and ideas. Weak UAI societies maintain a more relaxed attitude in which practice counts more than principles.

#### 5. Long term, orientation versus short term normative orientation (LTO)

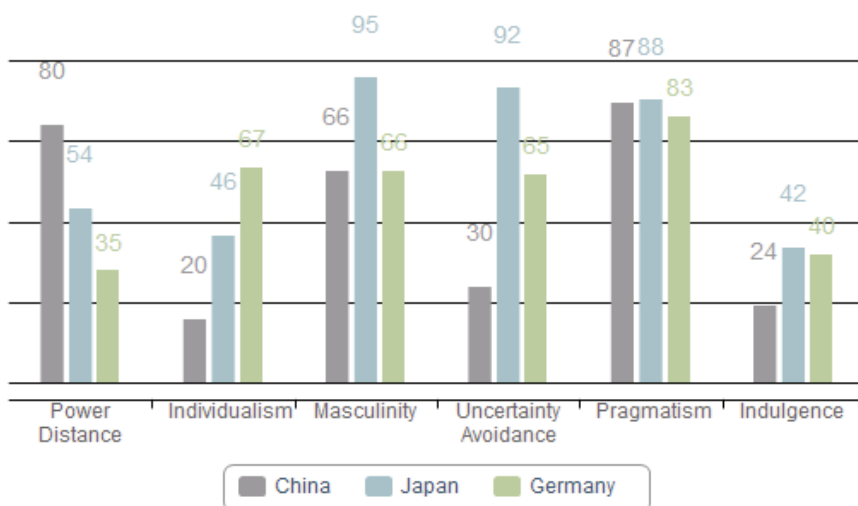
Societies who score low on this dimension, for example, prefer to maintain time-honoured traditions and norms while viewing societal change with suspicion. Those with a culture which scores high, on the other hand, take a more pragmatic approach: they encourage thrift and efforts in modern education as a way to prepare for the future.

#### 6. Indulgence versus restraint (IND)

Indulgence stands for a society that allows relatively free gratification of basic and natural human drives related to enjoying life and having fun. Restraint stands for a society that suppresses gratification of needs and regulates it by means of strict social norms."<sup>14</sup>

Next graphs present some of the results obtained on the basis of Hofstede dimensions website.<sup>15</sup>

Graph 5: Hosted dimensions (China, Japan, Germany)



Source: <http://geert-hofstede.com/dimensions.html>, accessed 4.1.2015

<sup>14</sup> <http://geert-hofstede.com/dimensions.html>, accessed 4.1.2015

<sup>15</sup> Source: <http://geert-hofstede.com/dimensions.html>, accessed 4.1.2015

Graph compared three countries (China, Japan and Germany). This countries were selected on the basis of following logic:

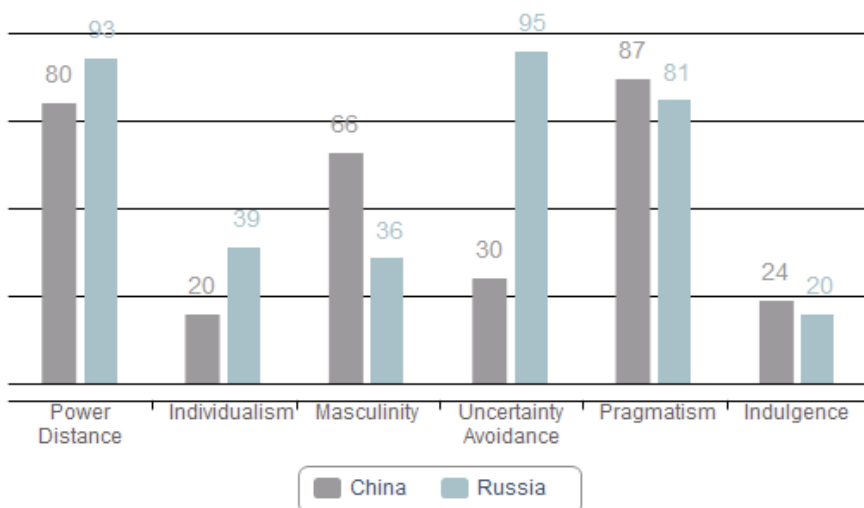
China: example of Asiatic mode of production – traditional society based on traditional culture, and, as Central empire, was not in the status of colony part of capitalist world economy and world system.

Japan: example of Asian feudal, not Asiatic mode of production, country, was not a as a colony part of capitalist world economy and world system. This enables us to exhibit experiment and to analyse influence of different traditional societies.

Germany: European capitalist economy, Japan Asian capitalist economy, China country of Asiatic mode of production.

The differences are due to traditional attributes of society and economy, not external influences, as three countries were not a colonies. Power distance is highest in China, (acceptance a hierarchical order in which everybody has a place and which needs no further justification) individualism highest in Germany, masculinity (The masculinity side of this dimension represents a preference in society for achievement, heroism, assertiveness) and uncertainty avoidance (rigid codes of belief and behaviour and are intolerant of unorthodox behaviour and ideas) in Japan, pragmatism similar in all countries, also indulgence. Hofstede index on the sample of three countries confirms expected hypothesis about the significance of historical heritage, values and culture of traditional society, and institutional path dependence.

Graph 6: Hosted dimensions (China, Russia)



Source: <http://geert-hofstede.com/dimensions.html>, accessed 4.1.2015



This Graph 6 compares two countries:

China: example of Asiatic mode of production – traditional society based on traditional culture.

Russia: semi-periphery, society and economy between Europe and Asia, in certain historical periods oscillated between center or periphery, capitalist and Asiatic mode of production. Individualism is higher in Russia, masculinity in China, uncertainty avoidance three times higher in Russia, pragmatism and indulgence almost the same.

What we can conclude from these examples is: the influence of historical heritage, institutions and beliefs is of decisive importance, more important than external influences in the examples of dominance of capitalist world economy over peripheral societies and colonies, or influence of nowadays global leaders over post-socialist countries (Russia and China): Hofstede's most important dimensions are influenced by internal, traditional, factors, not external ones.

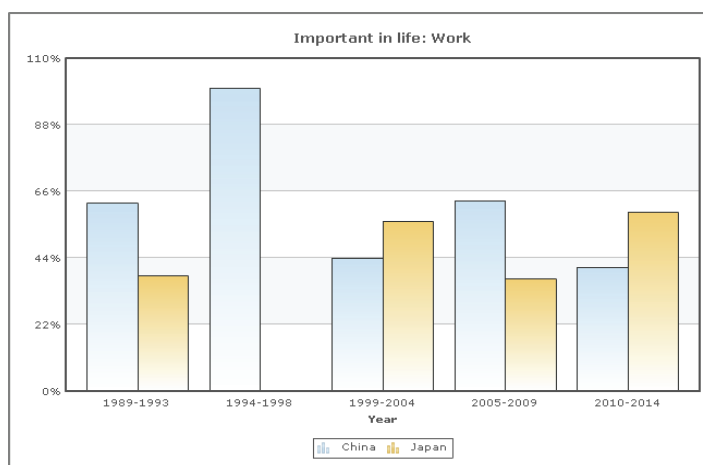
World Values Survey (WVS) is an indicator of the significance of values for specific countries. We selected the following countries: 1. China- Japan, 2. China – Germany, and 3. China- Russia, on similar logic applied to the Hofstede indices. The conclusions we can draw are as follows for the 1989-2014 period:<sup>16</sup>

- importance of work in China is reduced, in Japan slightly oscillated;
- importance of politics in subperiod 1994-2014 in China is significantly reduced, in Japan slightly oscillated;
- importance of religion in subperiod 1994-2014 in China is significantly reduced, in Japan slightly oscillated;

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Graph 7: World Values Survey (WVS) indicator for work (China, Japan)

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Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

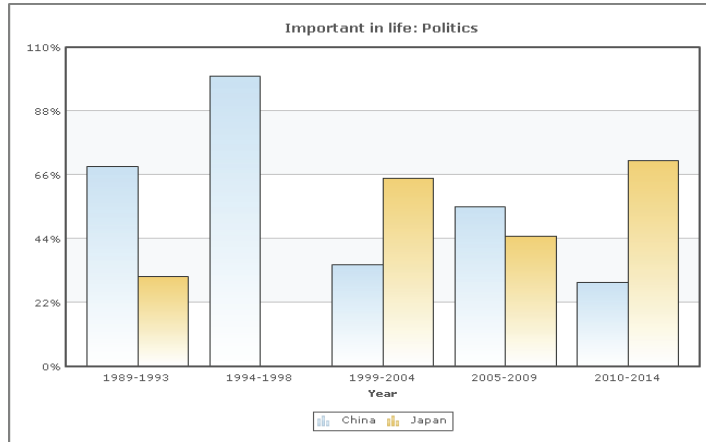
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<sup>16</sup> <http://www.worldvaluessurvey.org/WVSONline.jsp>, accessed 4.2.2015.

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 Graph 8: World Values Survey (WVS) indicator for politics (China, Japan)
 

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Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

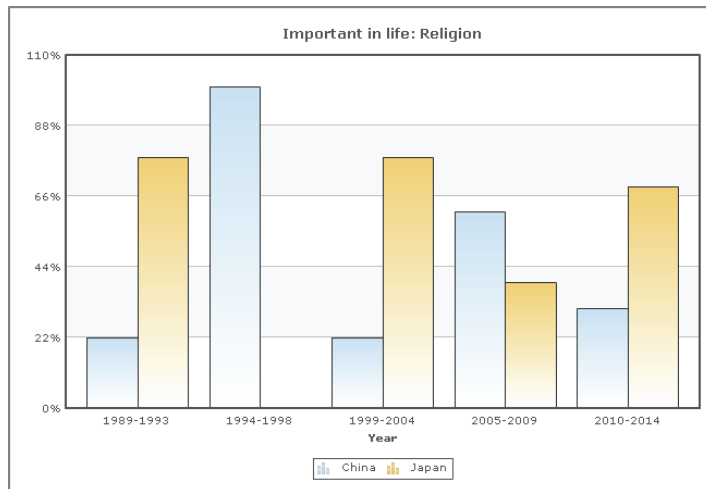
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 Graph 9: World Values Survey (WVS) indicator for religion (China, Japan)
 

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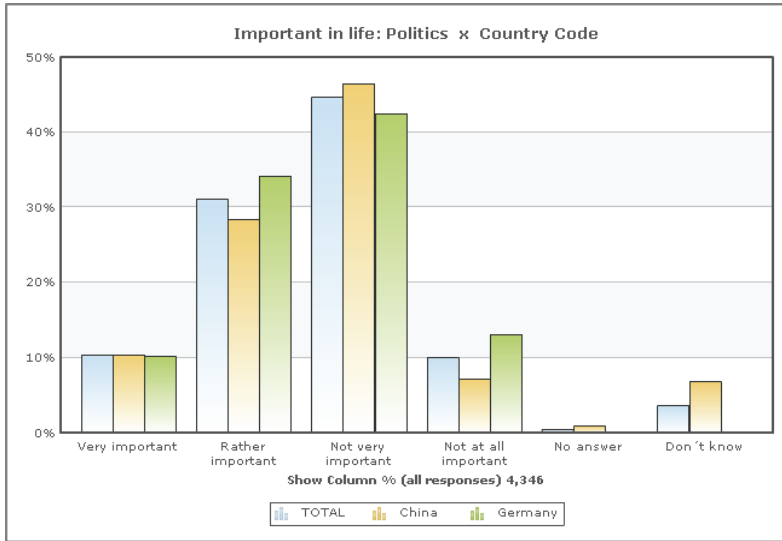


Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

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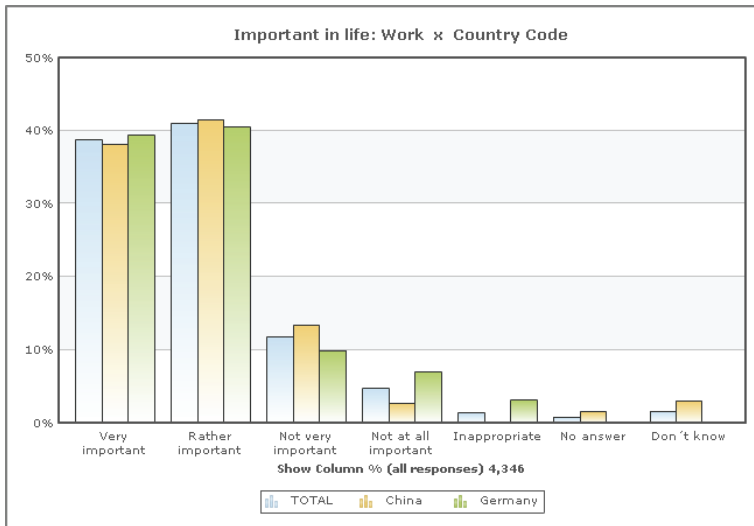
- In China, Germany and Russia for citizens politics is not very important (almost 50% of respondents), work is very or rather important (almost 80% of respondents), religion not or not at all important (China almost 80%, Germany almost 70% of respondents).

Graph 10: Important in life: Politics x Country Code



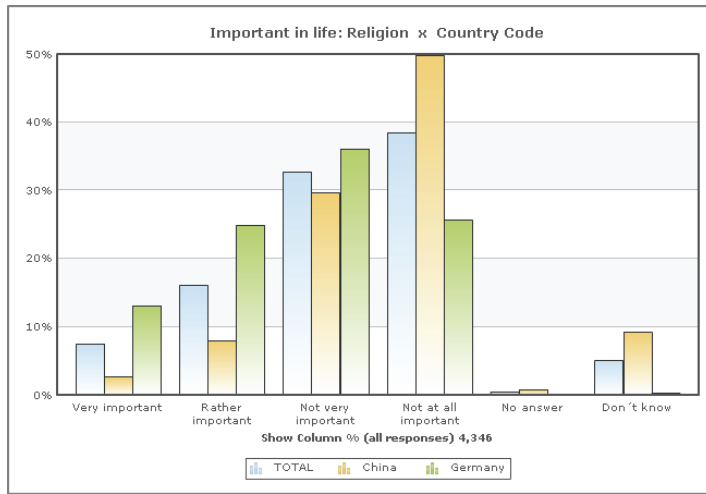
Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

Graph 11: Important in life: Politics x Country Code



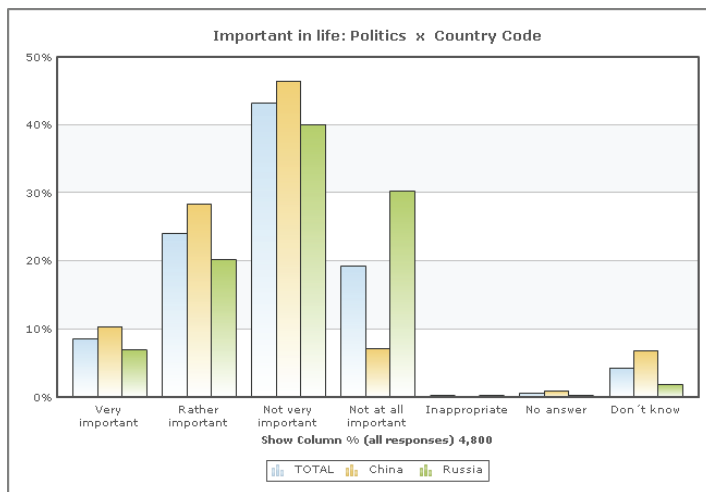
Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

Graph 12: Important in life: Politics x Country Code



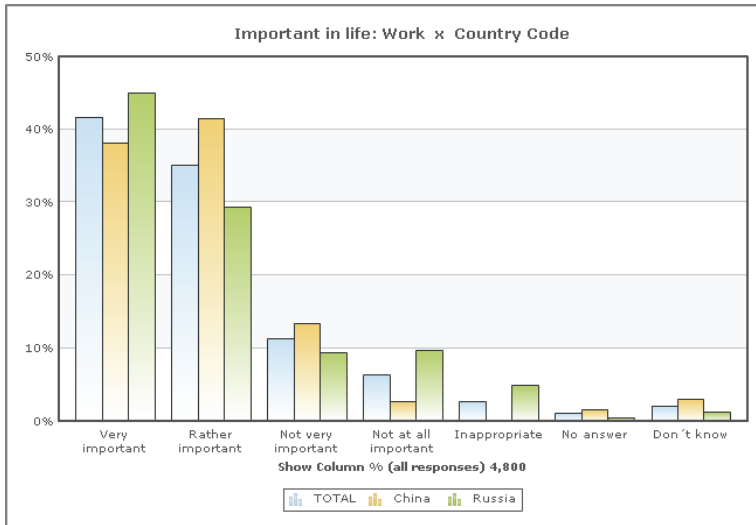
Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

Graph 13: Important in life: Politics x Country Code



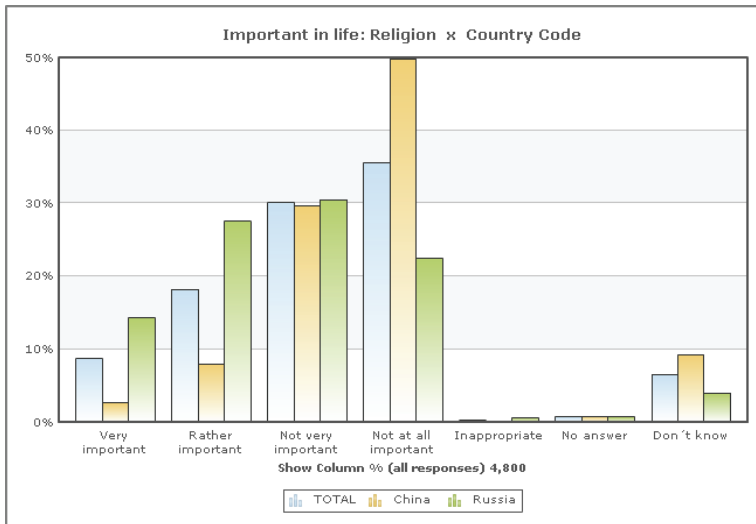
Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

Graph 14: Important in life: Politics x Country Code



Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

Graph 15: Important in life: Politics x Country Code



Source: <http://geert-hofstede.com/countries.html>, accessed 4.1.2015

### 3. HOFSTEDE MODEL AND FORMER YUGOSLAVIA REPUBLICS

Hofstede 6-D Model applied to Serbia and ex-Yugoslavia republics gives following results:<sup>17</sup>Power distance Serbia scores high on this dimension (score of 86) which means that people accept a hierarchical order in which everybody has a place and which needs no further justification. Individualism Serbia, with a low score of 25 is considered a collectivistic society. This is manifest in a close long-term commitment to the member 'group', be that a family, extended family, or extended relationships. Masculinity Serbia scores 43 on this dimension and is thus considered a relatively feminine society. In feminine countries the focus is on "working in order to live", managers strive for consensus, people value equality, solidarity and quality in their working lives. Uncertainty avoidance Serbia scores 92 on this dimension and thus has a very high preference for avoiding uncertainty.

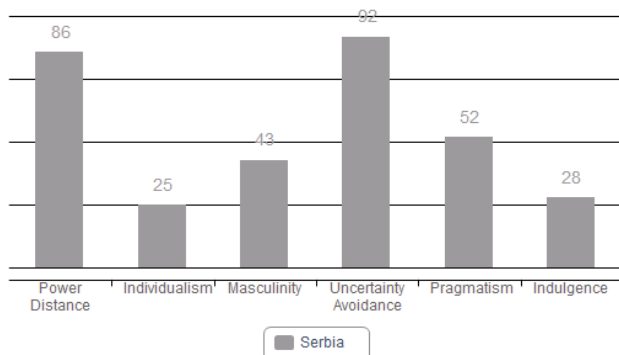
**Pragmatism.** With an intermediate score of 52, there is no clear preference for Serbia on this dimension.

**Indulgence.** A low score of 28 on this dimension indicates that Serbian culture is one of restraint. Societies with a low score in this dimension have a tendency to cynicism and pessimism. Also, in contrast to indulgent societies, restrained societies do not put much emphasis on leisure time and control the gratification of their desires. People with this orientation have the perception that their actions are restrained by social norms and feel that indulging themselves is somewhat wrong."

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Graph 16: Hofstede 6-D Model applied to Serbia

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Source: <http://geert-hofstede.com/countries.html>,

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In Serbia Power distance and Uncertainty avoidance are significantly high, Pragmatism and Masculinity rather high, while Individualism and Indulgence are low. This leads toward conclusion that Serbian society is traditional and collectivistic.

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<sup>17</sup> <http://geert-hofstede.com/countries.html>, accessed 4.1.2015.

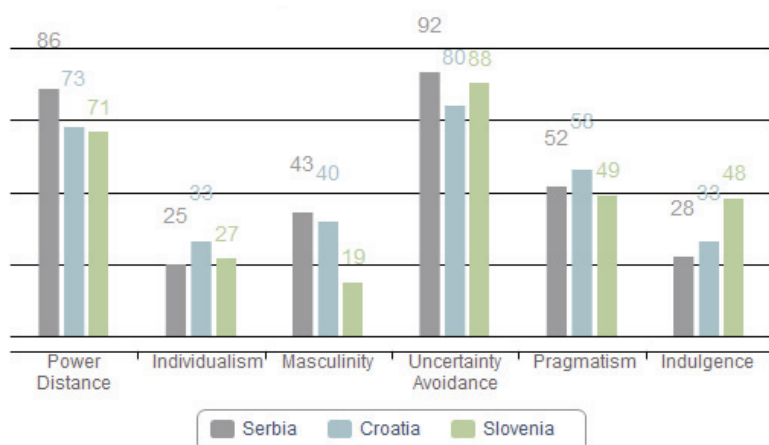
tic, with high influence of traditional values and culture which in essence derives from model of traditional society, similar to Asiatic mode of production.

Next graph compares three Ex-Yugoslavia republics (Serbia, Croatia and Slovenia): general conclusion is that there are no major differences concerning Hofstede dimensions: their historical position in world system was similar, and influence of former Ex-Yugoslavia common social and economic development is major explanation of those similarities.

Our comparison of major countries in world system 1. China-Japan-Germany, 2. China-Russia, and 3. ex-Yugoslavia republics demonstrates that internal causes (historical heritage, culture, values, beliefs) are of dominant significance in explanation of modern social and economic development, and that institutionalist path-dependence decisively influence their current social and economic development.

A. Alesina, investigating historical influence and current significance of culture and institutions, share the viewpoint that institutions and more formal and narrow in comparison with culture, and that out standpoint in exploration of social and economic development should be based on culture. First approach is measurement of influence of formal institutions: "One of the most common measures of formal institutions is an index of protection against expropriation (Acemoglu et al., 2001) ... A good summary of the institutional qualities characteristics associated with governance is the World Bank's Worldwide Governance Indicator (WGI) ... Easterly and Levine (2003) also show that they are strongly correlated with the standard measure of protection of property rights, one of the most used measures of institutions."<sup>18</sup>

Graph 17: Hofstede dim. in Ex-Yugoslavia republics (Serbia, Croatia and Slovenia):



Source: <http://geert-hofstede.com/countries.html>,

<sup>18</sup> Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.

A. Alesina support more broader approach, the one based of exploration of significance and influence of culture: "Recent contributions have looked at the coevolution of culture and institutions, leading to multiple equilibria characterized by a combination of some types of culture and some types of formal institutions. The general idea underlying this approach is that a country (or a region or an ethnic group, for example) shares certain cultural values, which leads to the choice of certain institutions. In turn, certain institutions lead to the survival (and transmission across generations) of certain cultural values."<sup>19</sup>

#### 4. CONCLUSION

In this work we demonstrated the importance of values - culture and governance for economic growth comparing Asian and European countries (China, Japan, Germany, Russia) and South-Eastern countries (Serbia, Slovenia, Croatia).

Importance of institutions, culture and values lies in the fact that contrary to previously dominant market fundamentalism there exist correlation between GDP and democracy, but not oneway unilinear causation, either from side of GDP or democracy. Fundamental factors of growth (culture and governance) are of much more importance for economic growth and were greatly neglected during social and economic development of post-socialist countries.

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<sup>19</sup> Alesina, A., Giuliano, P. "Culture and Institutions", 1. September, 2014.