

The Cultural Dimension of the Credit Crisis

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Culture has been consistently ignored in current search for the roots of the credit crisis. Cold data on the volume of Credit Default Swaps (CDS's) or Collateral Debt Obligations (CDO's) convey a harsh economic reality but little in terms of the cultural roots of the decisions that have lead to these ominous events. This article provided an attempt at exploring those cultural dimensions. China and the United States were taken as the focus players.

The article explores cultural norms related to attitudes towards consumption; saving, investment and debt are explored. This is followed by an analysis of events and developments that relate to one aspect of those cultural attitudes or the other. China's low consumption, high savings and high investment are viewed as a consequence of a strong Confucian cultural edict. American high consumption and low saving is projected as a possible consequence of the capitalist ideology. A few hypotheses were formulated in order to suggest each of the relationships.

The final discussion relates the findings to a commonly voiced solution i.e. more consumption in China and more savings in the United States. And the article argues that the strong cultural roots of both events will make it difficult to adopt this course of action.

【Key Words: Credit, crisis, culture, savings, consumption】

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The Problem

Naked facts conceal a strong cultural dimension of the credit crisis. Cold data on the volume of Credit Default Swaps (CDS's) or Collateral Debt Obligations (CDO's) convey a harsh economic reality but little in terms of the cultural roots of the decisions that have lead to these ominous events. Suggested solutions focusing on the need for a change in patterns of saving and consumption in one country or the other, again, ignore the possibly invisible and, at times, inflexible forces leading to consumption or a saving decision.

The following article is an attempt at exploring those cultural dimensions of the credit crisis. The United States and China are the focus countries.

The article deals first with what one may term the cultural face of the crisis. Here specific cultural norms standing at the heart of cultural attitudes towards consumption, saving, investment and debt are explored. This is followed by an analysis of the symptoms of these cultural norms and how they are translated into patterns of consumption, saving, investment and debt accumulation. Specific events and quantitative data are cited. The final discussion focuses, primarily, on the potential for application of a frequently voiced solution i.e. an increase in consumption expenditure in China and a parallel increase in saving in the United States. The challenge of cultural change features here and makes one wonder whether a quote by Peter Drucker "Company cultures are like country cultures. Never try to change one. Try, instead, to work with what you've got" could be quite relevant today.

The article concludes with a summary and a conclusion.

Cultural Norms and Values the Broad Framework.

Culture is "collective mental programming of people's minds" (Hofstede, 1980). It could assume a power dimension, an individuality dimension, a masculinity dimension and a certainty dimension (Hofstede, 1980). And those dimensions could embody a broad spectrum of values and attitudes that can go all the way from time, leisure and work to money, learning and the future.

Attitude towards money will provide a base for the following discussion. And it will evolve around four prime segments: attitude towards thrift and saving, attitude towards debt and attitude towards consumption.

Attitude towards consumption

Household consumption expenditure is a function of several variables some economic and others are cultural. Income, wealth, expectations, interest rates are the economic variables. Age, education, family size, attitude towards risk, the desire to leave a bequest as well as external social influences belong to the cultural and quasi-cultural factors. The standard version of the consumption function emerges from the "life-cycle" theory of consumption a theory of life cycle view of consumption decisions. (Modigliani, Franco (2001)).

There exists a common view that a state of excessive household consumption exists in the United States. And that free market ideology is a major contributing to this state.

Attitude towards saving.

What induces people to save? Cultural household norms may hold the answer here. There are several theories and they do differ in their emphasis but the one with the strongest cultural component suggests that households save because they want to leave assets to their children, either because they love them or as a way to bribe the children to look after their parents in old age.(The Economist, Sept 24,2005).

Thrift is the other side of the saving coin. Cultural norms, demographic shifts and economic growth are the most important drivers of thrift. There are indications that in rich countries the biggest disincentives to saving have been capital gains and the ability to borrow while in emerging markets the most powerful factors pushed in the opposite direction.

Attitude towards debt

Attitude towards debt and the high propensity to borrow are, largely, a function of debt ethics and the societal view of bankruptcy. This is followed by mundane issues of cost and ease of access to debt. Low interest rates, the rising popularity of Internet shopping and the aggressive extension of credit to consumers with weak credit credentials all help shaping an easy attitude towards indebtedness.

The debt of U.S. households has risen very substantially relative to income, especially in the past five years or so. This increase mainly reflects the efforts of households to smooth consumption over time in response to shifting perceptions about future income, wealth, and interest rates. Dynan and Kohn, 2007)

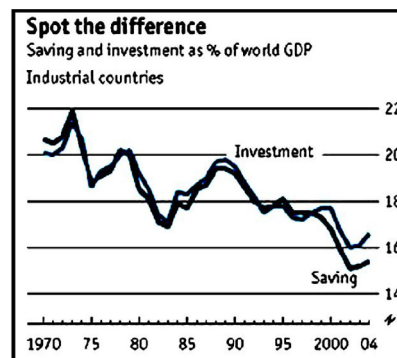
The Applied Dimension.

It is the author's contention that cultural forces of the type referred to above hold a direct relationship to the symptoms of credit crisis that we are witnessing today. Evidence is drawn from contemporary events related to consumer and country behavior with regards to consumption, debt, and borrowing, saving and investing. This evidence is drawn from a wide variety of countries but the main players, the United States and China are the prime actors.

United States dependence on foreign savings

United States 2006 gross national saving rate – the combined saving of individuals, businesses, and the government sector – stood at 13.7% of GDP compared to 16.5% a decade earlier. This is, by far, the lowest domestic saving rate of any major economy among the developed economies.

〈Figure 1〉 Decline in industrialized countries' savings and investments as percentage of World GDP between 1970 and 2004



Source: The Economist, Sept 24, 2005

The United States does not stand alone in this respect. Her position is shared by many developed economies (Figure (1)).

Decline in American savings and the reliance of the United States on foreign savings is more likely than not the outcome of a strong consumption culture.

Chinese ever increasing savings

China's gross domestic saving rate is high by global comparative standards and continues to rise despite a slowing of pace of economic growth, the rate stood at 40.7% in 2005 and rose to 50.6% in 2006. (Table ()). This applies to enterprises and government in the first place and households in the second. Actually household savings demonstrated some decline in 2006 although they rose again in 2007 and 2008.

China accounted for about 23% of the growth in global saving over the past decade.

〈Table 1〉 China's savings as a percentage of GDP 2005-2006

Savings % of GDP	2005	2006
Household	20.1	15.3
Enterprises	14.0	28.3
Others including government	6.6	7.0
Total	40.7	50.6

Sources: several including Kuijs, 2005 as well as WB data base

It is the authors hypothesis that high Chinese savings whether at household,

government or corporate level is more likely than not to be the outcome of a veiled observance of thrift as a Confucian cultural edict?

China's sea of reserves

China demonstrates an endless ability to attract and build savings! In addition to a very large current account surplus (US\$ 372 billion, or 11.3 percent of GDP in 2007), China also has a sizable capital account surplus (US\$ 90 billion, or 2.7 percent of GDP). Capital inflows especially those that are FDI-related continue to be attracted by China's growth prospects and investment climate. The result is an increase in China's official foreign reserves by US\$ 462 billion in 2007, which does not include a sizable amount of foreign reserves that were transferred to the China Investment Corporation and commercial banks. (World Bank, 2008)

The increase in reserves will be supported by exports that will continue to receive stimulance from a solid international competitiveness position of the country (Table (2)). This is evidenced by data on export growth and market share, prices in foreign markets, and profits in manufacturing.

〈Table 2〉 Change in China's reserves and ultimate balance
2006-2009

Variable	2006	2007	2008	2009
Change in reserves +/-	247	462	470	463
Foreign exchange reserves	1066	1528	1998	2476

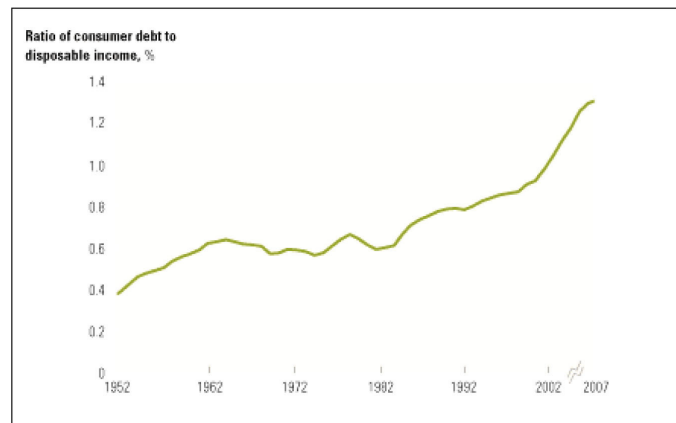
Source: World Bank Report, 2008

It is the authors' hypothesis that high Chinese reserves are more likely than not to be the outcome of a culture rooted in strong work ethic arising from Confucian cultural edict.

American consumer debt

US household debt has gone through a long period of growth with a distinctive upward trend in the late 1980's. The following figure (Figure (2)) illustrates this trend and reflects a 1.4 relationship between consumer debt and disposable income in 2007.

〈Figure 2〉 USA: Relationship between consumer debt and disposable income 1952-2007



Source US Bureau of Economic Analysis, US Federal Reserve, Mckinsey, 2008

It is the author's contention that attempts at decreasing American consumption expenditure is more likely than not to falter in the face of strong cultural norms glorifying spending, brand-search and the demonstration effect.

Discussion

China and the United States, respectively the largest manufacturer and largest consumer in the globe, have maintained a tacit economic balance for years. American consumers indulged into excessive consumption and Chinese wage earners saved and invested in the export generating machinery that China came to be known for. As we said earlier, Chinese wage earners, corporations and government saved, in 2007, a near 51.0% percent of GDP and "consumed", together with their government only 49.0%percent of that same GDP. This contrasts with the American household, business and government expenditure of 93.0% of US 2007 GDP. Common wisdom, today, points to a reversal of roles as a possible remedy to this credit crisis. If only American consumers increase their savings and Chinese consumers boost their consumption, current economic constraints could ease, as the argument goes.

The feasibility of this reasoning however, is suspect. Culture is the culprit.

There is a difference in the nature of consumption and saving in the two countries. Cultural roots of consumption in the United States and the corresponding cultural roots of saving in China could undermine this line of thinking". Chinese savings are culture driven. A considerable margin of these is "precautionary savings" or savings made to accommodate future uncertainties. They constitute an outcome of a process of choice between saving and consumption and the criterion is future economic safety.

Finally, let me stress that changing a national culture is a cumbersome and barrier-ridden process. Corporate cultures are difficult to change and can take time to put through, what about a national culture? For the American consumer to take distance from his decade long addiction to spending and for the Chinese

consumer to disregard the habitual saving practice he has pursued for years is not a simple affair. "Company cultures are like country cultures. Never try to change one. Try, instead, to work with what you've got" (Peter Drucker)

Yet another dimension of the issue is the effectiveness of resort to classic Keynesian monetary policy instrument i.e. interest rate in stimulating or discouraging savings and consumption in China. Resort to debt does not assume the same dimension assumed in the United States and the effectiveness of a monetary policy tool as the interest rate does not have the presumed impact of an economy as the American economy. The same applied to household savings. A reduction in interest rate has, in the Chinese case, a reverse effect as household increase savings to be able to earn the same level of interest essential for a livelihood.

Summary and Conclusions

Culture has been consistently ignored in current search for the roots of the credit crisis. Cold data on the volume of Credit Default Swaps (CDS's) or Collateral Debt Obligations (CDO's) convey a harsh economic reality but little in terms of the cultural roots of the decisions that have lead to these ominous events. This article provided an attempt at exploring those cultural dimensions. China and the United States were taken as the focus players.

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