

# Culture, Cold War, and Trade

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*This study evaluates how the impact of cultural differences on trade evolves over time, especially after the Cold War. We show that the negative influence of cultural differences on trade has increased over time. More specifically, it is more prominent in the post-Cold War era than during the Cold War. For instance, two countries with distinct religious majorities have 35% lower bilateral trade flows in the post-Cold War period compared to countries sharing the same majority religion. This negative effect was less than half during the Cold War (16%). In addition, we provide an explanation for the differential impact of cultural differences over time. By mapping out the transition of the effects of cultural and ideological dissimilarities, we show that cold-war ideological blocs might be a reason for the suppression of cultural differences during the Cold War. Therefore, long-term cultural determinants of trade gain more significance by the end of the Cold War and replace ideological differences as a major impediment to international trade.*

International trade is an important component of national income and contributes to higher welfare. However, there are a myriad of barriers to trade, and some of them are non-economic. For instance, cultural differences play an important role in economic interactions between countries (Felbermayr and Toubal, 2010; Guiso et al., 2009; Melitz, 2008; Rauch and Trindade, 2002). In this context, cultural differences are considered a source of informational cost and a source of uncertainty that acts as a barrier in bilateral trade relations between countries. Results indicate that culturally closer countries trade more with each other. In addition, as it was exemplified during the Cold War, there are political barriers to trade (Umana Dajud, 2013). Political differences have an impact on bilateral trade and, in fact, political proximity promotes bilateral trade.

Our paper (Gokmen, 2014) contributes to this line of discussion by scrutinizing how the impact of cultural differences on trade evolves

over time and how this impact interacts with the Cold War. This brief provides a short summary of our results.

## The Role of Culture in Bilateral Trade during and after the Cold War

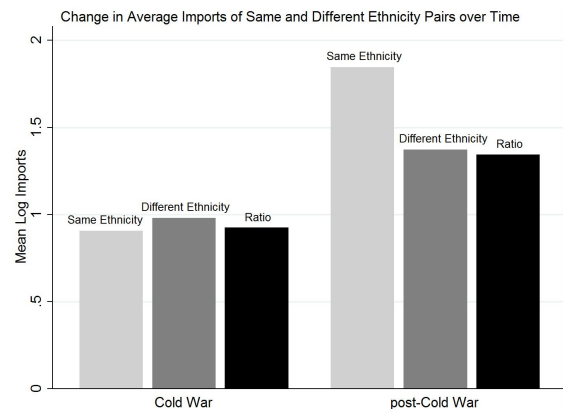
In 1993, Samuel Huntington proposed “The Clash of Civilizations?” hypothesis, which argues that the great divisions among humankind and the dominating source of clashes in the post-Cold War era will be cultural, and states from different cultures will compete for economic and political power (Huntington, 1993a, 1993b). When Huntington put “The Clash of Civilizations?” hypothesis forward he did not only have military clashes in mind but also economic and political ones. According to him, at the micro level, the violent struggles among people would result from the fault lines between civilizations,

while at the macro level, states from different civilizations would compete for economic and political power (Huntington, 1993a). Dissimilarity in culture would then engender differences over issues ranging from human rights to immigration and, more importantly in our context, to trade and commerce.

Although the Clash of Civilizations in the post-Cold War hypothesis has enticed a number of authors into studying militarized disputes between countries, its general implications for economic interaction among cultural groups remained largely overlooked. In our paper, we fill in this gap by focusing on the effect of culture and the Cold War on trade.

Researchers have tried to capture culture with various measures. However, the most standard and accepted ones are religion, ethnicity and language. Following up on the standard measures, we use the measures provided by Ellingsen, which are indicator variables for whether the two countries in a pair have a different dominant religion, language and ethnicity. We first plot mean imports of different and same ethnicity country-pairs, and their ratios over the Cold War and the post-Cold War periods. As such, Figure 1 delivers an illustrative understanding of how trade relations between countries with different and same ethnicities evolved over these two time periods. Average imports have increased from the Cold War to the post-Cold War period for both same ethnicity and different ethnicity pairs. This is not very informative, however, as the two seem to evolve in a similar pattern. Yet, if we look at the evolution of the ratio of the mean imports of the same ethnicity and different ethnicity pairs, the ratio of same ethnicity trade to different ethnicity trade is larger in the post-Cold War era than in the Cold War era, which means that the increase in average trade of same ethnicity pairs is more than the increase in mean trade of different ethnicity pairs.

*Figure 1: Change in Average Imports of Same and Different Ethnicity Pairs*



*Notes:* Evolution of Mean Log Imports over the Cold War and the post-Cold War Periods for Different and Same Ethnicity Country Pairs. Ratio is the ratio of mean log imports of same ethnicity pairs to that of different ethnicity pairs. Mean of log imports for same ethnicity pairs over the Cold War=0.907. Mean of log imports for different ethnicity pairs over the Cold War=0.981. Mean of log imports for same ethnicity pairs over the post-Cold War=1.848. Mean of log imports for different ethnicity pairs over the post-Cold War=1.373.

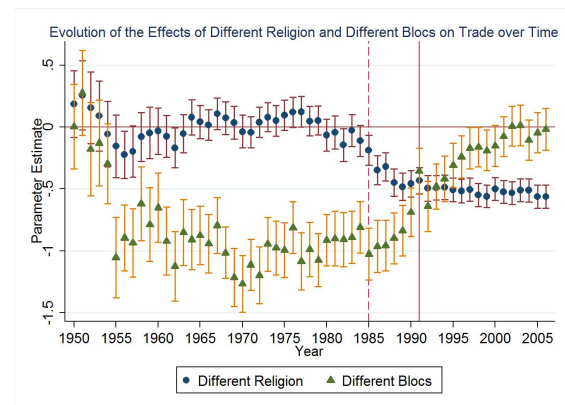
Motivated by the pattern observed in Figure 1, we further explore the time-varying effect of culture on trade and the potential channels for the mechanism. A possible explanation for the mechanism beneath the differential impact of cultural dissimilarity in the Cold War and the post-Cold War periods could be the role ideology and political institutions play during these two time periods. One can argue that although cultural differences have always been present, they were subdued by ideology during the Cold War. Once the Cold War ended, cultural differences are not suppressed anymore, and hence, they resurface. Thus, to understand how the effect of ideology on bilateral trade evolves in conjunction with culture we track the evolution of the impact on trade of cultural dissimilarity and different Cold War blocs over time. We create different blocs indicator whenever the two countries in a dyad were part of two different blocs (the Western Bloc and the Communist Bloc), and then, calculate the effects of different culture and different blocs on imports for every year from 1950 to 2006. We run a gravity model

regression of imports on the evolution of “different religion” and “different blocs” variables over time (via year-interaction terms) together with the standard trade control variables and time-varying country fixed effects. In Figure 2, we plot the effect of different religion and different blocs on trade together with a 95% confidence interval in each year.

The results are striking. Being part of different blocs impedes trade relations during the Cold War. This effect is sizeable both economically and statistically. The impact of different ideological blocs is salient starting from 1955 and this could be attributed to the fact that in 1955, the Warsaw Pact was formed and communist bloc countries started acting in unison. This can thus be seen as the initiation of two separate camps. From 1955, this effect remains negative and significant. Toward the final years of the Cold War, however, we observe a decreasing trend (in absolute values) in the negative effect of ideological differences, and after the demise of the Cold War it is not significant anymore.

On the other hand, throughout most of the Cold War the effect of having different religious backgrounds on bilateral trade lingers around zero and is insignificant. However, towards the end of the Cold War the impact of different religion variable exhibits a jump and almost doubles. This jump takes place in the year 1986. In 1985, the coefficient on the different religion variable is about -0.18, whereas in 1986 this coefficient doubles to -0.35, significant in both cases. This evidence in the data overlaps with the first signs of the end of the Cold War when Mikhail Gorbachev assumed power in the Soviet Union in 1985 and put into effect both economic (Perestroika) and political (Glasnost) liberalization packages.

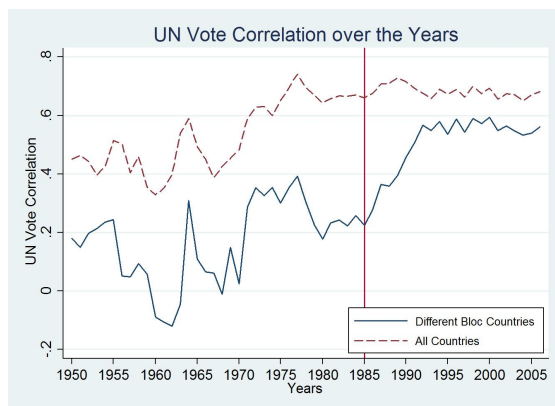
*Figure 2. Evolution of the Effects of Different Religion and Different Blocs on Trade over Time*



*Notes:* Parameter Estimates and 95% Confidence Bands of Different Religion and Different Blocs Variables Throughout Years. The values are from the following regression specification. Regressand: log Imports. Other Regressors: log Distance, Contiguity, Colonial Link, Same Country, Common Colonizer, Same Legal Origin, FTA, Both in WTO, Common Currency, GSP and time-varying importing country and exporting country fixed effects.

To better understand whether the political relationship between the two blocs start to improve in 1985, when Gorbachev came to power, we plot the average UN General Assembly Voting correlation across countries of the two blocs and across all countries over time. Figure 3 shows that the average UN vote correlation for all countries started showing an upward trend in the second half of 1960s, and stabilized around the end of 1970s. However, up until 1985 the UN voting correlation for different bloc countries is about the same as in the mid-50s or mid-60s. At the same time, from 1985 there is a gradual increase in the correlation of different bloc countries and it stabilizes in the 1990s after the end of the Cold War. This evidence supports the hypothesis that the end of the Cold War might have helped trade relations return to their fundamental determinants, and hence, the influence of cultural differences becomes more salient.

Figure 3. UN vote Correlation over Time



Notes: UN Vote Correlations over time for different bloc country pairs and for all country pairs.

## Conclusion

Out of non-economic barriers to trade, culture stands out as a strong determinant of bilateral trade. However, culture can also be subdued, as was the case during the Cold War. The influence of culture on trade was suppressed by greater political and ideological differences, and culture was forced to take a backstage role. Yet, once the Cold War was over and the suppression of culture by ideology was lifted, the importance of culture in determining trade relations has taken its natural more salient role again.

Unstable trade relations might be a source of concern for policy makers and such instability might stem from cultural differences. Such a destabilizing phenomenon at a global scale needs better understanding. More disaggregated trade flows data, for example, could shed some more light on this question by showing which components of trade and what types of goods drive the findings. Also, the role minorities play could help our understanding. Lastly, in order to mitigate negative effects of cultural differences, policy makers could focus on promoting inter-cultural trade.

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