Economist.com FINANCE & ECONOMICS

Trade and culture

Scorn laws

Jul 21st 2005
From The Economist print edition

Why cultural biases may be the ultimate trade barrier

HOW do people decide whether to trust a country's investment climate, or the quality of its goods and services? Objectively, to a degree: places with skilled workers and high technology tend to make reliable stuff; countries with clear laws and clean politicians are more trustworthy. You might suspect, though, that plain prejudice also affects trade and capital flows. A trio of economists* from the University of Sassari, Northwestern University and the University of Chicago have found evidence of precisely that.

The three took a look at trade and trust inside the European Union. EU countries that trust each other for cultural reasons tend to trade with each other more than with other EU partners; the same is true of cross-border investment. If cultural biases are skewing economic patterns even within the EU -- where education levels are high and where a common market has been expanding for decades-- they are potentially even more important in other parts of the world.

As a first crack, the trio looked at Eurobarometer surveys, which frequently ask EU citizens how much they trust people from various countries. Most EU members trust Germans; fewer trust Italians. To the authors, it is much more noteworthy that different countries give different answers: for instance, Germans trust the British more than the French do. When two sets of people gauge a country's reliability differently, cultural preconceptions may be at work.

Because trading with another country may also breed trust, the economists had to sort out which causes the other. So rather than rely only on Europeans' direct answers about trust, they looked at these in conjunction with three long-run factors that might affect prejudices religion, a history of wars and widespread genetic differences—and used these to try to isolate the effects of cultural biases on trust and trade.

The economists find that cultural biases do drive wide variations in trust among European countries. And after accounting for other factors (such as geography) that also foster trade, they claim to show that culturally driven trust does shape trade and investment patterns. A one standard-deviation increase in their trust measure is associated with a boost to trade between two countries of 30%, and a rise in bilateral foreign direct investment of as much as 75%.

They also find that high education levels and more information tend to lessen these effects (no doubt by correcting misconceptions about unfamiliar countries). So ignorance, it seems, does even more damage than free traders thought: it not only limits trade by fostering protectionism, but also distorts the trading that does occur.

---

* “Cultural Biases in Economic Exchange”, by Luigi Guiso, Paola Sapienza and Luigi Zingales, May 2005.