What happens when different cultures interact

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Since the 1980s, the term "globalization" has been gaining currency even among ordinary people in parallel with the growth of international trade and investment. As long as relations between countries are mediated by goods and/or money, there is only pecuniary externality. However, globalization seems to be a phenomenon that is far more complicated than just the deepening of cross-border economic relations. Globalization entails an increased incidence of interactions between people/firms with diverse backgrounds, which may include custom, culture, conventions, social norms, etc. In addition to the proper working of such formal institutions as WTO and FTA, how to structure those interactions matters for economic performance. Therefore it will pay off to learn more about what happens when different institutions/cultures interact and how to structure the interface between different institutions/cultures.

Since economic theory began to focus on institutions other than the market, economists have developed various ways to analyze the working of those institutions in greater depth. Recently Aoki (2001) compiled his study of "comparative institutional analysis" into one book, where he clearly presented basic proto-types of economic institutions and conditions under which economic institutions work well. Remarkably, he emphasizes that the coexistence of various governance mechanisms is conductive to the governance of market and they are mostly complementary. Along the same strand, Matsui (2003) analyzes the effect of interaction between different cultures on economic welfare. More recently, Dixit (2004) also conducted a study on the interactions between relational and formal contracts, between relation-based governance and rule-based governance and so on, the result of which may be regarded as a formal confirmation of Aoki's claim.

The theory developed so far tells us that, as the volume of trade and/or the number of traders increases, traders become increasingly anonymous and relation-based contracts become less enforceable. Thus relation-based contracting will eventually have to give way to formal contracting, as an economy develops. In fact, the transformation of economic system Japan is now undergoing seems to be the one from a relation-based system to a system based on formal contracting. However, as we all now witness, this is a long and painful process, and many Japanese people/firms still seem to rely on relation-based contracting.

On the other hand, in most other Asian countries, trades are mostly relation-based. Thus, it may appear that Japan has some apparent advantage in building fruitful relationship with businesses in those countries. However, this is not necessarily the case. Relation-based contracting usually relies on a common understanding of how to behave in unforeseeable contingencies. Thus, cultural difference between parties to transaction might matter.

Matsui (2003) considers an evolutionary game where traders with different cultures are randomly matched with each other to exchange goods. Traders must coordinate on the same mode for exchanging goods. However, each trader has a preferred mode of transaction such as his mother tongue, and suffers a welfare loss when he exchanges goods in his less preferred mode. Matsui's model thus accommodates both the usual benefit of trade and the cost of trading with people with different culture, and shows that that cost can be considerable. In an extreme equilibrium, people in a small country may have to adapt themselves to the customs of a larger country.

In his model, a trader matched with another trader with different culture is directly involved in cultural difference and incurs cost in changing his preferred mode of transaction. In reality, however, when a trade occurs between traders with different institutional backgrounds, they may set some interfaces rather than jump into direct conflict of different institutions. The importance of interface is exemplified by the so-called financial crisis in Asia in the late 1990s. The cause of this crisis can be attributed to the lack of interfaces between the money markets in Asian countries, where a relation-based system is effective, and foreign investors that believe in rule-based system (Aoki, 2001). This example also tells us that it matters how to structure an interface between systems with different properties.

The same logic seems to apply to the case of foreign direct investment. Firms that operate in foreign countries will have to deliberate the way how to deal with problems arising from accommodating different cultures in a single organization. In what follows, I illustrate this problem relying on a speech that Professor Seki of Hitotsubashi University gave at RIETI research seminar.

There are great differences among Korean, Japanese and American firms in the way that they operate a factory in China. Korean managers tend to fully commit themselves to Chinese life with their families. They even prefer their children going to a top university in China. So they incur the cost arising from cultural difference personally by adapting themselves to the culture of the place where they decide to operate a factory. Here the costs are internalized within those managers, who in turn work as a smooth interface between Korea and China.

On the other hand, typical American firms tend to delegate management to Chinese managers that they think are reliable, and monitor the performance of the factory only periodically. They will usually monitor the performance of the factory by comparing it with that of other factories operated in China. Everyday practice of management here may be said to be encapsulated. They thus avoid the cost arising from cultural difference by limiting their attention to formal contracts with small number of Chinese people.

In contrast with both Korean and American practices, Japanese firms usually dispatch a relatively minor figure to directly manage their factory in China. Thus the managers cannot make a quick decision for themselves. They prefer to preserve the standard of living they used to enjoy in Japan, which is very costly in China and naturally pushes up the cost of operating a factory. This practice seems to me to bring costs arising from the difference of culture into a factory. I wonder if this way of management continues to be viable.

Admittedly, the above described different ways of managing a foreign factory reflect the cultural differences among the Koreans, Americans and Japanese. However, it should also be noted that pros and cons of different ways of management can be debated in a universal way.

Although interactions between different institutions/cultures abound in human history, economic study on its effect on contract enforceability and economic performance in general has only just begun. The ongoing economic integration of East Asian countries will certainly provide a rich variety of “food of thought” to economic theorists. I hope, as economic analysis on this subject develops, some feedback from theory to practice will also become possible.

References

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