How culture shapes legal systems and relationships

Arnab Banerji

Arnab Banerji, chief investment officer for Foreign & Colonial Emerging Markets, Ltd. (see page about the Asian Trade Threat), focused this segment of his talk on the law and environmental issues such as discount rates, incomes and population.

Like two trains on parallel tracks, two kinds of law operate side by side: internal and external, said Arnab Banerji.

Depending on the social structure of your particular society, you will be governed more by one than the other. In business transactions, knowing which kind of law prevails in the other person's country can go a long way toward better relations and easier deals.

Neither internal law nor external law is perfect in its execution; each has its advantages and disadvantages.

Internal law

The internal law is what guides you and what controls individuals in unofficial groupings such as family, tribes, companies and nations. It is often buttressed by religious and moral principles, not by written rules and laws.

Internal law is dominant in societies where external law is minimal. The advantage of internal law is its flexibility. Trust and relationships rule, eliminating the need for written rules and lawyer-driven contracts with every i dotted, every t crossed. Paperwork is reduced dramatically.

With flexibility, the group is able to adapt to economic circumstances. The individual's obligations to the group come first, and the interdependence of group members is apparent: you need the cooperation of other members to make your life easier.

For the system to work, there must be:

- Relationships
- Significant group obligations, connections and structure
- A hierarchy, with the person at the top who is meant to be the moral man.

A disadvantage of internal law is its limitations in scope and range. It's difficult to control people outside your group because they feel no obligation or connection to the group. And there are no sanctions you can apply to enforce the law. Without sanctions, law has no meaning.

External law

Non-homogenous societies need lots of external rules. What external law does is set up a level playing field where everyone knows the rules and plays by the rules. When the law is broken, the consequences too are well known.

Rules are especially important when you are doing business globally and are not part of the group or the culture. External law provides the structure that allows you to make deals with a measure of confidence.
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The disadvantage of external law is the high cost of regulation and litigation. "You need a complete system, not just elderly relatives, to manage it and administrate it. It can get expensive."

Other disadvantages are reduced flexibility - it is difficult to make instant decisions - and reduced social interdependence. If you don't need your group to make deals or decisions, then you're on your own. This can result in decreased social cohesion with every man and woman for himself or herself.

Personal commitment

When working with business systems that are heavily biased towards internal law, you have to be aware of the need for personal commitment, said Banerji.

He referred to a situation in Venezuela where an American corporation was competing with a French company for a lucrative contract. The Americans had a glitzy presentation and a superior product.

The French spent a couple of months in the country getting to know the executives and the wives and children of the executives. Although their product was inferior to the Americans', they got the contract.

It's all about relationships and trustworthiness, said Banerji, and these things take time to develop.

Environment

Discount rates and growth

The concept of discount rates is simple: It's what future money is worth today due to discounting and compounding. Fast growth, high inflation, uncertainty, and the high marginal utility of income are all factors that cause the discount rate to rise.

- Fast growth attracts available capital and all investments are discounted into the future at a higher than normal rate.
- High inflation rates cause an investor to evaluate on the volatile higher monthly inflation rate, particularly on a short term investment.
- Uncertainty means that you need your money quickly, and at a high rate of return.
- Marginal utility of income means that disposable dollars are valuable; therefore, you would want a high discount rate on your investments.

High discount rates create a take-your-money-and-run mentality when it comes to development. "It is more profitable to quickly build skyscrapers or factories than to provide sewage and infrastructure," said Banerji.

"So the higher my rate of return, the more socially damaging I'm going to be. It's called intergenerational theft."

"This is at the heart of much of what goes on. Great pollution in the world today comes about because of economic activity."
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Income and pollution

In our society, status equates with money, and more is never enough. The demand for higher incomes is an environmental issue, said Banerji, pointing out that if the need for income were not so status-related, "we'd possibly be a less polluting society."

Banerji speculated that perhaps we need "alternative systems of competition where people can achieve status. Or perhaps systems of social regulation where your status in the group depends on what you do for others, not necessarily what you do for yourself."

Population and investment

Europe had explosive population growth from 1700 to 1900. Death rates came down, birth rates went up a bit. Populations grew rapidly. This growth peaked after the first World War, and started coming down as birth rates fell.

The rest of the world is now going through a similar transition, except the time structure is much shorter, said Banerji. Birth rates everywhere are coming down. In South Asia, East Asia and Latin America, the number of children per family has fallen from an average of 6 in 1965 to under 3 today.

But population growth is still going to be a problem as today's children grow up and have children while their parents are still living. "So the population is going to grow rapidly," said Banerji.

There is a question in the emerging markets as to whether these people can be employed and how much they will require in increased resources.

Brazil in 1989 had 15 workers for every 10 dependents (children and old people). By 2025 it will have 27 workers for every 10 dependents. The U.S. has 19 workers for every 10 dependents and it is falling to 16 due to the aging of its population.

Japan and Germany have two of the highest numbers of workers per dependents in the world today. But in the year 2025 they will have two of the lowest numbers of workers per dependents.

"The populations of emerging markets are clearly in transition," said Banerji, "but they're demanding greater and greater resources. And herein lies an opportunity for investment because currently these people need our capital; later, we will need their output."