



Cultural border, administrative border, and regional economic development: Evidence from Chinese cities



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ABSTRACT

Current province-level administrative division in China breaks the distribution of local culture and many cities are separated from their respective local culture regions to locate in other provinces. These cities encounter potential cultural conflicts with the mainstream culture of the provinces they belong to, but also face various local protectionism barriers with cities in the neighboring province that share the same border and local culture with them. As a result, transaction costs could be higher whichever side they trade with, leading to potential harm to their economic development. Using dialect as a proxy for local culture, we find that the cultural segmentation caused by the misalignment between cultural and administrative borders can significantly hamper economic development of the segmented cities. This negative effect is aggravated by greater local protectionism in neighboring provinces but alleviated by a longer history of being administrated by the same province with the current provincial capital. These findings support the hypothesis that cultural and administrative border misalignment works together with local protectionism to bring about substantial economic loss. The results thus highlight the importance of both formal and informal institutions in affecting transaction costs and economic growth, and also shed light on the potential interactions between the two types of institutions.

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1. Introduction

The substantial variations in natural resources and geographic conditions across various Chinese regions, combined with a number of large-scale migrations throughout Chinese history, have resulted in a multitude of local cultures in China, each with its own distinctive characteristics in dialect, customs, social norms, and codes of ethics. The current system of administrative division in China does not sufficiently take into account of such cultural differences, thus often dividing up a region belonging to the same local culture to two or more provinces. As the local culture of the provincial capital city usually defines the mainstream local culture in a province, substantial differences may exist between the local culture of a region that has been separated from its own local culture and the mainstream local culture of the province that the region belongs to administratively. In the current paper, we will refer to such separation of a region from its own local culture as cultural segmentation caused by the misalignment between cultural border and administrative border, and we will explore the potential impact of such segmentation on regional development.

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As shared cultural values help establish mutual trust, which in turn lowers transaction costs and promotes trade, we would expect a culturally segmented region to suffer lower economic development when the following two conditions hold: Inter-regional trade is important and the region faces local protectionism. The reason is that no matter whether the region chooses to trade with other regions located in the same province but from a different local culture or to trade with regions that share the same local culture but belong to a different administrative unit, it will face higher transaction costs, compared to regions not culturally segmented. The higher transaction costs will lead to less trade and less economic cooperation with other regions, which will in turn lead to less benefit from the division of labor and specialization. The inability to enjoy the comparative advantage through trade will potentially result in slowed economic growth for the culturally segmented region. We, therefore, propose the following hypothesis: *Cultural segmentation caused by the misalignment of cultural and administrative borders, if combined with local protectionism, will lead to less economic development level in the segmented regions.*

Using regional dialect as the proxy for local culture, we empirically study how economic development relates to cultural segmentation among Chinese prefectural level cities, and we make the following findings: A city with a local culture different from the mainstream culture of the province where it is located has a per capita GDP level that is on average 15% below the other cities in the same province, even after controlling for various factors. Furthermore, the income gap increases with the severity of local protectionism in the city's neighboring province, but declines with the time length the city has been administered by the same province with the current provincial capital. These findings thus provide empirical support for the hypothesis above relating economic development and cultural segmentation.

More generally, the empirical patterns found in our study highlight the important roles of both formal and informal institutions (for example, cultural borders) in influencing transaction costs and economic growth (North, 1990, 1991). They also help shed light on the interesting ways in which the two types of institutions interact with each other. While formal institutions (such as local protectionism) may be the source of the growth disadvantage of culturally segmented regions, informal institutions (such as local cultural communities) tend to reshape themselves around administrative borders to regain their growth potentials (Hofstede, 1980, 2001).

The remainder of the paper is structured as follows: In Section 2, we review several strands of literature that the current paper contributes to, including research linking formal and informal institutions to development, that on local protectionism, as well as that relating administrative division to growth. Section 3 develops the theoretical hypotheses to be tested, while Section 4 discusses the historical reasons for cultural segmentation within Chinese provinces and introduces the measure for cultural segmentation. Econometric models and empirical data are discussed in Section 5, while empirical results and the related discussion on potential mechanisms are offered in Section 6. Section 7 compares and evaluates alternative explanations for the observed patterns, and Section 8 includes a short conclusion and some potential policy implications.

2. Literature review

In this section, we review related research and position our study in the existing literature. The first important line of research the current study relates to is the institutional economics literature regarding the roles of formal versus informal institutions. Although culture can be defined more broadly (see, for example, Hoebel, 1966, or Geertz, 1973), a more relevant concept is the much narrower one, which refers to the customs, social norms, and ethic rules shared by people that inhabit the same region and interact with one another for a long period of time. Thus defined, the concept is close to that of informal institutions proposed by North (1990), where he divides institutions into formal ones versus informal ones, with formal institutions including statutory laws and regulations, whereas informal institutions including customs, social norms, and behavioral rules.

Because informal institutions enjoy the wide recognition and acceptance by the society at large, they are often self-enforced, without having to be implemented or even supported by government agencies, as required for formal institutions. As a result, informal institutions, including culture, have often been argued to play a crucial role in determining human behaviors, even more so than formal institutions (McMillan & Woodruff, 1999; Michalopoulos & Papaioannou, 2011, 2014).² Yet convincing empirical findings are still scarce in support of the important roles of formal and informal institutions in lowering transaction costs and facilitating exchange. In addition, there are no empirical studies to our knowledge that explore how formal and informal institutions interact with each other in influencing economic growth. In the current study, we will examine the Chinese setting, which provides a unique opportunity for shedding light on these issues.

The second strand of related literature is the one on culture and development. Existing research has established the connection between the two in three steps: First, various studies have provided evidence that cultural heterogeneity leads to a lower level of trust, where Delhey and Newton (2005) use social divisions as the measure, while others use ethnicity heterogeneity (Knack, 2003; Knack & Keefer, 1997; Zak & Knack, 2001; Zerfu, Zikhali, & Kabenga, 2009). Second, many papers have shown the link between trust and transaction costs and trade, using different approaches. While Axelrod (1984) and Gambetta (1988) make theoretical arguments, Ostrom and Walker (2003), Buchner, Gonzalez, Guth, and Levati (2004), and Bjørnskov (2009) rely on experimental findings. Third, empirical evidence has been provided using cross-country data to show the correlation and causality between trust and international trade, investment, and economic growth (Mezias, 2002; Park & Ungson, 1997; Spolaore & Wacziarg, 2009). In particular, Guiso, Sapienza, and Zingales (2009) and Tabellini (2010) are two studies that very carefully address the endogeneity issue.

² Also see Beugelsdijk and Maseland (2011) for a comprehensive review on the link between trust and economic growth.

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