

“Cultural Beliefs and the Organization of Society: A Historical and Theoretical Reflection on Collectivist and Individualist Societies” by Avner Greif

Why do societies fail to adopt the institutional structure of more economically successful ones?

Paper examines cultural factors which lead societies to develop distinct institutional structures

Societal organization correlated with per capita income?

- most developing countries are “collectivist”
- most of the developed West is “individualist”

Collectivist societies:

- social structure is segregated (individual socially and economically interacts members of a specific group)
- contract enforcement achieved through informal institutions
- noncooperation between members of different groups

Individualistic societies:

- social structure is integrated
- economic transactions conducted among people of different groups
- enforcement achieved through specialized organizations (court)
- self-reliance is highly valued

What are the origins of systems of societal organization?

What factors make these systems path dependent?

Paper considers two premodern societies:

- Maghribi traders of 11th century (Muslim world)
- Genoese traders of 12th century (Latin world)

Paper models an economic transaction central to these two trading societies to examine relations between culture and societal organization

Theoretical and historical analyses indicate the importance of cultural beliefs in affecting the evolution and persistence of diverse societal organizations

Cultural Beliefs and the Organization of Society

Cultural beliefs:

- ideas and thoughts common to a group of individuals that govern interaction between these people
- become known through socialization

cultural beliefs influence economic outcomes is intuitive, but formal examination of relations between cultural beliefs and societal organization is subtle (cultural beliefs is very vague and huge)

Historical analysis indicates importance of specific subset of cultural beliefs: rational cultural beliefs that capture individual's expectations with respect to actions that others will take in various contingencies

when each player plays his best response to these cultural beliefs, the set of permissible cultural beliefs is restricted to those that are self-enforcing

Enforcement institutions are composed of cultural beliefs and the rules of the game

Rules of the game may be changed endogenously by establishing organizations (court system, credit bureau, firm)

Necessary condition for an organizational change is to gain from it. Expectation depends on cultural beliefs – diverse cultural beliefs lead to a distinct trajectory of organizational development

Cultural beliefs also influence societal organization since strategic interactions occur within a specific social and historical context

Social and economic patterns of interaction also affect moral enforcement mechanisms: enforcement based on the tendency for humans to derive utility from acting according to their values

Agency Relations and Cultural Beliefs

Both trader groups faced similar environment, same technology, similar goods

Efficiency of trade depended on handling goods abroad:

- (i) merchant do job themselves (high cost option)
- (ii) hire overseas agent (more efficient)

to employ agent: organization of society must enable agent to commit to be honest

social organization in both groups allowed this (trade based on agency relations among nonfamily members)

how to mitigate merchant-agent commitment problem?

Consider one-side Prisoner's dilemma game:

- M merchants and A agents: $M < A$ (historically correct)
- Players live forever, have time discount factor β
- Unemployed agent receives: in each period ϕ_u
- One agent per merchant
- Matching is random but merchant can limit themselves to subset of unemployed agents who have previously taken particular sequences of actions
- Merchant who does not hire agent receives payoff κ
- Merchant who hires agent pays wage $W > 0$
- Employed agent decides whether to be honest or cheat

Agent is honest: merchant's payoff: $\gamma - W$, agent's payoff: W , gross gain = γ

Agent cheats: merchant's payoff = 0 , agent's payoff = $\alpha > \phi_u$

Assume cooperation is efficient: $\gamma > \kappa + \phi_u$

After each allocation of payoffs: merchant can decide whether to terminate relations with agent

Probability σ merchant is forced to terminate agency relations: assumption captures merchant's limited ability to commit to future employment because of need to shift commercial operations over places and goods

Analyse stationary equilibria that can support efficient outcome.

Let h_h denote the probability that an unemployed agent who was honest in the last period he worked will be hired in the current period.

Let h_c denote a similar probability for someone who was dishonest in the last period of work.

Proposition 1 specifies the minimum wage that supports cooperation:

$W^* = w(\beta, h_c, h_h, \sigma, \phi_u, \alpha)$. Increasing in $h_c, \sigma, \phi_u, \alpha$, decreasing in β, h_h .

How can differences between collective and individualistic societies manifest themselves in agency relations?

Collectivist societies: everyone is expected to respond to whatever has transpired between any specific merchant and agent

Opposite holds for individualistic societies

Two strategies formalize this:

In each strategy: merchant hires for wage W^* an unemployed agent whom he rehires as long as cheating or forced separation does not occur

Under individualistic strategy: merchant randomly hires unemployed agent

Collectivist strategy: merchant randomly hires only from among unemployed agents who have never cheated

Agent's strategy: play honest iff. Offered at least W^* relevant to him given the history of the game

W^* is lower under the collectivist strategy

Proposition 2 shows that both ind. and coll. strategies are subgame perfect equilibria

Subtle

Individualist strategy is subgame perfect because expects probability of a past cheater to be hired is same as an honest agent

Collectivist equilibrium: probability cheater re-hired in case of break-up is lower. Then – given proposition 1 – pay someone who was previously a cheater higher wage to keep them honest – merchant's strictly prefer to hire honest agent – expectations are self-enforcing.

What if $\sigma = 0$?

Can both strategies still constitute equilibria?

Yes, but now there is indifference.

Paying for knowledge

Analysis so far assumed history is common knowledge but acquiring and transmitting information during the late medieval period was costly – model should incorporate merchant's decision to acquire costly information

Investing requires Λ each period – learn private histories of all of the merchants who also invested

Under the individualist equilibrium – history has no value – no merchant will invest

Collectivist equilibrium – wages depend on histories – merchants will invest

Individualist equilibrium – never makes sense to invest

What if $\sigma = 0$?

Proposition 3 shows that merchants will invest since the action is common knowledge and hence one who does not invest is cheated if he pays the equilibrium W_C^* . Let W_{-i}^* denote the wage that would induce cooperation if only i does not invest. Then provided $W_{-i}^* - W_C^* > \Lambda$ it is an equilibrium to invest.

Analysis relates two societal organizations and different cultural beliefs, that is, different expectations with respect to actions that will be taken off the path of play.

In an individualist equilibrium, players are expected to be indifferent, and in a collectivist equilibrium players are expected to respond to whatever transpired between others.

Since these cultural beliefs correspond to an equilibrium, they are self-enforcing, and each entails a different wage, enforcement institution (second vs third party enforcement) and investment information.

On equilibrium path, both beliefs entail the same actions: merchants randomly hire unemployed agents and agents never cheat

Origin and Manifestations of Diverse Cultural Beliefs

Historical records suggest that cultural “focal points” and social and political events in the early development of these societies were likely to be instrumental in shaping diverse cultural beliefs and the related equilibria in these groups

When both groups began trading, they had already internalized different cultures and were in the midst of different social and political processes

Among Maghribis – collectivist equilibrium was a natural focal point

Genoese – individualist equilibrium was natural focal point

Maghribis: non-Muslims who adopted values of muslim society: members of the same umma (nation, mother) reflecting mutual responsibility + part of jewish community (all israel is responsible for every member). Migrated from Iraq to tunisia and retained social ties that enabled them to transmit information required to support collectivist equilibrium

Genoese: Christians – individual at the center of its theology, established city with a contract between individuals (not families or other social groups), in absence of social networks for information transmission: individualist equilibrium likely to be selected

Historical evidence indicates Maghribis invested in sharing information and Genoese instead seemed to conceal information

Cultural factors that coordinated expectations altered the relevant games in the formative period directed the Maghribis and Genoese toward different cultural beliefs

What are the implications of different cultural beliefs on economic relations and dynamics of wealth distribution?

Can different cultural beliefs manifest themselves in distinct social structures?

Examining this issue requires extending the theoretical analysis to allow each merchant to serve as an agent for another merchant

Collectivist cultural beliefs now include expectations that whoever is hired by a merchant who cheated in the past is not expected to be subjected to collective punishment if he cheats that merchant

In the extended game, two social patterns of agency relations and associated dynamic patterns of wealth distribution can emerge

- (1) vertical social structure: merchants employ only agents (individual functions as either a merchant or an agent)
- (2) horizontal social structure: merchants employ only other merchants (individual functions as an agent and a merchant)

Formally:

Consider optimal wage required to ensure the honesty of a merchant who functions as an agent.

If merchant is honest:

Utility of merchant who functions as an agent: V_h^a

Present value of being a merchant: $(\gamma - W^*) / (1 - \beta)$

If merchant cheats:

If merchant cheats while being an agent, gains α from cheating plus lifetime utility: V_c^a

Receives $\gamma - W^*$ in current period, and lifetime utility V_c^m

honesty condition for merchant:

$$(1) V_h^a + \frac{\gamma - W^*}{1 - \beta} \geq \alpha + \gamma - W^* + V_c^m + V_c^a$$

honest condition for agent:

$$(2) V_a^h \geq \alpha + V_c^a$$

honesty conditions enable examination of relations between diverse cultural beliefs and hiring decisions

Collectivist beliefs:

Merchant who cheated in the past can no longer rely on collective punishment to deter his agent from cheating and must pay a higher wage to keep him honest: merchant's lifetime utility from being a merchant decreases if he cheats as an agent:

$$(3) \frac{\gamma - W^*}{1 - \beta} > \gamma - W^* + V_c^m$$

for agent (2) holds, so that merchant strictly prefers to hire another merchant as his agent

Individualist beliefs:

Merchant who cheats as an agent does not have to pay more to his agent in the future:

$$(4) \frac{\gamma - W^*}{1 - \beta} = \gamma - W^* + V_c^m$$

merchant is not motivated to hire another merchant

merchant's capital serves as a bond that encourages their employment under collectivist cultural beliefs. Merchant's higher reservation utilities discourage their employment under individualist cultural beliefs

under individualist beliefs, society reaches vertical social structure for a larger set of initial conditions, under collectivist beliefs, society reaches horizontal social structure for larger set of initial conditions

differences in social structure are observed among Maghribis and Genoese

Maghribis: no merchant class and agent class, forms of business associations established agency relations

Genoese: two classes: wealth merchants hired poor agents.

Diverse cultural beliefs lead to diverse dynamics of wealth distribution: vertical society provides better opportunity for upward mobility to wealthless individuals.

Under individualist beliefs: agent's ability to commit is negatively related to his wealth, wealthless individuals are better able to capture the rent (above reservation utility) available to agents.

In horizontal society, wealthless individuals not able to capture rent available to agents, since under collectivist beliefs one's commitment ability is positively related to one's wealth

Historical sources: mute for Maghribis but Genoese: wealth transfer reflected in declining concentration of trade investment and increase over time of trade investment by commoners (non-nobles)

Both groups had opportunity to expand their trade

Maghribis responded in a segregated manner – hiring other maghribis

Genoese in an integrated manner – hiring non-Genoese

To see why, consider expanding two separate economies into one.

How to react to intereconomy relations?

Either treat such agents as cheaters or not.

Assign a probability distribution over this.

Given this probability distribution, the probability of collective punishment being enacted is less than one. This makes it worse for a collectivist community to initiate an integrated relationship.

Segregation ensues.

Now consider an individualist community. They are indifferent to hiring agents from their own or other community – and may even prefer to hire them from a collectivist community if their efficiency wage is lower.

Hence integration ensues.

What happened – “Latin merchants penetrated the Muslim world”

Conclusions

Constrained by same technology and environment and facing same organizational problem, Maghribis and Genoese had divergent cultural heritages and political and social histories that gave rise to different cultural beliefs.

Theoretically, different cultural beliefs are sufficient to account for their diverse trajectories of societal organization, indicating how these forces have lasting impact despite their temporary nature

Intriguing that Maghribis societal organization resembles that of contemporary developing countries, Genoese more the developed West: suggest individualistic system may be more efficient in the long run.

Is this paper about Culture or is this about Institutions?