Growth, Culture and Institutions: Are IV regressions of any value?

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Abstract

The last decade has witnessed an increasing interest in the relation between economic performance, institutions and culture. Institutions are formal rules (laws and written rules) and culture refers to informal arrangements such as values, habits and customs. A large part of the literature has found reasonable relations between two or three of these concepts. Moreover, this literature claims that past events (the form of colonization, the transition towards agriculture) still have effects. The empirical claims are derived by means of Instrumental Variables regressions. These regressions are used for estimating the effect of a treatment (the form of colonization) or for correcting a simultaneity bias. The present paper questions the usefulness of this technique for studying the evolution over time of growth, institutions and culture. It argues that essentially two cross-section regressions are performed from which one can’t make any claim about the dynamics of the process. The claims are substantiated by some regressions and a simulation study. Essentially the message of this paper reinforces recent claims that the study of the effects of institutions and culture on growth has to focus on the time dimension: the evolution of the concepts over time.