

Mapping Cultural Psychologies and Economic Performance in Lima, Peru*

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Abstract

The power of transaction cost analysis lies in its ability to describe how economies *actually work*, free from neoclassical normative assumptions. Likewise, the theory's leading architects have also argued for a behavioral corollary, which questions expected-utility's normative biases and proposes instead to study humans *as they are*. Scholars address the second problem in several ways – ranging from behavioral economics and the psychological analysis of incentives and motivation to a game theoretic approach to norms and evolutionary psychology. Approaches have even been combined as seen in behavioral game theory and neuroeconomics. However, an analytical gap remains. While offering crucial insights, these approaches fail to account for the pervasive influence cultural categories of perception *and* norms of behavior have for both sides of the means-ends equation. This paper offers a model for how to integrate cultural psychologies into institutional analysis by using the analytic narratives method to examine the economic decisions taken by two cultural groups in the wake of Peru's neo-liberal reforms. Members from both groups realize economic success and failure, but in their own ways, through different cultural and institutional pathways. Just as transaction costs never reach zero, so too will we never act as full and automated wealth-maximizers. The challenge is to develop a descriptive framework that does for human agents what transaction costs achieves for exchange.

“Modern institutional economics should study man as he is,
acting within the constraints imposed by real situations.”
-- Ronald Coase¹

The power of transaction cost analysis lies in its ability to describe how economies *actually work*, free from normative neoclassical assumptions. Likewise, leading institutional theorists have also argued for a behavioral corollary, which critiques expected-utility’s normative biases and proposes instead to study humans *as they are*. Though great insights have resulted on the first front, advances on the second, as Douglass North has stated, remain in their infancy.² In the attempt to address this problem, scholars have pursued several tactics for integrating culture and/or psychology into institutional analysis, ranging from behavioral economics and the psychological analysis of incentives and motivation to a game-theoretic approach to norms and evolutionary psychology. Some of these approaches have even been combined as seen with behavioral game theory and neuroeconomics. However, while all offer insights that bring us closer to Coase’s call to “study man as he is,” they fail to adequately account for the pervasive influence cultural norms of behavior *and* categories of perception have for *both* sides of the means-ends equation.

This paper addresses this analytical gap by offering a model for how to integrate “cultural psychologies” into institutional analysis. It does so through the construction of analytic narratives that trace the decisions taken by two distinct cultural groups in Lima, Peru in the face of that country’s economic crisis and subsequent neoliberal reforms. Through extended fieldwork and intensive interviewing, I discovered that members from both groups have realized economic success and failure, but in their own ways, through different cultural and institutional pathways. Just as transaction costs never reach zero, so too will we *never* act as full and automated wealth-maximizers, though certain sociological shifts can produce mental shifts that asymptotically approach this ideal, as has occurred in Peru. Given this, the analytical challenge is to develop a descriptive meta-language that achieves for human agents what transaction costs does for exchange.

¹ Ronald Coase, “The new institutional economics,” *Journal of Institutional and Theoretical Economics*, 140 (March 1984), p. 231.

² Specifically, North wrote that while “we do have a good deal of recent research modeling specific norms and their impact set in a game theoretic framework . . . examining the overall consequences of culture for economic performance is still in its infancy.” See Douglass North, *Understanding the Process of Economic Change* (Princeton: Princeton University Press, 2005), p. 57.

Seeds of Formal Contradiction

From a behavioral standpoint, the New Institutional Economics (NIE) finds itself caught in three sets of formal contradictions.

First, different analytical contexts require distinct behavioral models. On the one hand, the assumption of wealth-maximization serves as a cornerstone to the discipline's seminal work, beginning with Coase's "The Nature of the Firm."³ The "as if" *homo economicus* model adequately describes actor and organizational behavior in advanced capitalist societies, thus providing valuable institutional insights. On the other hand, historical and cross-cultural studies of institutional change call for either the modification of behavioral assumptions or the incorporation of norms into game-theoretic analysis.⁴ Actors are either motivated or constrained by unacknowledged cultural or psychological conditions.

Second, responses to these cultural and psychological challenges have generated a subsidiary set of potentially contradictory frameworks. For example, the behavioral economic critique focuses on both computational limitations as well as framing effects. The former highlights the need to modify our assumptions about the cognitive *means* actors use to make decisions and the latter emphasizes the mutability of desired *ends* or preferences.⁵ However, a game-theoretic approach assumes the expected-utility the behavioral economists critique, yet seeks to explain how cooperation emerges through normative recourse to trust, altruism, fairness, and reciprocity.⁶ Theorists view norms as preferences attached in an ad-hoc manner to utility functions, while continuing to assume individual and universal utility-maximizing psychological processes. In a subsequent attempt to explain the unpredicted cooperative outcomes of economic experiments, scholars have sought internal biological

³ This is true for Coase's founding texts, as well as for seminal articles from the "Washington School" and "Governance" approaches. See Ronald Coase, *The Firm, the Market, the Law* (Chicago: University of Chicago Press, 1988); Stephen Cheung, "The Contractual Nature of the Firm," *Journal of Law and Economics* 17: 53-71; Yoram Barzel, "Measurement Cost and the Organization of Markets," *Journal of Law and Economics* 25: 27-48; and Oliver Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985).

⁴ See Douglass North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990) and Avner Grief, *Institutions and the Path to the Modern Economy: Lessons from Medieval Trade*. (Cambridge: Cambridge University Press, 2005).

⁵ Behavioral economics is an umbrella term that includes various approaches. While the bounded rationality critique began with Herbert Simon and his "satisficing" approach, other research agendas have grown. Chief among them are Prospect Theory, see Daniel Kahneman and Amos Tversky, eds., *Choices, Values, and Frames* (New York: Cambridge University Press, 2000) and the Heuristics approach, see Gerd Gigerenzer et al., eds., *Simple Heuristics that Make Us Smart* (New York: Oxford University Press, 2000).

⁶ For early examples, see Robert Axelrod, *The Evolution of Cooperation* (New York: Basic Books, 1984); Robert Bates, "Contra Contractarianism: Some Reflections on the New Institutionalism," *Politics and Society* 16: 387-401; and Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Actions* (Cambridge: Cambridge University Press, 1990).

explanation.⁷ Evolutionary psychologists argue that humans have developed specialized mental modules that facilitate cooperative behavior. However, a major challenge to such a hypothesis lies in the existence of substantial cross-cultural differences in wealth-maximizing and reciprocal behavior.⁸ In sum, socio-cultural factors cannot be explained away by biological or universal psychological assumptions, nor are norms fully exogenous to human psychology. Meanwhile, the assertion that formal and informal institutions emerge as heuristic responses to computational limitations in the face of environmental complexity implies an undeniable instrumental relation between culture and psychology.

This problem is further compounded by a third contradiction that confuses two types of cultural explanations of economic performance. An older literature beginning with Weber argues that the capitalist spirit or mentality, i.e., the normative wealth-maximization model, is not universal, but gets formed socially and historically.⁹ For this reason, Weber drew a distinction between “capitalist” and “traditional” mentalities. The former seeks profit as a goal or duty in itself, the latter seeks only enough material wealth as is necessary for living in the way that the person or group is accustomed.¹⁰ Many Cold War scholars adopted this approach to argue that the cultural and psychological *ends* of society – their lack of achievement motivation, etc. – explained poor economic growth. However, with research into the free-rider problem beginning in the 1960s and its subsequent integration into NIE analysis in the 1980s, scholars altered their cultural critique. Unlike Weber, many assumed a psychic universalism and focused on the cultural *means* of society, e.g., its lack of trust, reciprocity, or social capital. It is not coincidental, then, that this analysis draws inspiration from a different sociological tradition – not the German but a French one, as represented by de Tocqueville and later Durkheim. In sum, while both critiques are cultural, they target different sides of the means-ends equation.

⁷ These come in the guise of evolutionary psychological and neuroeconomic explanations. The latter combines both evolutionary psychology and behavioral economic approaches. See Elizabeth Hoffman et al., “Behavioral Foundations of Reciprocity: Experimental Economics and Evolutionary Psychology,” *Economic Inquiry* (July 1998), 36(3): 335-252; Paul Zak, “Neuroeconomics,” *Phil. Trans. R. Soc. Lond* (2004) 359: 1737-1748; and Colin Camerer et al., “Neuroeconomics: How Neuroscience Can Inform Economics,” *Journal of Economic Literature* (March 2005) 43(1): 9-64.

⁸ Joseph Henrich et al., eds., *Foundations of Human Sociality: Economic Experiments and Ethnographic Evidence from Fifteen Small-Scale Societies* (New York: Oxford University Press, 2004)

⁹ Max Weber, *The Protestant Ethic and the “Spirit” of Capitalism and Other Writings* (New York: Penguin Press, 2002)

¹⁰ Unexplored affinities exist between Weber’s distinction and behavioral economic research. However, despite advances behavioral economic experiments have not yet been systematically tested cross-culturally, especially in applied settings.

We are faced, then, with a Keplerian situation – subsidiary theories develop which make the task of modeling human behavior ever more complex, much as the early-Modern integration of ever more intricate geometrical models failed to reconcile observed data with the assumption of a geo-centric universe. A central issue for NIE is the inability to theorize the relationship between culture and psychology – its Keplerian task is the reconciliation of an *assumed* psychic universalism with *observed* cultural and institutional differences.

But what if we have new evidence challenging the assumption of psychic universalism? What implication would that have for modeling the relation between culture, psychology, and institutions? Fortunately, much of the theoretical and empirical work has already begun. A new discipline – Cultural Psychology¹¹ – has made much headway over the past two decades questioning the fundamental assumptions of general psychology in much the same way NIE has critiqued traditional microeconomics.

A Cultural Psychological Framework

Cultural psychology rests on the fundamental proposition that culture (i.e., shared beliefs about what is true, good, beautiful and efficient made manifest through practices) and psyche (i.e., the self-reflexive thinking, feeling, wanting intentional agent) co-constitute one another. Whereas canonical psychology assumes psychic unity, searches for universal processes, and attempts to filter out the “noise” or content of thinking, feeling, and wanting in cross-cultural research, cultural psychology takes a “one mind, many mentalities” approach. It acknowledges the mind’s universal *potentiality* but seeks to document *actual* systematic divergences in mental functioning as emergent from socio-cultural practices.¹²

In this sense, the discipline parallels Coase’s critique of economics: “[T]he acceptance by economists of a view of human nature so lacking in content is of a piece with their treatment of institutions.”¹³ In other words, the analysis of markets without attention to institutions is akin to the study of a human psychology that ignores its context and content.

¹¹ Cultural Psychology has several different variants. See Richard Shweder, *Thinking Through Cultures: Expeditions in Cultural Psychology* (Cambridge: Harvard University Press, 1991) and *ibid.*, *Why do Men Barbecue?: Recipes for Cultural Psychology* (Cambridge: Harvard University Press, 2003); Michael Cole, *Cultural Psychology: A Once and Future Discipline* (Cambridge: Harvard University Press, 1996); Hazel Markus and Shinobu Kitayama “Culture and the Self: Implications for Cognition, Emotion, and Motivation,” *Psychological Review* (1991) 98: 224-53; and Jerome Bruner, *Actual Minds, Possible Worlds* (Cambridge: Cambridge University Press, 1987) and *ibid.*, *Acts of Meaning: Four Lectures on Mind and Culture* (Cambridge: Harvard University Press, 1992).

¹² For this reason, a prime site of cultural psychological study is the developmental process. For an overview, see Richard Shweder et al., “The Cultural Psychology of Development: One Mind, Many Mentalities,” in W. Damon, ed., *Handbook of Child Psychology* (New York: Wiley, 1998), pp.865-937.

¹³ Ronald Coase, *The Firm, the Market, and the Law*, p. 5.

Cultural psychology helps address this pivotal NIE issue. It theorizes how cultural categories affect how we perceive, reason with, and interpret information and recognizes how norms of behavior act as constraints on action and serve as sanctioned goals.¹⁴

But what is the best way to study the beliefs and practices of others? According to Richard Shweder, a leading proponent of cultural psychology, responses to this question take one of two forms. We can either “rationalize” or “irrationalize” the actions of others. A Rationalization approach identifies a “good reason” for a behavior that both justifies and explains it. An Irrationalization strategy details a causal explanation for the behavior, but the cause does not necessarily serve as a justifiable “good reason” for the action.

Many of the current attempts to integrate culture and psychology into institutional analysis *tend toward* an Irrationalization approach to the actions of others. For example, many behavioral economists recognize that humans are intendedly rational in their attempt to maximize utility, but limitedly so. Game-theoretic approaches judge the “rationalization” of participants according to how closely they achieve Pareto-optimal goals. And finally, evolutionary psychologists search for causal biological explanations that often fall out of conscious control; an action is deemed rational from the perspective of its adaptive function. In other words, such approaches focus on the rationality of *means*, to the detriment of acknowledging and understanding the differing rationality of *ends*.¹⁵

In contrast, cultural psychology opts for a Rationalization strategy, focusing on both means and ends. It assumes that the subject is an intentional agent and that the task of exegesis is to *rationalize* – justify and explain – the mentalities that both generate and are generated by socio-cultural practices. However, this does not mean that its task is to rationalize all behavior, i.e., to argue that all that is, is justified. As such, it distinguishes between a rational action, a rational practice, and a rational person. A rational action is a *discrete behavior* that can be both explained and justified with reference to a “good reason.” For example, in some societies a man will help a woman pick up a box because of beliefs

¹⁴ Much research has been done on the cultural psychology of attention, perception, and cognition, especially as guided by the self. For attention see T. Masuda & R. Nisbett, “Attending holistically versus analytically: Comparing the context sensitivity of Japanese and Americans,” *Journal of Personality and Social Psychology*, (2001), 81(5), 922–934. For perception see Shinobu Kitayama, et al., “Perceiving an object and its context in different cultures: A cultural look at new look,” *Psychological Science* (2003), 14(3): 201–206. For cognition see Richard Nisbett et al., “Culture and systems of thought: Holistic vs. analytic cognition,” *Psychological Review* (2001), 108, 291–310. For the role of the self in social cognitive settings, see Hazel Markus and Shinobu Kitayama, “Culture and the Self,” as cited in footnote 11.

¹⁵ Notable exceptions to the “irrationalization” tendency are found in the research on the psychology of incentives and motivation. See footnotes 38–40.

about gender capabilities and responsibilities. Second, a rational practice is an *habitual action* that someone might do for a “good reason.” For instance, in some areas of the American South it is still *custom* for the man to hold open the door for a woman. However, this does not mean that the person that engaged in the practice necessarily did so with that cultural reason in mind. The man may have held open the door because he wanted to avoid standing in line with someone he recognized, thus he let the woman go in front of him. And finally, a rational person is someone that acts based on the motivation to have a “good reason” for behavior. For example, imagine that a transvestite approached the door. The man may choose to hold open the door because he accepts the biological man as a “cultural” woman. In other words, he seeks a good reason for his behavior by fitting a potentially anomalous fact into his existing cultural psychological model. Such a tri-partite framework leaves open the identification of irrational actions, practices, and persons, while allowing adequate space for cultural pluralism, i.e., the justifiability of different shared rational ends.¹⁶

Cultural psychology thus adheres to a preferences/constraints model familiar to economists, but enriches it with a modified set of precepts. “Observed behavior,” Shweder states, “is rendered intelligible through an interpretive analysis which makes reference to what a person knows, thinks, feels, wants, and values (as good or bad) as a meaning-maker.”¹⁷ The explanatory task is to provide a thickened description of observed preferences and constraints, which are justified and explained according to a socio-cultural frame of reference. On the preferences side, cultural psychology understands “utility” not as profit, wealth, self-interest, nor even the tautological and unfalsifiable “anything wanted.” Rather it is that which offers coherent moral justification or meaning within a given socio-cultural frame. This could be profit, but it could also be honor, status, generosity, fairness or any other number of moral goods. These goods are not stand alone, for they *have meaning as part of a moral system*. On the constraints side, the discipline demonstrates how cultural

¹⁶ An action may be deemed irrational when it is not done for a “good reason.” A person may be called irrational when either they cannot provide a moral justification for their behavior or when they have a breakdown of rationality. Shweder classifies the latter into several types: “(1) breakdowns in voluntary control (e.g., compulsive/obsessive disorders); (2) breakdowns in subject/object relations (e.g., hallucinations and reality-testing disorders); (3) breakdowns in means-ends thinking (including, for example, “phobic” disorders); and (4) breakdowns in impulse management.” See Richard Shweder, “The Psychology of Practice of the Practice of the Three Psychologies,” *Asian Journal of Social Psychology* (2000) 3: 207-22. A practice may be deemed irrational when it results from a collective breakdown or rationality as enumerated above or when it serves the interest of a powerful minority.

¹⁷ Richard Shweder, “From Persons and Situations to Preferences and Constraints,” Paper presented for a Festschrift in honor of Walter Mischel titled “Toward a Science of the Person: Paradigm Change in Psychological Models of Human Nature,” Columbia University, June 11, 2005.

categories affect perception and reasoning and how norms condition means, alongside the additional constraints of time, resources, knowledge, opportunity structures, and computational limitations. A cultural psychological approach need not be exclusive of other economic, sociological, or psychological insights.

This cultural psychological framework thus enables new possibilities for a descriptive modeling of the relationship between culture, psychology, and institutions, as seen in the differing responses made by two cultural groups in Lima, Peru in the face of changing political economic realities.

Design and Methodology

One of the major challenges to incorporating cultural analysis into institutional and psychological frameworks lies in the “messiness” of interpretative analysis, which is often unpalatable to the disciplinary epistemologies of economists and psychologists. However, this can be overcome by (1) extending the cultural psychological framework and its task of a “thick description” of preferences and constraints into a field in which (2) a natural cultural comparison exists and then (3) focus data collection on gathering the information needed to construct analytic narratives which (4) offers a systematic means for analyzing the differential effects cultural psychologies or mental frames of reference and their associated practices have for economic performance over a certain period of time.

According to Bates et al., analytic narratives are constructed in two phases – first a “thick” apprehension is sought from which a “thin” explanation is abstracted. Specifically, one should seek to

identify agents: some are individuals, but others are collective actors, such as elites, nations, electorates, or legislatures. By reading documents, laboring through archives, interviewing, and surveying the secondary literature, we seek to understand the actors’ preferences, their perceptions, their evaluation of alternatives, the information they possess, the expectations they form, the strategies they adopt, and the constraints that limit their actions. We then seek to piece together the story that accounts for the outcome of interest: the breakdown of order, the maintenance of peace, the decision to fight or collude. We thus do not provide explanations by subsuming cases under ‘covering laws,’ in the case of Hempel. Rather we seek to account for outcomes by identifying and exploring the mechanisms that generate them. We seek to cut deeply into the specifics of a time and place, and to locate and trace the processes that generate the outcome of interest.¹⁸

¹⁸ Robert Bates, Avner Greif, Margaret Levi, Jean-Laurent Rosenthal, and Barry Weingast, *Analytic Narratives* (Princeton: Princeton University Press, 1998), pp. 11-12

The analytic narrative thus parallels the exegetical goal of cultural psychology in that it too seeks a fuller description of the actors' preferences and constraints. However, although Bates et al. rely on rational choice and game theory to abstract "thin" explanation, they do recognize that "a range of models could serve as the basis of analytic narratives."¹⁹ My analysis thus privileges a cultural psychological framework and seeks to locate the mechanism for differential economic outcomes in the mental logics of the two cultural models – one Andean and the other *criollo*. Lima, Peru is an ideal site for studying the differing influence of culture-bounded economic decisions since it offers a natural case in which two distinct groups, one Andean and the other *criollo*, confronted the same free market reforms in a shared social space, but with differing and often surprising results.

Like Bates et al., my data collection sought a "thick" apprehension of differential economic performance in Lima, Peru through 18 months of fieldwork. Data included daily participant-observation fieldnotes which helped identify the cultural logics of the Andean and *criollo* groups, the historical analysis of changing legal codes and the popular press which traced political economic shifts, and the recording of 128 life- and oral-history interviews (81 for the Andean and 47 for the *criollo* groups) ranging from 30 minutes to 3 hours which I triangulated with interview transcripts done by researchers of Lima's urban migration dating back to the 1950s. This resulted in a reservoir of over 200 individual trajectories embedded in a wealth of historical and ethnographic material. The challenge was then to identify narratives of embedded decision-making to determine what led to economic success and failure, as measured by the ability to accumulate wealth.

I relied on the transaction cost framework and cultural psychological interpretation to abstract "thin" explanations out of the "thick" account. Adjustments to Peru's economic crisis and neo-liberal reforms were dictated by how the country's two major cultural groups first *interpreted* and then *projected* their own solutions onto their changing reality. In other words, they used their own cultural psychological or mental frames of reference to first understand their new reality and then adapted their established cultural practices and concomitant strategies to navigate their way through the economic crisis. This modification of cultural practices eventually effected a change in their mentalities – on both sides of the means-ends equation.

¹⁹ *ibid.*, p. 3

Cultural Psychologies and Economic Performance in Lima, Peru²⁰

To understand the effect of cultural psychologies on economic performance, we first need to appreciate Peru's cultural history and the differing logics of its Andean and *criollo* practices. Only then can we trace how four major strategies – two each from both cultural logics – emerged in response to the economic crisis and reforms.

Background

The effects of Peru's Conquest era remain etched into the country's landscape. After the Spanish quelled its indigenous subjects in the 16th century, they codified Peru's Hispanic and Andean heritages into two sets of laws. While much cultural and ethnic intermixing occurred during the three centuries of colonial rule, forcing the Lima-based viceregal government to modify its caste laws, two distinct though related cultures – one Andean and the other *criollo* – developed at the extremes of society. Despite the long-term erosion of Andean social organization caused by forced relocation and tribute and labor laws, highland peasants continued to live in semi-subsistent conditions adhering to pre-Colombian social and economic practices. Meanwhile, a *criollo* culture emerged on the coast and in cities from an amalgamation of mainly Hispanic but also African components. The two distinct but politically and economically inter-related sets of Andean and *criollo* practices persisted, albeit with historical transformations, until the 19th century post-independence period when Peru, free from Spanish strictures, reinvented itself as a diversified primary export economy.

Subsequent economic specialization and transport projects spurred profound shifts in both the Peruvian coast and highlands and led to the eventual formation of two new urban groups in Lima. Hacienda encroachment and demographic growth placed pressures on land and water resources, forcing highland community members to abandon semi-subsistent lifestyles and migrate, first to provincial and coastal urban centers and then to Lima. Parallel to this process, increased specialization created new demands for white-collar transaction sector jobs – including government bureaucrats, office workers, managers, accountants, and lawyers.²¹ Former landowners and merchants squeezed by the changing political economy

²⁰ This section is based on my doctoral dissertation, which offers a full cultural psychological and institutional analysis of the five phases of historical change Lima's Andean migrant and *criollo* middle-class groups passed through during the 20th century: Arriving, settling, reacting, surviving, asserting. Due to space considerations, references to secondary literature on Peru have been limited.

²¹ For parallel developments in the US, see Douglass North and John Wallis, "Measuring the Transaction Sector in the American Economy: 1870-1970," in *Long Term Factors in American Economic Growth*, Stanley Engerman and Robert Gallman, eds. (Chicago: University of Chicago Press, 1986).

and new European and Asian immigrant who arrived during the liberal export era both began to fill these positions as the 20th century progressed. After all, Peru's social structure closed off these new middle-class positions from its Andean population.²²

By mid-century, Lima's burgeoning landscape had become dominated by these two groups – a traditional middle class and Andean migrants. Middle and lower-middle class families settled in newly urbanized formal districts, while Andean migrants, with some of the city's *criollo* poor, founded a series of squatter settlements beginning in the 1940s. The differing uses of *criollo* and Andean socio-cultural practices quickly became evident in the distinct neighborhood organizations and economic strategies. The *criollos* followed a logic of *arribismo* to gain access to resources, while the Andeans used highland reciprocity strategies as an initial boon to organize their residential areas and become small-scale merchants and producers. The two basic cultural models emerged as follows, presented intuitively.

Andean Model

Traditional Andean social and economic organization is characterized by a unique form of reciprocity or *ayni* (“today for you, tomorrow for me”) grounded in kinship ties and emergent from Andean ecological demands. Due to highland ecological diversity, select staple foods could only grow in certain altitudes or production zones. To meet subsistence needs, communities settled between the major maize and tuber growing areas to gain better “vertical control” of the surrounding agricultural areas. Households were apportioned their own land for each level. To meet the labor demands necessary for harvesting or turning over one's fields, families called upon a dense system of horizontal (*ayni*) and vertical (*mita*) reciprocal relations for producing, collecting, and sharing products at the village level. Despite historical transformations, basic reciprocity rules remained intact among rural highland groups until the 20th century.

Criollo Model

Middle-class *criollo* practices emerged from the logic of *arribismo*, which coalesced during the liberal export era via the formation of a white-collar middle class. Its defining principle was the prizing of status due to a basic “limited good” or zero-sum view of available resources, though this vision did not necessarily match the economic reality. Since status implied greater resource access through social networks, economic success came to depend on rational investment in status with an eye toward maximizing wealth. This marked both horizontal and vertical relations. Strong group identities formed which heavily guarded against anyone that sought upward mobility, since another's gain implied relative loss. However, members also understood that to achieve mobility, merit alone did not suffice. A patron of some sort who controlled resources had to be secured. As such, a competitive and exclusionary form of middle-class patron-client relations developed.

²² A third “working class” or “*obrero*” group formed, which occupied the space between the traditional middle and migrant groups. While they consisted of a mixture of native Limeños and provincial migrants, culturally they adhered to a *criollo* ethic. However, limited industrialization prevented this group from exercising the kind of political influence seen in Argentina and Brazil.

The two groups thus distinguish themselves not so much by their sociologies – both use vertical and horizontal social networks – but by the distinct cultural beliefs and sanctioning meanings which hold the social networks in place. It is not enough to say that both depend on networks; rather they create and utilize networks in different cultural ways.

Given structural economic constraints, strategies emergent from both cultural models achieved a modicum of success in the 1950s and 1970s, despite the attempt of a leftist military regime to “revolutionize” Peruvian society between 1968 and 1980. The white-collar group realized its own middle-class ideal while navigating economic ups and downs. Meanwhile, Andean migrants forged their own “informal” society, with hard-fought housing and economic improvements. But by the 1980s, governance errors and continued highland poverty created a double-helix spiral of problems: crippling hyperinflation stemming from macroeconomic mismanagement and political violence led by a Maoist guerrilla group began to feed off of one another. The social crisis and its remedy – an authoritarian crackdown and neo-liberal reform – forced the two groups to continue to develop their own solutions for navigating through this era.

Responses to the crisis and reforms emerged from the confrontation of differing cultural psychologies or mentalities with new political economic realities. Much like a person’s reaction to a Rorschach inkblot, members from the Andean and *criollo* groups projected their logics onto the new social reality. Four basic strategies emerged, two each from the *ayni* and *arribismo* logics. The Andeans followed either a splintering or grouping route while the *criollos* adhered to either a parasitic or symbiotic path. All four achieved success and failure, in their own ways, depending on their cultural and institutional contexts.

Andean

When Peru’s 1980s economic crisis arrived, Lima’s Andean migrants already had four decades of experience in the capital. While the migratory flood began in the 1940s, it grew in successive waves until the 1980s. Despite this, the initial solutions imposed by the city’s first migrants created an “extra-legal” framework for the incorporation of new arrivals. With limited formal employment opportunities upon arrival, Lima’s migrants created an informal sector that used *ayni* strategies in both neighborhood and commercial organization to meet housing, labor, transportation, and consumption demands. Yet by the 1980s, extra-legality had begun to reach its operational limits, as Hernando de Soto astutely recognized, forcing

the group's members to follow either a "splintering" or "grouping" path in order to address changing *ex ante* property rights and *ex post* contract enforcement problems.

Splintering

The original heart of migrant activity in Lima centered on "La Parada," the site of the city's bus terminal and its retail and wholesale markets. It was there that the city's first major squatter settlements formed and it was there that Gamarra, today Latin America's largest textile cluster consisting of over 15,000 firms and nearly \$1 billion in annual sales, took shape. As such, it serves as an ideal case for understanding how "splintering" strategies developed.

The majority of Gamarra's business owners began either as poor Andean migrants or as their sons and daughters. Most started as street vendors, with nothing more than the small amount of capital they scraped together and a ferocious drive to improve their situation. The cluster's founders benefited from first-mover advantage and now speak nostalgically about the 1960s and 1970s. "Anything you made was sold," one pioneer said. "You couldn't manufacture fast enough." Although firms confronted both *ex ante* property rights and *ex post* contract enforcement problems, they initially addressed these obstacles through *ayni*-based practices.

Analysis of an essential question upon which transaction cost economics was built – what explains firm size – helps clarify how the Andean migrants developed extra-legal solutions to institutional obstacles. When Hernando de Soto and his colleagues took to the streets of Lima, including Gamarra, in the early 1980s, they identified the lack of property rights as the leading cause of limited firm size.²³ The high costs of business formalization – of obtaining the proper licenses and registrations – outweighed the short-term costs of staying informal. However, extra-legality exacted a greater long-term price. When you're not legal, the costs of avoiding detection lead you to disperse activities, shun publicity, and spend on sanction-dodging bribes. When you're not legal, you're forced to deal exclusively in cash within an inflationary environment and choose to save in tangible goods rather than in cash with financial institutions. When you're not legal, you may benefit from avoiding taxes and labor laws, but this forces you to hire less qualified workers and become more labor, rather than capital, intensive. When you're not legal you have no guarantee over your ability to use

²³ Hernando de Soto, *El Otro Sendero* (Lima: Instituto de Libertad y Democracia, 1986).

an asset, appropriate returns from it, or change its form or substance. You thus lack the incentive to invest in your own property and cannot use it as collateral for credit. When you're not legal, you have trouble enforcing contracts. Many exchanges rest on oral agreements, and when a dispute occurs you cannot easily resolve it through a judicial court mechanism.

Owners combated these problems through *ayni*-based strategies. In the Andes, kinship and community ties mediate one's access to resources. For example, when households need to turn over one's fields, harvest their crops, or build a roof, they use *ayni* by calling on kin and community members to help them. The household head's family is then beholden to the kin and community members for when they need assistance. Often, village heads also call on the *mita* or communal labor to build a school or irrigation canal. Community members donate a day of labor and in return they receive the "public good."

A similar process occurred in Lima, especially in Gamarra. Instead of land, families ran their own firms. They developed *ayni*-supplier relationships and often hosted and hired kin and community members as workers, though the ideal, as in the Andes, was to become "independent," with your own set of *ayni* relationships. For in the Andes, wealth is measured not by material goods but by the density of one's social networks, since it mediates access to resources. Within such a context, reneging on a socially embedded "contract" has enormous mental repercussions, since it implies that you also renege on the relationship and the community. As for the *mita*, this also operated but at the residential neighborhood and commercial gallery level. Migrants created communal kitchens, collected monthly quotas used for community improvements, and adhered to an informal code of mutual surveillance to protect one another's (extra-legal) property. Cultural expectations associated with *mita* held the system in place. Thus, to make a game theory argument that reputation, investment in information, and repeated plays determine whether a person cooperates or defects is only *partially* correct. Social networks and collective organizations that give rise to organic private order mechanisms may serve the same bare ends, but the *cultural means* for realizing these ends may vary. In the field, the creation of reputations and the flow of information can take several forms and may be infused with different sanctioning meanings. Regardless, the argument that extra-legal solutions fail to achieve economies of scale still holds.

In the late-80s and early-90s, the Peruvian government attempted to address this problem through property rights reform, first with the help of de Soto's Institute of Liberty and Democracy (ILD) and later with the assistance of the World Bank. The results were

astonishing. In the early 1980s, the ILD found that it took 289 days and \$1231 paid in either registration fees or bribes to formalize a business. After reform in the 1990s, the World Bank estimated that it took 100 days and \$510 to complete the process. And in 2003, researchers discovered that Gamarra's formalization costs had fallen to 61 days and \$163.²⁴ A parallel development occurred with the introduction of micro-credit institutions. With formalization, the appearance of microfinance, and the willingness of larger banks to extend loans, a plethora of credit became available.

However, these reforms had unintended consequences. They have fostered a pernicious firm multiplier effect that has weakened the limited informal enforcement mechanisms already in place, thus preventing firms from specializing in order to capture gains from trade. In sum, the new industry environment creates *ex post* enforcement problems both between and within firms, which squeezes businesses and forces them to “rationally” stay small.

Whether they were founders or latecomers, Gamarra's entrepreneurs adhere to the holy trinity of capital's logic—work, save, reinvest. They labor 60–70 hours per week. Unlike many of Peru's white-collar employees, these small business owners are frugal with their earnings, conceptualizing spending decisions as a choice between “business” and “home.”²⁵ Home expenses are limited to basics—food, clothes, and, most important, education for their children. Many avoid investing in additional goods or home repairs because, as one daughter of a Gamarra businessman who now runs her own firm said, “to invest in the home is dead capital.” It does not offer you any return. This woman, like many in Gamarra, possesses an insightful understanding of what capital is—an asset that must be thrown back into circulation repeatedly in order to self-valorize.

But the most striking characteristic of Gamarra's entrepreneurs is neither their work ethic nor their capacity to save and reinvest. It is their drive for independence. More than a motif, it appears as a low and consistent bass line in nearly every interview. The goal of hired workers, street vendors, and the sons and daughters of entrepreneurs is to “be independent,” to establish their own income stream by starting their own business. This ideal has likely emerged from a combination of economic and socio-cultural factors. First, Gamarra has

²⁴ Miguel Jaramillo, “Starting a Garment Manufacturing Firm in Peru: Background and Case Study,” *Ronald Coase Institute Research Report Series*, Research Report #1, June 2004.

²⁵ Richard Thaler's behavioral economic work on mental accounting may be applied to this cultural context, for interesting psychological and cultural interactions may be taking place. See Richard Thaler, “Mental Accounting Matters,” *Journal of Behavioral Decision Making* 12 (1999): 183-206.

relatively low entry barriers. Second, worker salaries often don't meet income needs. And third and perhaps most important, the ideal of becoming a "self-sufficient" business owner offers many cultural pride and self-respect, a similar ideal found in the Andes. Regardless of its origin, this drive for independence initiates a firm multiplier effect that leads to fierce industry rivalry and greater anonymity.

Both have created a series of problems. First, low entry barriers and set-up costs, resulting from improved formalization procedures and the labor-intensive nature of the industry, crowd the marketplace and erode profit margins. Competitor rivalry turns Gamarra into a buyer's market. Second, lower purchasing and production costs could offset this, but the needed economies of scale can't be achieved. Smaller firms don't have bargaining leverage with their suppliers, and low levels of technology and limited market size result in excess capacity. And finally, greater anonymity increases opportunistic or shirking behavior that, because of Gamarra's size, cannot be checked by informal Andean contract enforcement mechanisms.

Experience has taught Gamarra's business owners that each transaction they enter into presents a risk of loss. A couple walks up to your stand and places an order for 500 T-shirts. They leave a small down payment, but when they return they renege on the deal and refuse to pay. Because agreements are oral you can't demand payment, and because of Peru's high court enforcement costs you never bothered to sign a contract. Owners combat these problems with the same informal solutions de Soto identified in the 1980s—reputation, investment in information, social networks, collective organizations, and even violence. But these solutions have limited efficiency because of Gamarra's growth and anonymity. Combine this problem with a fiercely competitive market, and owners jealously guard their goods and services. Every day owners extend less credit as businesses come to depend more on formal financing, and demand more up-front cash payments in order to reduce risk of loss. Most owners can tell you a story of how a prosperous business went under because of one bad deal. So high are these risks, entrepreneurs opt to reduce them by eliminating more market activities and integrating them into their firm.

Attempts at joint production accentuate these between-firm obstacles. When several firms come together to fill a large order, they must set the conditions of their association by specifying liability, property rights divisions, and quality control procedures. The challenge is twofold: to specify rights and operational protocol *ex ante* and to enforce the agreement *ex post* should a firm not fulfill its obligation. But again, anonymity in the absence of effective

enforcement (either because courts are inefficient or because informal strategies are limited) creates problems. Since businesses use joint production to fill short-term orders, the risk of partners “stealing” designs and taking advantage of supplier contacts after the contract ends impedes full development of trust. In light of such costs, owners again rationally choose to integrate activities into their firm.

Given this, you’d think Gamarra’s firms would have extra incentive to expand. But they’re squeezed. The push to integrate runs up against internal agency costs. Owners find it difficult to enforce employer-employee and owner-manager contracts. How can a firm provide incentives for employees to work in the firm’s or the owner’s best interest when many employees also rationally seek to become independent and start their own business once the opportunity arrives? Gamarra’s owners now resort to four strategies. First, many rely heavily on piece-rate labor, since workers respond to production incentives. Second, most prefer to hire only those *recommended* by friends or family. Third, owners delegate major responsibilities in the firm only to “trustworthy people” such as the closest of family members or friends who constitute its inner circle. And fourth, some firms have begun to subcontract activities, an option that has grown given the excess capacity of some businesses. But piece-rate and service contracting just brings us back full circle to between-firm enforcement issues.

Post-reform, the leading cause of firm size has shifted from one of *ex ante* property rights in the 1980s to *ex post* contract enforcement today. Gamarra’s firms stay small because they are squeezed. On the one hand, they’re pushed to integrate activities within the firm. On the other, they avoid internal agency costs by returning to the market. In the end, owners decide to do the work themselves—sewing, accounting, purchasing, and marketing. Productivity growth suffers, since they can’t achieve gains from the division of labor. Capital must be defined and protected, but it also must be allowed to circulate and self-value through specialization.

In sum, increasing market reliance, aided by property-rights reforms and micro-credit associations, eroded former Andean practices, leaving them with psychologies that shifted from a “traditional” mentality to one that became more opportunistic and progressively resembled the expected-utility model, but without the formal institutions needed to solve collective action problems. As such, these problems did *not* result from “deficient” pre-existing socio-cultural practices. Rather the transition from agricultural subsistence to market relations creates a new type of collective action problem.

Grouping

However, not all migrant groups have splintered. Some have gained a degree of cohesiveness and turned themselves into formidable multi-million dollar investment groups. The case of migrants from the town of Unicachi, located on the shores of Lake Taticaca in Peru's Puno region, serve as the most salient example.

The first migrants arrived in the late-1940s and worked in La Parada as salted meat merchants thanks to their natural contacts with Puno's cattle-raising region. However, mass migration from the area did not begin until the 1960s. On the whole, migrants came to work either in La Parada or in the fishmeal industry in Lima's port city, Callao, and with time, they began to accumulate their own capital. This occurred through reliance on close kinship and community ties. Like many towns and provinces, Unicachi members utilized the *mita* practice to organize their own regional clubs. They collected monthly quotas and sponsored major public works projects (e.g., construction of schools and plazas) in Unicachi and Lima.

Yet by the mid-1980s, the Unicachinos began to feel the pressures of economic crisis and social change. Several of Lima's district mayors initiated discussions about relocating the city's wholesale market from La Parada due to urban congestion. This sparked a speculative spiral in the city's other markets, hurting the Unicachi merchants in La Parada. For this reason, they proposed the idea of constructing their own retail and wholesale market. However, neither the city's municipal government nor the Unicachi group made much headway due to the political and economic crisis. In 1996, once stability returned and growth ensued, 29 Unicachinos pooled their resources and embarked on their first joint venture. With \$720,000 they bought a lot in Caquetá and built "Plaza Unicachi." On the heels of this success, 280 Unicachinos formed a commercial association, raised \$2.4 million between them, outbid 13 other interested firms, and bought 7.5 hectares of prime real estate next to the city's major north-south highway where they constructed "Megamercado Unicachi." Afterwards, six other multi-million dollar projects emerged, bringing the overall investment total to over \$50 million. While these eight projects are distinct, consisting of eight different Unicachi shareholder groups, they are closely linked through the same kinship and community ties they used upon arrival to Lima between the 1940s and 60s. Only after the success of their first projects did future Unicachi groups gain formal access to bank financing, an avenue closed to them for their first investments.

What explains Unicachi's ability to create strategic alliances, especially if they relied on the same practices used by Peru's other Andean migrants? Why did they group and not splinter? No doubt a local explanation exists in the unique communal tightness seen in the Puno region, but this answer does not suffice.²⁶ Why Unicachi and not other villages in Puno? The answer lies in three additional factors. First, the success achieved by their regional club projects, which fostered decades of repeated exchange, reinforced and extended the relationships and strategies they brought to Lima. After all, their foray into real-estate projects was modeled after earlier public works projects in both Unicachi and Lima, just on a greater scale. In comparison, many other regional clubs dissolved after a couple of decades once community members integrated more fully into Lima society. Second, the nature of real-estate investment shielded the group from the type of intense contract enforcement difficulties one confronts on a daily basis in commercial clusters like Gamarra. The investment group sizes are relatively small, ranging from 29 to 280 people, compared to Gamarra's 15,000 firms. Given previous group success, little gain from shirking existed, for that would ostracize the person from the investment community. These costs were not only financial but cultural and psychological, a sanction arguably more powerful than monetary loss, especially for Andean groups. And third, success created both a precedence and a network of support for other Unicachinos to model.

Unicachi is not the only example of grouping success. It is simply the most prominent and impressive, for other groups even in Gamarra have managed to create successful alliances. Caution thus must be taken in how elegant game theoretical models apply to the field. Although the anonymity created in Lima has pushed the limits of extra-legal solutions, thus creating greater tendencies to shirk, "gobs" or micro-sociologies of trust remain and are built everyday in Lima's extra-legal sector, for opportunism even in Lima can still be foreclosed with evermore complex network and information sharing relationships which find micro-sociological and cultural niches in the marketplace, as seen with Unicachi and other groups in Gamarra. Such a situation raises the question of how the application of game theory models would change if we were to replace its behavioral assumptions with a cultural psychological framework.

²⁶ The Puno region has a reputation among people in Peru for possessing particularly tight community and kin relationships.

Criollo

The traditional middle-class experience is distinct from that of Lima's migrants. The new position these white-collar workers obtained in a society transformed by the liberal export era allowed it to obtain privileged and competitive access to resources – *privileged* because it occupied a social structural position that indigenous and Afro-Peruvian groups could not achieve and *competitive* because one still had to succeed at playing the new “*criollo* market” rules of the game. This market was thoroughly embedded within the logic of *arribismo*, which the traditional middle-class group used adroitly to navigate through the era of liberal policies between 1948 and 1963 and increasing state intervention between 1963 and 1980.

On the whole, the group benefited enormously from the first era. Between 1950 and 1966, the country averaged an annual GDP growth of 5.7%, thus providing the middle-class with the economic space needed to consolidate itself as a social group following its tenuous birth at the turn-of-the-century. It obtained secure white-collar employment complete with pensions and health-care benefits. It also gained formal access to housing credit, which allowed them to move out of the city center and form their own neighborhoods, often alongside Peru's small number of economic elite.²⁷ And finally, it founded and controlled the country's leading political parties. This era came to a close with a left-wing military coup in 1968. While employees of foreign companies suffered, since many of the mostly American firms were expelled from the country, the group managed to defend its social position. They were full members of Peru's *formal* economy. However, with the 1980s crisis, the middle-class dream crumbled.

This placed the *criollo* group in a bind distinct from Andean migrants. A major component of rational middle-class investment relies on the projection of status, since it implies greater access to social networks and, by extension, resources. Given the continued “limited good” cultural view of resources, which was reinforced by the renewed scarcity experienced during the 1980s crisis, middle-class families adjusted using the proven strategies they already knew. With the wealth-erosion caused by hyperinflation, the middle-class redoubled its efforts to maintain status distinctions. For example, they insisted on keeping maids despite its strain on family budgets. Instead of selling their homes and moving

²⁷ Strong ties exist between the two groups. Many of the traditional middle-class descended from the country's old aristocracy. Likewise, many of its business elite were originally from foreign migrant families and came from middle-class backgrounds, having made their fortunes over one to three generations. Inter-marriage between the two is common, as families with status or legacy though little fortunes can ‘legitimate’ nouveaux riche upstarts.

to more affordable areas, they opted to consolidate their families and build additional floors in order to stay in their neighborhoods. And most importantly, they refused to economize on education for their children, for these institutions were an investment in their own right that provided their kids with not only skills but valuable contacts. As for marketplace decisions, middle-class families followed one of two interrelated strategies – parasitic and symbiotic. The first focuses more on employment-seeking behavior, the experience most common to middle-class individuals. The second demonstrates how these *arribista* activities were used by small to medium-sized entrepreneurs in order to address transaction cost obstacles.

Parasitic

Activities at one of Lima's most prestigious private schools serve as an example of the parasitic strategy. The school is recognized as the most expensive and prominent in Peru, where many of the nation's business elite as well its foreign executives and dignitaries send their children. Mostly Peruvians run the school board. While they hire international teachers, Peruvian educators also hold a significant number of positions.

For a Peruvian to get a job in the school is a difficult task, often requiring the "right" contacts. To obtain an interview a person needs not only the requisite language and pedagogical skills, but in most cases an "introduction." In general, when someone interviews for white-collar positions in Lima, the candidates must adhere to the local *criollo* codes of "decency." Men's shoes must be shined. Women also need to wear the "right" clothes *and* "right" jewelry. For example, a woman shouldn't overdress with a gaudy diamond ring. In many cases, she looks best if she wears older antique jewelry such as pearl earrings and necklaces. This *signals* that you come from a "decent" family, because the jewelry likely belonged to a grandmother or great aunt. The same subtle codes apply to manners. Furthermore, these practices do not apply only to job interviews, but to daily appearances in public. For this reason, many upper- and middle-class Limeños refer to their city as "Lima, la horrible" – not because of the city's physical characteristics but because of the social pressures placed on people to appear and behave in certain ways, to constantly signal their social position. The same pressures do not exist among the Andean migrant or "new limeño" groups.²⁸ This game of distinction is controlled by elaborate gossip practices. For example, if

²⁸ However, this is beginning to change. As many Andean migrants and their children and grandchildren have made significant economic gains, they must master *criollo* codes if they want to transition into the white-collar sector. Meanwhile, the *criollo* groups redouble their enforcement of these codes to police social boundaries.

one is fortunate enough to get a position at a prestigious school, a typical question asked by co-workers on the first day of work is “how did you enter?” – meaning who did you know that helped you get the job. Answering it both legitimates you as a part of the group and exposes you to typical *arribismo* practices of “raje” – meaning people will criticize you behind your back since your presence also poses a latent threat, should you openly seek promotion within the school.²⁹

While office worker and teacher assistant positions are not generously remunerated, candidates accept the job for two major reasons: (1) there may be opportunity for professional advancement; and perhaps most importantly (2) it offers status and contacts which may be parlayed into additional opportunities or resources for the person or their family members. A common practice is for workers to supplement their incomes through the activity of “recursearse,” i.e., by doing odd-jobs or side-sales, a practice that has grown over the past two decades due to the erosion of middle-class wealth. In the school, this takes the form of women making their own handbags, jewelry, clothes, or gourmet foods and then advertising them through e-mail or word of mouth at the school. Because of the presence of the country’s economic elite, the market is lucrative. Word of mouth extends both throughout the school and beyond, following established social networks. These parasitic activities may be understood as non-financial remuneration on the part of the school, since it turns a blind eye to the commerce. While not encouraged, it is accepted perhaps in exchange for the secondary benefits the school receives.

Arribismo practices help the school reduce measurement and agency costs while keeping salaries low. When someone purchases a good or service they also buy its attributes. You therefore need to devote resources to measuring these attributes in order to ensure that the good or service purchased is what was agreed upon with the seller. However, there are also diminishing returns to one’s investment in information before deciding to purchase an item or hire an employee. For this reason, warranties, guarantees, trademarks, and brands have emerged to reduce these costs.³⁰

In Lima, “recommendations” serve this purpose. Lima’s dense social networks and gossip practices enable fluid information flow between its 1.5 million middle-class residents.

²⁹ This sociological situation is not unlike the upper echelons of, say, US or European society. However, while sociological similarities exist, they are cloaked with different cultural frames of reference and meanings for motivating action. In other words, while the ends are the same, the cultural means differ.

³⁰ Douglass North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990)

Given that a person's family name, private school, university, social clubs, and neighborhoods immediately identify them and that this is coupled with elaborate and ritualized gossip practices centered around "raje," middle-class residents are never more than one to two degrees of separation from one another. The *criollo* middle's social network system and sanctioning cultural meanings thus helps it defend itself from the anonymity Andean migrants face due to its urban demographic expansion. As such, an informal code for not abusing contacts continues to exist. This is because the person recommending someone has an incentive to not support an unworthy candidate, since that would reflect immediately and negatively upon the recommender, thus damaging his or her reputation. On the other end, if the recommended person abuses the recommender's trust, then that contact and the others it implies are lost. This is distinct from the *ayni* model since *arribismo* model is conducive to more extensive networks while *ayni* supports denser immediate relations because of direct reciprocity rules. The end effect for the school is that it obtains a guarantee of an agent's attributes due to the "strength of weak ties" which helps reduce future enforcement costs.³¹ Additionally, the new employee accepts the contract not based on salary alone but with informal rights to use the contacts the position offers for accessing resources.³²

Among the traditional middle-class, the phrase "la hiciste" or "you did it" or "you're set" often applies to a situation in which a worker achieves this position. It means that you have a degree of security and that you don't have to push yourself too hard in order to live a comfortable life. You have achieved a certain status and position whose contacts serve as a social safety net. Traditional middle-class economic success and failure therefore teeters on differing emphases placed on the pursuit of two types of ends – status versus wealth. Status can either serve as a means for gaining wealth or as an end in itself. The same applies to wealth. It could serve as a means for obtaining status as its own end. As such, within middle-class groups, greater mental limits are often placed on one's pursuit of wealth-maximization. Economic success occurs when individuals know how to use the cultural means and codes at their disposal for maximizing wealth. Failure occurs when the concern for status, a prerequisite for middle-class wealth creation, becomes a dominant and "counter-productive"

³¹ Mark Granovetter, "The Strength of Weak Ties," *American Journal of Sociology* Vol. 78(6), May 1973, pp. 1360-1380, and *ibid.*, "The Strength of Weak Ties: A Network Theory Revisited," *Sociological Theory* Vol. 1 (1983), pp. 201-233.

³² For discussion of the complex cultural and economic relation between formal and informal rights see Jean Ensminger, "Changing Property Rights: Reconciling Formal and Informal Rights to Land in Africa," in John Drobak and John Nye, eds., *The Frontiers of the New Institutional Economics* (New York: Academic Press, 1997), pp. 165-196.

motive. For this reason, the inflation and unemployment caused by the economic crisis caught many middle-class members off guard since they opted to defend their socio-economic position through status maintenance, yet did not manage to get to a situation where they could “cash in” and say “la hiciste.”

Symbiotic

The flipside of a parasitic view is the symbiotic model. In this case, middle-class entrepreneurs identify and create businesses around an economic *mamadera*, a crude reference to a “cash cow.” These firms or organizations, which may be either family-run or international subsidiaries, foster the creation of secondary friend or family-run firms that service the parent company, thus forming a loose corporation. The parent family/company obtains services at below market cost while subsidiary family-friends/firms have a guaranteed business with a “respectable” income. Several variations of this model exist. The case of a Peruvian airline demonstrates the basic operational strategy.

The company was founded by an Argentine pilot who came to Peru in the 1950s to work as a crop-duster, mostly for the country’s northern sugar plantations. He moved with his Guatemalan wife and eventually settled in a new middle-class district, where his children were born and raised. In the 1960’s a new business opportunity emerged. An upscale travel agency, begun in the 1950s, was seeking to offer fly over services for the famed Nazca lines, mysterious football-field size etchings in the southern Peruvian desert that can only be seen from the air. A charter company was born from this relationship, offering services to business and tourist clients.

During the 1980s, the company benefited at first from the multiple exchange rate mechanisms instituted by the APRA government, though it still had to deal with rising cocaine trafficking and political terrorism, which threatened both the company’s reputation and the arrival of legitimate foreign clients. The owner and his family were targeted for kidnapping and extortion, while attempting to manage both hyperinflation and political instability. As the owner’s Peruvian children grew, they incorporated themselves into the company as pilots and office workers, though the company often sat on the verge of bankruptcy. Arguably the most important resource at this time lay in the special personal relationships the owner formed with certain “patrons” which allowed him to weather the political and economic storms through the trading of favors. Meanwhile, he focused on developing the firm’s tourist business. Earlier, it bought land in Ica and founded the city’s

airport, using it as a base for its Nazca flights. Subsidiary firms run by family members grew up alongside the core business, including tourist shops, hotels, and ground transport services.

With the fall of the Fujimori government and of the country's major national carrier – Aerocontinente – due to the owner's narcotrafficking operations, an opening was created for the charter company to reinvent itself as a commercial carrier. However, this transition required the formalization of business practices and the creation of new organizations. In the meantime, the major Chilean carrier – LAN – grew to control upwards of 80% of the national market, while a bevy of foreign start-up operations positioned themselves to emerge as the number two carrier, a potentially lucrative situation given the country's tourist potential and the reluctance of major international airlines to assume flights to the Andes, areas in which the charter company already possessed expertise. The initial challenge, however, was two-fold: obtain credit for the purchase of commercial jets and formalize the “family” business with efficient organizational procedures.

While the “arribismo” logic acted at times as an obstacle, it also facilitated the reduction of transaction cost obstacles, thus allowing the firm to become the country's second largest carrier while continuing to take market share from LAN. One of the major figures in this transition was the company CFO, a childhood friend of the family who grew up in the same middle-class neighborhood. Because of the manager's pre-existing networks (gained through life-long membership at a prestigious social club and attendance at the country's leading economic and business school), he possessed both the financial knowledge and, perhaps more importantly, the status and contacts necessary for growing the company.

First, his special relationship with many bank managers, which he knew as friends, allowed him to open generous credit lines which he used to purchase the company's first commercial jets. Once the first aircraft was purchased on credit and began achieving returns, the CFO leveraged it as collateral for a second and third aircraft – a risky maneuver allowed thanks in part to the CFO's good personal reputation with financial contacts.

Second, the company had to find ways to expand operations and cut organizational costs. It did so through what I consider “criollo” sub-contracting. In reality, the airline fostered the creation of subsidiary service and supplier businesses: catering, ground transport, marketing, cargo, and e-business strategy. The people responsible for these services were either family or friends. The upside was that these established relationships allowed the company to obtain services at below market price while also solving agency costs. Although the quality of the service often suffered due to the non-competitive “awarding” of contracts,

the short-term benefits outweighed the costs, as the company CFO explained, due to the nature of value in the airline industry. Customers place greater emphasis on lower prices than on added-value services.

In sum, *arribismo* practices have acted not as an obstacle but as a facilitator for achieving greater efficiency by cutting both production and transaction costs. Pre-existing social networks mediated both horizontal and vertical access to resources. However, the logic is distinct from the Andean case, for status and not *ayni* plays the crucial role. Andeans can afford, though not necessarily by choice, to forsake investment in status markers – such as neighborhood residence, schooling, social clubs, education, clothes, and even *criollo* manners. However, if members of the *criollo* middle-class do not invest in these goods they commit social suicide, akin to the Andean who refuses to honor an *ayni* relationship. Without the contacts that status and its associated networks afford, you possess limited economic options, for one cannot start their own business and compete without these cost-cutting advantages. Status investment in the *arribismo* context is thus a rational economic decision. Furthermore, this system is held in place thanks to the relatively smaller size of the upper and middle-class group vis-à-vis the “new limeño” population. The density of social networks, secured through gossip, allows members of the upper and middle-class group to be no more than one and at most two degrees of separation from one another. Everybody knows somebody that knows somebody. By contrast, foreign non-Latino investors that tried to enter Peru’s commercial airline industry have learned the disadvantages of act “as if” the market for labor, goods, and services worked perfectly. A *criollo* approach to a *criollo* market proves more efficient.

Addressing the “Culture” Gap

The Peruvian, and below it the Andean and *criollo*, and below them the splintering/grouping and parasitic/symbiotic analytic narratives leave us with two remaining questions. How valid is a cultural psychological analysis for explaining ethnographic and historical facts in Peru? What implication does cultural psychology have for current attempts to integrate new behavioral models into institutional analysis? Each question will be addressed in turn.

Evaluating the Analytic Narratives

Bates et al. pose five questions for evaluating the validity of analytic narratives: “Do their assumptions correspond to what is known? Do their conclusions follow from their premises?

Do their implications find support in the data? How well do they stand up by comparison with other explanations? And how general is the explanation.”³³ Each can be addressed for the Peruvian case.

Do assumptions correspond to known facts?

To pose this question for the Peruvian case is to ask – Do the cultural psychological models of *ayni* and *arribismo* fit established data? Ultimately, answering this question awaits empirical challenge. However, the models were built up both from secondary literatures which key onto the same cultural elements discussed and from my fieldnotes and interviews. Furthermore, when the model was presented to native informants, they not only confirmed its conjectures but provided an even deeper understanding of the cultural logic. A simple independent test is to visit Lima, observe behavior, and ask someone from one of the two groups whether the logic “makes sense” or approximates how people think and act.

Do conclusions follow from premises?

For the Peruvian case, this question is an inquiry into the model’s internal logic – Are people who follow an *ayni* or *arribismo* model motivated to act in the way that the model predicts? Fortunately, the comparative nature of the Peruvian case allows the study to have a built-in test. The cultural psychological approach asserts that the two groups responded in distinct ways to the economic crisis and neo-liberal reform because of differing mental frames of reference and their associated cultural practices. The ethnographic, historical, and interview data support this assertion, clearly indicated patterned differences in the economic responses of both groups. Additionally, one does not see traditional middle-class families engage in intricate *ayni*-inspired exchange nor do we see Andean migrants worry extensively about following *criollo* codes of conduct in order to secure social status. Nowhere is the effect of mental frames seen better than when people from the respective groups are taken out of their social contexts as when an upwardly-mobile family of Andean descent moves into a traditional middle-class neighborhood or when a lower-middle class *criollo* man retired from the military tries to start a business in Gamarra.

³³ Bates et al., *Analytic Narratives*, pp. 14-18.

Do implications find support in data?

This question is akin to asking – How was the theory shaped by the case materials? In other words, Bates et al. encourage scholars to readily adapt their theoretical models to the data at hand. As an inductive approach based on the fundamental premise of the co-constitution of culture and psyche, the cultural psychological approach is already highly sensitive to modification by the case materials. However, while constructing the analytic narratives it has become readily apparent that other theoretical approaches, e.g., game theory, behavioral economics, or social network models, provide insights about the Peruvian case that a cultural psychological framework cannot fully capture. Further research is needed for understanding the links between these insights and cultural psychology. For example, Richard Thaler’s notion of “mental accounting” begins to address how families from the two groups conceptualize their household budgets. However, a “positive” theory of consumer choice in the Peruvian case also depends on how *cultural* conceptions of the “home,” “family,” and “business” and their differing implied responsibilities motivate economic decisions. Cultural psychological task experiments are now being piloted to examine how the two groups think differently about budget and spending decisions.

How well does theory compare to other explanations?

To pose this question is to ask how to deal with other models that appear to fit the data. For example, one could conceive of a counter-explanation existing in a game theoretical approach to norms or even in a rich behavioral game theory account that combines elements of network theory. Faced with such an alternative, the researcher may either opt to choose between the two based on the criteria of “fruitfulness” and “simplicity,” as Milton Friedman proposes, or one could attempt to subsume the accounts, especially if they do not appear mutually exclusive, as Margaret Levi and Barry Weingast have done in their analytic narrative studies.³⁴ Given that a cultural psychological approach merely attempts to fill the “culture” gap unaddressed by current attempts to integrate new behavioral models into institutional analysis, it need not be exclusive of other insights. Rather, it argues for the importance of viewing psychologies not as universal but as multiple mental frames constituted by socio-cultural practices and their associated beliefs. There may be one

³⁴ Milton Friedman, “The Methodology of Positive Economics,” in *ibid.*, *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953), pp. 3-43. For discussion of Levi and Weingast see Bates et al., *Analytic Narratives*, pp. 17-18

potential mind but there are many *actual* worldviews. Yet this brings us to the last question – How general is the explanation – which will be addressed in the final section.

Contribution of Cultural Psychological Analysis

Robust critiques have been leveled against the expected-utility model assumed by economic theory. They come from several different perspectives and target both sides of the means/ends equation. We live in complex and uncertain worlds and we lack the cognitive capacity to process this information, weigh the probabilities, and take decisions that allow us to maximize our economic utility.³⁵ Our preferences are also mutable and frame-dependent, despite the best efforts of the “de Gustibus” school to prove otherwise.³⁶ In both experimental and real-world situations, we demonstrate more fairness, altruism, and reciprocity than the *homo economicus* model predicts.³⁷ We seek to avoid social disapproval and often like social distinction.³⁸ We are also retaliatory and can be hijacked by our emotions, though they may possess reason that only the heart knows, to mangle Pascal’s phrase.³⁹ The structure of incentive systems also matter, and extrinsic motivation can crowd out intrinsic, self-driven behavior.⁴⁰ In a word, we are human. However, although advancements have been made on these fronts, the influence of culture remains underexplored, despite its acknowledged role in economic decisions and institutional performance. Part of the reason lies in the difficulty of getting a handle on such a nebulous and slippery concept. This paper has attempted to address this issue.

It does so by taking the position that culture and psyche cannot be analytically separated. To understand norms, it is not enough to see it as a type of extrinsic *sui generis* entity, which “universal” psychologies take into account when rationalizing decisions. Cognition, attention, perception, moral reasoning, emotional functioning, mental health, life-

³⁵ See Herbert Simon, “Rationality in Psychology and Economics,” *Journal of Business* Vol 59, no. 4(2), (Oct. 1986), pp. S209-S224 and Matthew Rabin, “Psychology and Economics,” *Journal of Economic Literature* Vol. 36, no. 1 (Mar. 1998), pp. 11-46.

³⁶ See, for example, Kahneman and Tversky, eds., *Choices, Values, Frames*

³⁷ See Hoffman et al., “Behavioral Foundations of Reciprocity” and Henrich et al., eds., *Foundations of Human Sociality*

³⁸ See Ernst Fehr and Armin Falk, “Psychological Foundations of Incentives,” *European Economic Review* 46 (2002), pp. 687-724, and Bruno Frey, “Giving and Receiving Rewards,” *Perspectives on Psychological Science* Vol. 1(4) (2006), pp. 377-388.

³⁹ Ernst Fehr and Simon Gächter, “Fairness and Retaliation: The Economics of Reciprocity,” *Journal of Economic Perspectives* 14(3), (2000), pp. 159-181, for an analysis of emotions see, for example, Jon Elster “Rationality and the Emotions,” *The Economic Journal* 106(438), (Sept. 1996), pp. 1386-1397 and *ibid.*, “Emotions and Economic Theory,” *Journal of Economic Literature* 36(1), (Mar. 1998), pp. 47-74.

⁴⁰ See, for example, Roland Bénabou and Jean Tirole, “Intrinsic and Extrinsic Motivation,” *Review of Economic Studies* 70 (2003), pp. 489-520.

span development, and the person's very concept of the "self" are infused with the "content" of culture. Without it, we do not have fully formed psyches. Just think of why it is some societies privilege shame over guilt, or why depressive symptoms differ in China compared to the US, or why the prognosis for schizophrenic patients is better in non-industrialized as compared to industrialized societies. Or why it is that people from India when given the task to describe a person identify concrete acts – e.g., he gave me his umbrella on a rainy day – while citizens of the US opt to name abstract attributes – e.g., kind, smart, or happy. Given the incontrovertible evidence of psychic diversity, why mustn't economic decision-making differ across societies and history as well? This, after all, was arguably Weber's great insight in his study of the "affinities" between the Protestant ethic and the "spirit" of capitalism.⁴¹

The implication of the prospect of psychic diversity has not yet been appreciated. While Weber's argument has been misappropriated as an argument about the superiority of certain economic mentalities over others, one could argue instead that it is proof that multiple economic mentalities exist and that ultimately, as recent research claims, the normative ideal of the *homo economicus* behavioral model is an empirical impossibility.

This empirical impossibility hits at the very heart of a *second* assumption implicit in the famed Coase theorem. The fictional world of zero transaction *also* postulates that economic actors will behave as full and automated wealth-maximizers. In light of the impossibility of zero transaction costs, Coase emphasizes the importance of studying the "positive" nature of transactions. The same should hold for economic actors. Instead of assuming that we act as wealth-maximizers and then adapting utility functions to account for other-regarding behavior, for example, it may be just as fruitful to begin with the positive nature of our psychologies as embedded within their real-world contexts, as behavioral economists have already begun to do. Unfortunately, the same approach has not been taken in regards to culture. Such a move requires a shift from deductive to more inductive analysis, as opposed to a game-theoretic analysis of norms, which advances in the opposite direction.

In general, what is needed is a meta-descriptive language, which achieves for human psychologies what transaction costs does for exchange. The proposal of such a language is beyond not only the scope of this article, but exceeds my expertise. Regardless, such an approach would no doubt begin with the preferences/constraints model, yet it would need to explore at least the following *cultural* tenets:

⁴¹ Max Weber, *The Protestant Ethic and the "Spirit" of Capitalism*

- (1) Culture and psyche co-constitute one another through practices;
- (2) Actions, practices, and persons are deemed rational if they can be both justified and explained according to the existence of a “good reason”;
- (3) Attention must be paid to both the rationality of means *and* ends;
- (4) Cultural psychology construes preferences as any “want” or desired end that offers moral justification or meaning within a given socio-cultural frame of reference. (Preferences are also subject to framing effects, reference points, incentive structures, etc.);
- (5) “Irrational” wants may emerge from breakdowns in rationality (see footnote 16);
- (6) Cultural psychological constraints focus on how cultural categories affect perception and reasoning and how norms condition means. (Additional constraints of time, resources, knowledge, opportunity structures, and bounded rationality hold);
- (7) Just as transaction costs never reach zero, so too will we never act as full and automated wealth-maximizers; however, a shift in practices can induce a “Weberian effect,” i.e., a mental change that approximates the expected-utility model, thus explaining the latter’s success as an “as if” model in much economic and NIE research, especially in advanced capitalist societies;
- (8) Learning may not occur at a material level when people are committed to moral universes that generate goals contrary to economic objectives.

Other principles surely exist and, undoubtedly, the one’s listed will require further testing and should be modified if and when contradictory evidence emerge. Additionally, research must also focus on cross-cultural experimentation that attempts to relate differing findings to the cultural field in question.⁴²

Only with the construction of a behavioral framework and meta-language, akin to the specification of transaction cost analysis, can more flexible decision-making models be integrated into institutional analysis. We may approach the normative ideal of *homo economicus*, a situation in which our instrumental rationality is oriented to the complete realization, in all facets of our lives, of the goal of wealth-maximization. But in my estimation, we will never realize it. Practice makes perfect, but we will never realize perfection. It is an empirical impossibility, for if we did achieve it, we would sacrifice our humanity – including our compassion and cruelty and mystery, in a phrase “man as he is” – along the way.

⁴² For example, while I have presented findings from fieldwork in Lima, Peru, economic experiments – including behavioral economic and public choice experiments – have been piloted.