

CHAPTER I. INTRODUCTION

1.1 Background of the Study

On facing globalization, the 1990s marked a dynamic change in international trade; thereby initiating institutional change for the nations which are active in international trade with the United States. As a result of the United States' interaction within the WTO, efforts were made to reduce the tariffs on imports and waive quotas in an effort to deregulate governmental intervention on business. This was the beginning of institutional reform with the goal of reducing transaction costs incurred by governmental intervention and ambiguous agreements.

A reduction in transaction costs equals more resources allocated to international trade pursuits. This attempt to increase trade has had profound effects on culture and organizational behavior. Increased international trade affects the cultural value systems of both trading partners; hence increased trade performance shows the changing values of American business policy. The use of a neo-institutional school of economics perspective is an applicable method to measure this change. The effort to alter existing United States institutional understanding for improved economic performance will require an understanding of the change in cultural value systems as different shared mental models come into contact. The result from this understanding is that the path dependence of organizations is altered.

Cultural value systems are learned behavior thus Hofstede termed them collective programming. (Hofstede 1980) It is basically the same as what Douglas North calls institutions. (North 1994) They have been changing to allow transparent rules to form leading to an open forum where the international body can negotiate trade. Economic performance is an indicator of institutional change.

The economic performance of a region has historically benefited from trade with other regions. The first explorers sent to other regions to engage in cross-regional trade often brought back stories of strange and unusual practices of the people they encountered far away. These distinct belief systems held by regional people and the practices they followed began to be known as culture. These facets of civilization still exist today.

Culture is the most common starting point when comparing social practices among nations in the world today. Global business takes the collaboration of a large number of cultures, countries, organizations, and individuals. These classifications of societal groups have to come together to some sort of understanding so that people are able to interpret and react to the environment effectively. Within traditional national boundaries this collective reasoning is called culture. If a group of people has stability and a common history is shared and allowed to evolve then a culture is born. Stability is necessary to pass on the information obtained from one generation to the next.

The term culture is an extremely general term though and is manifested in various formats. As the discussion of the need for individuals to understand a “culture” is important for examining different belief patterns across cultures, the term culture can be broken down into dimensions of culture. Culture is meant to signify what has been historically perceived as socially acceptable behavior which is exhibited informally and is what Douglass North calls institutions. The study of institutions can be furthered by not just looking at the people who live in a societal region but also on how that region’s economic performance has changed over time in increased or decreased international trade.

One assumption that must be made before continuing it is that all agreements, organizations, governments, and individuals are flawed. It is in the knowledge gained from repeated agreements and the increased understanding of the different behaviors nations exhibit that has the greatest impact on the global economy today which in turn filters down to affect organizational behavior and through the organization can filter down further to the lowest levels of the employee in an organization.

Collective programming changes over time. The more information that is discovered through international trade, gathered from foreign environments, the more this will alter the existing framework of a national cultural structure. Change is slow and encounters much resistance. Change is only accepted when the benefits that arise from change can be realized. Change is region and nation specific. Different nations, having different interpretations of their environment and different frameworks upon which they function, change in different ways and at different speeds.

This study arose from the realization that there are gaps in the knowledge collected thus far about institutional understanding. Most study of culture has been to place nations on a scale

at one point in time. This scale is then used to classify that culture. However, this scale if not updated becomes obsolete as it does not take in culture change. A study to gauge the rate and degree of culture change at present is not in existence.

Modern studies of culture have also been limited to the national level. A study focusing on regional analysis has not been performed. Instead, countries are classified at the national level first and after classification, trends are looks at to see if there are any similarities across regions. A regional analysis is not usually performed at the same time as a national analysis.

Population is another indicator that is traditionally left out of cultural studies. Population can have an effect on the rate of change a nation will experience when it tries to alter its institutional frameworks. Past studies and current studies examine culture at one point in time but when examining culture over a period of time, population needs to be taken into account to measure cultural change.

This study takes into account the existing frameworks that have been built. It tries to reconcile any missing indicators of past models. It also endeavors to update national classifications of where a nation fits on a scale of cultural dimensions.

1.2 Statement of the Problem

For decades social scientists have endeavored to classify culture on the national level by using questionnaires and interviews of multinational employees as a way to measure where a nation ranks on cultural dimensions. This has not included other factors that need to be taken into consideration such as population size, path dependence, and regional factors such as free trade agreements or regional trade associations. As nations engage more and more in international trade there is an increase in cultural exchange that works in bilateral directions. This can be measured through economic performance. By using econometrics to quantify the results of cultural values by using economic performance as an indicator of cultural change, a nation's orientation can be measured overtime quantitatively instead of qualitatively. This will show value change as a result of numerous factors. A change in cultural belief systems through trade will show changes in opportunities in the markets for the United States and will have implications for the United States' economy if continued success is desired. New orientations of nations engaging in trade with the United States will challenge the preconceptions of where these countries previously have been rated by other social scientists in the past. This will determine where the problem areas of United States trade performance are located and what measures are needed to either strengthen current United States' diplomatic and economic policy or where a change in United States' diplomatic and economic policy is needed if the United States wants to reduce the trade deficit and enter new markets.

1.3 Purpose of the Study

The purpose of this study is to see how institutional understanding and institutional change affects economic performance. United States' exports, imports, and export-minus imports (otherwise known as balance of trade), measured in United States' dollars in multiples of 1,000 were used to calculate the economic performance of a specific country. If there is economic growth for the duration of the time period of 15 years under study than it is believed this can be attributed to a greater institutional understanding. This would arise from the knowledge of foreign markets that have been gained by individuals, organizations, or nations that have understood opposing institutional frameworks. These opposing, or foreign, frameworks could possibly have been incorporated into the home country's framework creating path dependence change.

On the other hand a decline for the 15 year time period of the study is believed to be attributed to either lesser institutional understanding or an unwillingness to change existing behaviors thereby keeping local frameworks pure, free of foreign influence. This would keep a nation upon its path dependence.

The focus is on the need for nations to understand institutional differences and the ramifications thereof. The starting point to this study was to see whether there is an effect of cultural interaction on the economic environment of a specific country. Since the policies of countries differ when comparing areas between regional and national boundaries it is assumed that the policies can either promote or hinder economic performance when making contracts across cultural boundaries.

This study endeavors to show a relationship between the ongoing processes of how countries are trying to understand each other's business practices and the amount of international trade performed by these countries. Previous work has been done by researchers to classify countries into dimensions of performance and attitude. They then in turn have taken this classification and looked at how these differences have affected the organizations of a country. This study intended to broaden that further to show that the ramifications of cultural understanding on a country's economic performance can be used as a measurement of institutional change. Therefore, this study not only looked at culture from a social science perspective but also crossed over to an economic perspective by looking at these dimensions of culture from the viewpoint of the neo-institutional school of economics.

The information gained from this study shows how cultural understanding can affect a country's economic performance for the better or worse. To do this some metrics were chosen to show causality between increased/decreased economic performance and changes in cultural policy, decision making, population size, and regional differences.

1.4 Questions of the Study

The dimensions under study are greater in number than in traditional models that measure cultural orientation to include not just the institutional orientation of a nation but also influences that are attributed to population size, regional trade agreements, the era of institutional reform, emerging regions rich in resources, regions with long standing cultural and economic relationships, and ethnic similarity/diversity to show an increase or decrease of institutional understanding and changes over time. The process of international education is an important cause of institutional change. Therefore one question will be on whether learning the host country's cultural framework by foreign study and then bringing the learned cultural and technical knowledge back to the students' home country has a positive or negative relationship to the home country's trade performance. This will show if there is a change in the dimension of masculinity over time.

It is assumed that the dimensions of masculinity, power distance, uncertainty avoidance, and the individualism of a nation all affect the international trade with nations that rate differently on these scales and that increased trade will be a result of changing attitudes of cultural belief systems. In effect, to increase trade countries have to take on viewpoints other than what exists in the national consciousness. This will alter the path dependence of the country and change the amount of trade with the United States.

By seeing which countries joined the World Trade Organization and when; an indication will show if countries are changing their power distance orientation in order to increase their trade. This will indicate if countries want to decrease power distance in favor of more equitable agreements. Lowered power distance may increase trust and be shown in increased national revenue. If a foreign country can increase its revenue then this raises the question of what are the implications for the United States economy. This trust takes the form of a guarantee for equitable negotiation of trade and is implicitly needed to enter into a contract with other countries for free trade. It is then asked if trust between countries regionally will have positive or negative trade impact on the United States economy.

Even though there is trust, disputes still happen in the WTO. Communitarian countries are more accepting of free riding than individualistic countries because they would rather preserve the relationship of trade for long term benefits rather than to punish transgressions in the short term. However, more countries are joining the WTO for an equitable playing field.

These countries may also be filing disputes against the United States or other member countries because they want to start looking after their own interests first. If countries change from a mentality of accepting free riding to one that does not then this shows a move from communitarianism to individualism. This study endeavors to show which countries are exhibiting this cultural change.

Countries around the world have been influenced by the English language. This is especially true in the past for countries that have wanted to trade with the United States since comparatively the United States is not as multilingual as other countries. Engaging in trade within one's own language and not across the language barrier shows a high degree of uncertainty avoidance. The model used here will examine the relationship between uncertainty avoidance by the use of native languages vs. foreign languages to determine changing institutional attitudes about uncertainty and the resulting impact on economic performance.

These four dimensions of culture created by Hofstede are not sufficient to measure the affect of institutional change on economic performance. It is important to consider large/small or open/closed markets as another determining factor of trade performance. This study categorizes these markets based on population. The questions of how open the countries' markets under study are, how quickly these markets are changing, where focus of international trade should be located, and if entering into free trade agreements or regional trade associations have had any effect on the U.S. economy are answered.

A regional analysis was performed with the intent of determining regional success in trade with the United States. Significant results different from zero show regional differences in trade through the use of regional trade agreements (EU, NAFTA, ASEAN, MERCOSUR, etc.). Also, student migration, entry in the WTO, number of disputes, population, and official language are often region specific. A regional analysis is needed to determine where future efforts are needed to increase trade by Americans studying abroad and diplomacy in the form institutional understanding.

1.5 Significance of the Study

The use of econometrics as a way to measure culture has until now not been realized. The primary objective was to build an econometrics model as a way to measure institutional change that arises with increased international trade. Here, a model was built by Shih to measure the cultural change during the time period of institutional reform in the countries that have the highest performance in international trade with the United States for a 15 year period, from 1990-2004. There were three sub objectives:

The first was to measure institutional change by taking cultural values and comparing them with economic performance. Masculinity was measured by using place and number of American students studying abroad to show aggressive orientation. Power distance was measured by WTO membership and individualism by WTO disputes. Uncertainty avoidance was measured by using English as an official language as an indicator of fear of ambiguity in the establishing of contracts internationally.

The four cultural variables were created by Geert Hofstede. Change on these factors showed how countries are changing their institutional orientation as a result of repeated trade transactions with people who hold different mental models. The results show the bilateral relationship between trade and institutional change. Therefore, the orientations of countries have to be updated because when the key cultural orientations for economic success are pinpointed then other countries that are exhibiting the same cultural dimensions would potentially be good markets for trade relations if the cultural dimensions have historically shown positive trade performance for the fifteen year time period. Inversely, if nations consistently show that their current cultural orientation for the fifteen year period is not beneficial for United States' trade then other countries exhibiting the same cultural orientation should be avoided (until the time that their cultural orientation changes).

The second objective was to use country size in terms of population to gauge the rate of cultural change. This is a new indicator added to Hofstede's model. Large populations will have a slower rate of institutional change and generally a more closed market. This will have implications on the effects of the trade-institutional relationship. The significance of this added variable is to tell where current markets are producing trade surpluses and trade deficits. If the country is producing a trade surplus then population can be correlated with the other cultural variables to see if there is a combination of factors that are benefiting the United States. If the

country is producing a trade deficit for the United States then the study will pinpoint if this is due to population or not. Implications of large and small populations can also provide strategic planning for when the United States will be able to invest in those markets since countries with large populations usually have closed economies and therefore take longer to change their path dependence. Population in conjunction with the other cultural variables allow the investor to prioritize which markets to focus on first and which can wait until the path dependence is changed.

A regional analysis being the third sub-objective showed that this type of analysis will be able to answer the questions of whether regional trade agreements have a positive, negative, or nil effect on the United States' economy. Also, a regional analysis answers the question of what regions are outperforming other regions. This will be able to pinpoint which regions are creating trade surpluses and deficits implying where diplomacy is needed to balance trade.

These factors in combination have implications for the international trade of the United States. The trends marketed in this study show results that are positive due to correct measures taken by the United States or negative results from United States governmental policy mistakes. By using the time series regression method as a tool for analysis of recent United States policies and their results, the model can be used to forecast the results of future trade possibilities.

1.6 Delimitations and Limitations

One limitation of this study is that all of the data that will be used in the research experiment does not exist in Taiwan where the study was performed; they were compiled from the official websites of United States governmental organizations and physical data sent to Taiwan from the United States by independent organizations.

The websites where information is taken from are the official sites of government or NGO organizations. Therefore, the information taken by this website is only acceptable if it was received in a non-alterable format like Adobe Acrobat Reader or official non-alterable government data tables to add credibility to this study.

The data used in this study is matched with the cultural dimensions made by Gerte Hofstede which in the literature review is somewhat criticized. At this point in time, the cultural variables were becoming outdated as newer dimensions created became more relevant. This does not diminish the usefulness of the older dimensions and therefore they were used to test the model. The new data classifications obtained by the GLOBE experiment are updated dimensions building on Hofstede's model and though perhaps more accurate; however at this time they have not been tested by enough researchers to be included in this study. Also the GLOBE experiment has nine dimensions and for the purposes of this study the first four dimensions from Hofstede's original experiment are sufficient. Trompenaars and Hampden-Turner focus on the organization and this is not currently applicable for a test of the model but could produce fruitful results in further study.

Since cultural belief systems are not easily classified across regions due to differences in religion, language, ethnic diversity of citizens, the degree of continents versus islands, and the remaining colonies of other countries makes regional classification imperfect. Language and religion were not used as basic classification parameters. Colonies were treated as independent. Cross referencing for regional classifications was performed by comparing the regional classification of the International Institute of Education and The United States Trade Representative Office.

In this same token, a cross referencing to obtain information of a country's population and official language lists was used. The sources were Encyclopedia America Online and the CIA Factbook (secondary sources of data). Population numbers had to be relied on estimates and statistical projections since countries perform censuses at different times (if at all).

Language was listed officially for most of the countries in one of the sources used. However, in others such as South Africa, countries were listed as percentage of population that speaks it. A large percentage of the population speaking English signified using the language officially and also whether that country was a former colony of an English speaking nation and continued to speak English in some regard.

According to the classifications from the International Institute of Education and The United States Trade Representatives Office, the countries Bermuda and Canada fell within the realm of North America while Mexico fell within the realm of Latin America. The purpose of this study is to determine cultural change in different regions than the United States and also to determine if nations that have different cultural dimensions than the United States are becoming more homogenous as the two trading partners engage in international trade. Therefore, Canada and Bermuda were exempted from the study.

Data on foreign students coming to the United States to study was complete for every year. However, data for Americans studying abroad was inconsistent for the school years 1990-1991, 1992-1993, and 2003-2004. A smoothing method was used to fill in the missing data for these years.

Germany was not listed as unified until 1991. Therefore for the year 1990 both East and West Germany are considered as one.

Two key variables in the study have to deal with the WTO which came into existence on January 1, 1995. This is five years after the beginning of the time period of this study, which starts in 1990. The WTO was based on the foundation of GATT. Countries that were members of GATT automatically became members of the WTO on January 1, 1995 with the exception of the United Arab Emirates which left the GATT in 1994 and didn't join the WTO until 1996. Since the foundation of both organizations are basically the same as in providing a forum to facilitate trade and reduce transaction costs the GATT and the WTO are considered the same organization listed solely as the WTO. Dates that members joined the GATT and disputes filed in the GATT system are listed under the WTO.

1.7 Definition of Terms

Masculinity (Achievement)

A national culture attribute describing the extent to which societal values are characterized by assertiveness and materialism, the inverse meaning being a caring attitude towards others in your community over the individual and sacrifice of material things in favor of providing assistance to others. For purposes here it means the amount of aggressiveness a nation exhibits by either recruiting foreign students or sending its students abroad to study.

Balance of Trade

The balance of trade is the difference between the monetary value of exports and imports in an economy over a certain period of time. A positive balance of trade is known as a trade surplus and occurs when a country exports more than it imports; a negative balance of trade is known as a trade deficit or, informally, a trade gap.

Bounded Rationality

Rational behavior, in economics, means that individuals maximize some target function under the constraints they face (e.g., their utility function) in pursuit of their self-interest. Bounded rationality is the rational behavior humans exhibit under environmental constraints.

CIF (Customs Insurance & Freight)

The c.i.f. (cost, insurance, and freight) value represents the landed value of the merchandise at the first port of arrival in the United States. It is computed by adding "Import Charges" to the "Customs Value" (see definitions below) and therefore excludes United States import duties.

Cognitive Structure

The knowledge one possesses and the manner in which it is arranged.

Convergent Mental Models

The gradual convergence between the two individuals, ending with a moderate difference, suggesting a measurable difference in their mental models; when visually compared taking geographic location into account, convergence rises with greater geographical proximity suggesting similar physical situations amplify convergence.

CV (Customs Value)

The Customs value is generally defined as the price actually paid or payable for merchandise when sold for exportation to the United States, excluding U.S. import duties, freight, insurance, and other charges incurred in bringing the merchandise to the United States.

Domestic Exports

Commodities grown, produced or manufactured in the U.S., including commodities imported from foreign countries that have been significantly changed or enhanced in value, in either the United States or a Foreign Trade Zone.

Emic Perspective

A perspective that focuses on the intrinsic cultural distinctions that are meaningful to the members of a given society. The native members of a culture are the sole judges of the validity of an emic description.

Etic Perspective

A perspective that relies upon the extrinsic concepts and categories that have meaning for scientific observers.

Expatriation

The moving of a citizen who has left his or her own country to live in another, usually for a prolonged period in many cases on assignment for a company.

Explicit Knowledge

Knowledge that can be documented, categorized, transmitted to others as information, and illustrated to others through demonstrations, explanations and other forms of sharing.

Factionalism

A group of persons forming a cohesive, usually contentious minority within a larger group. However, a rating high on this scale signifies conflict within an organization or nation; internal dissension.

Free Riding

Free riding occurs when one country, firm, or individual benefits from the actions and efforts of another without paying for or sharing the costs.

GATT

GATT stand for the General Agreement on Tariffs and Trade. Treaty organization affiliated with the United Nations whose purpose is to facilitate international trade. GATT was superseded by the WTO.

General Imports

This number measures the total value of merchandise shipments that arrive in the United States from foreign countries, whether such merchandise enters consumption channels immediately or is entered into bonded warehouses or Foreign Trade Zones under Customs custody.

Gross National Product (GNP)

GDP plus the income accruing to domestic residents as a result of investments abroad, minus the income earned in domestic markets accruing to foreigners abroad.

Impatriation

The process of integrating the locals to the ideals of the home country.

Implicit Knowledge

Knowledge which draws on the experience and learning of a person and which is hard to reproduce or share with others.

In-group

A group of people united by common beliefs, attitudes, or interests and characteristically excluding outsiders; a clique.

Individualism

A nation's cultural attribute describing the degree to which people prefer to act as individuals and look out for their own interests rather than act as members of the group and look out for the welfare of the community. For purposes here it means a high number or an increase in the amount of disputes filed in the WTO.

International Joint Venture

A joint venture is a legal entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity by both contributing equity, and then they share in the revenues, expenses, and control of the enterprise. An international joint venture is between two parties that are from different countries.

Institutions

The informal constraints or rules that dictate the governing of an organization or on a larger scale society.

Institutional Framework

A set of organizations and rules that determine incentives for participants in planning process.

Knightian Uncertainty

Knightian uncertainty is simply unmeasurable risk.

Neo-Institutional School of Economics

A school of thought that seeks to extend the understanding of economic performance by focusing on the social and legal rules that underlie economic activity.

New Institutional School of Economics

See Neo-Institutional School of Economics

Organizations

These are the players of the game, or the business that engages in international trade. It is here that the formal rules of society are found. These formal rules have been influenced by institutions.

Power Dependence Theory

Bargaining power rests on the exchange relationship between two actors, individuals and organizations, where one actor's power results in another's dependence.

Power Distance

The extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally. For purposes here, a decreased power distance is exhibited by countries that are members of the World Trade Organization.

Rational Choice Institutionalism

Argues that the rational choice institutionalism provides an analytical framework for scholars to explore theoretical puzzles and conduct empirical research on a wide range of issues in political science. (New Institutionalism)

Rationality Postulate

A mental framework that encompasses as many variables as possible in order to make a more informed choice.

Schemes

The cognitive structures formed by society as ways to interpret the environment.

Scripts

The behavioral responses that are elicited from schemes.

Sense-making

The process of making sense of uncertainties in environments through interaction, how members of organizations make choices (or are forced to make choices) when uncertainty arises.

Shared Mental Models

Mental models are internal representations that individual cognitive systems create to interpret the environment. Ideologies, then, may be seen as the shared framework of mental models that groups of individuals possess that provide both an interpretation of the environment and a prescription as to how the environment should be structured. The decisive characteristic of shared mental models is their path-dependency.

Shirking

To avoid work, duty or responsibility.

Substantive Rationality

Individuals might consider a range of possible values or actions, and attempting to make them consistent. It is considered problematic in modern society in that rationalization of social life makes it difficult for people to pursue particular values. For example, pursuit of family or religious values may be difficult in modern society, given economic pressures and dominance of bureaucratic organizations.

Tactic Knowledge

See implicit knowledge.

Total Exports

The total physical movement of merchandise out of the United States to foreign countries whether such merchandise is exported from within the U.S. Customs Territory or from a U.S. Customs bonded warehouse or a U.S. Foreign Trade Zone.

Transpatriation

The process of enhancing individual learning in conjunction with multinational organizational learning and values across the whole system of the organization.

Uncertainty Avoidance

A national cultural attribute describing the extent to which a society feels threatened by uncertain and ambiguous situations and tries to avoid them. For purposes here it, a high amount of uncertainty avoidance would characterize nations who prefer to do business through a common national language. Inversely, a characterization of a low rating on this dimension is indicative of nations who do not mind engaging in business with nations in which they do not share a commonality of language.

World Trade Organization (WTO)

An international agency which encourages trade between member nations, administers global trade agreements, and resolves disputes when they arise.