The spirit of capitalism

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Abstract:
Two books are reviewed: 1. The Mystery of Capital: Why Capitalism Succeeds in the West and Fails Everywhere Else, by Hernando De Soto, and 2. Culture Matters: How Values Shape Human Progress, edited by Lawrence E. Harrison and Samuel P. Huntington, are reviewed.

Full Text:

The Mystery of Capital: Why Capitalism Succeeds in the West and Fails Everywhere Else. BY HERNANDO DE SOTO. New York: Capital- Why Books, 2000, 245 PP- $27.00.

Culture Matters.- How Values Shape Human Progress. EDITED BY LAWRENCE E. HARRISON AND SAMUEL P. HUNTINGTON. New York: Basic Books, 2000,348 PP. $35-00

THE TRIUMPHANT RELIGION of the twentieth century was not Christianity or Islam but economic growth. Over the decades, governments throughout the world jumped onto the growth bandwagon as a way to expand national power, relieve abject poverty, and create social justice. True, they argued and fought over the best way for societies to create and distribute wealth. Communism, capitalism, and socialism in their various forms all vied for supremacy. But now a consensus seems to have emerged. Free trade, free markets, and international investment are the intellectually anointed paths to prosperity. Communism and socialism are definitely out.

Yet the consensus is more fragile than it seems. Not only are there conspicuous dissenters, most visibly the street protesters in Seattle and Prague; there is also the inconvenient fact that today's global capitalism has yet to produce anything like universal prosperity. Much of humanity still lies in the grip of extreme poverty. The World Bank estimates that $1.2 billion people-a fifth of the world's population-live on less than $i a day. Worse, little progress has been made since the late 198os, when the new global capitalism began flourishing. From 1987 to 1998, the share of sub-Saharan Africa's population living on less than $i a day remained constant at around 46 percent. The story was the same in Latin America and the Caribbean, where the poverty rate stayed steady at about 16 percent from 1987 to 1998. In South Asia, it fell from 45 to 40 percent, but that region's rapid population growth added So million people to the ranks of the poor. Only East Asia (including China) experienced notable success, with the region's poverty rate dropping from 27 to is percent.

The truth is that global capitalism's benefits are spotty. Some societies have not tried it, and elsewhere others have achieved only scant success. Global capitalism faces an "hour of crisis," contends the Peruvian development expert Hernando de Soto in The Mystery of Capital, because countries as different as Russia and Venezuela are disillusioned by failed excursions into market economics.

To explain what has gone wrong, de Soto argues that global capitalism cannot succeed without local capital-and therein lies the rub. Global capitalism's orthodox remedies-balanced budgets, free trade, foreign investments, and stable currencies-are not everything. Although they can aid economic growth, local development is decisive for success. But local development founders in most poor nations because a critical catalyst, local capital, is missing. Property rights remain primitive, and what little the poor do have (assets such as huts or small businesses) cannot be used as capital to propel economic growth.

In country after country in the developing world, squatters' rights prevail because the obstacles to obtaining legal titles defeat most of the poor. As de Soto explains, In Egypt, the person who wants to acquire and legally register a lot on a state-owned desert land must wend his way through at least 77 bureaucratic procedures at 31 public and private agencies. ... This explains why 4.7 million Egyptians have chosen to build their dwellings illegally.

If, after building his home, a settler decides he would now like to be a law-abiding citizen and purchase the rights to his dwelling, he risks having it demolished, paying a steep fine and serving up to lo years in prison.

Egypt is no exception. In Peru, building a home on state-owned land requires 207 procedural steps at 52 government offices, says de Soto. In Haiti, obtaining a lease on government land-a preliminary requirement to buying-takes 65 steps.

According to de Soto, clearly defined property rights generate what economists call positive externalities, or benefits shared by everyone. Not only do property rights help people borrow more easily, because property can be pledged as formal collateral; they also create information needed by markets. If property rights are recorded, for example, utility companies can deliver power and bill customers more easily. But without such rights, markets are untapped and commerce is disconnected from much of the legal system. People deal only with those they know and trust or through informal associations that substitute for formal law. Extralegal arrangements flourish because they are essential for survival. Some of these arrangements are ethical, but others are corrupt. In Peru, for example, bribes raise the cost of running a small business by lo to 15 percent, de Soto writes.

Aside from depressing economic growth, the denial of property rights destroys any constituency for popular capitalism. Some wealthy investors do enjoy property rights and legal capital. "But they are only a tiny minority-those who can rely upon the expert lawyers, insider connections, and patience required to navigate the red tape," de Soto says. This makes "capitalism a private club, open only to a privileged few, [enraging] the billions standing outside looking in."

LAW AND (DIS)ORDER

DE SOTO'S BOOK rings true when it describes how grand theories of development stumble on crippling practical details. It builds on his 1989 work, The Other Path, which convincingly revealed the widespread informal or underground economies in many poor countries. That book's argument was similar, noting that the bureaucratic difficulties in creating legal businesses usually compel the poor to skip the process. They instead establish small businesses with few, if any, of the necessary permits or licenses. In the informal economy, street vendors, taxicabs, small bus services, shops, tiny factories, and urban marketplaces predominate.

De Soto's insight has clearly influenced developmental economics. A recent study by four economists (three from Harvard, one from the World Bank) examined regulations affecting the certification of new businesses in 75 countries. The study found that government obstacles to creating firms in most of those countries are "extremely cumbersome, time-consuming, and expensive." On average, they require 63 business days to fulfill, assuming an unrealistic absence of delays. Bribes and corruption seem to correspond loosely to the level of regulation.

Unfortunately, de Soto strains too much. He wants to make property rights-or their absence-the center of everything. Some societies, mainly in the United States and Europe, have indeed developed workable property rights regimes. Others, mainly in Africa and Latin America, have not. The first group has prospered; the second has floundered. (De Soto generally omits Asia, except for some references to Indonesia and the Philippines.) He concludes that if countries can convert squatters' property into legal property, they can make capitalism work. This transition is difficult, de Soto admits, because many politicians, lawyers, and property owners profit from the status quo and oppose change. Still, expanding property rights remains the secret to unlocking development.

De Soto's logic implicitly accepts a standard economic assumption: human nature is universal: Confronted with the same incentives, people everywhere will respond similarly. But human nature is not uniform. It is molded by history, geography, religion, climate, and tradition-all the influences that create culture. Peoples around the globe have different values, beliefs, and customs. They behave differently and create societies with different legal and political systems. This observation is mere common sense, but it also suggests a politically incorrect conclusion: Some societies may be more culturally friendly to economic growth than others. The same forces that affect property rights systems may, for better or worse, also affect enterprise, invention, and material accumulation.

CULTURE CLUB

IN APRIL 1999, the Harvard Academy for International and Area Studies held a three-day symposium on culture and development. The conference's highly readable papers, collected in Culture Matters, offer an intriguing counterpoint to de Soto. "The revolution of economic development occurs when people go on working, competing, investing, and innovating when they no longer need to be rich," argues Mariano Grondona, an Argentine political scientist and columnist. This revolution can happen only if the values that promote prosperity -he lists zo, including competition, innovation, and hard work-do not disappear when that prosperity first arrives. Trust in the individual is also essential:

If individuals feel that others are responsible for them, the effort of individuals will ebb. If others tell them what to think and believe, the consequence is either a loss of motivation and creativity or a choice between submission or rebellion. However, neither submission nor rebellion generates development. Submission leaves a society without innovators. And rebellion diverts energies away from constructive efforts toward resistance. ...

Carlos Alberto Montaner, an exiled Cuban writer, takes a similar approach in his paper, noting that the rapid growth of the once-impoverished Asian nations has shown that "Latin America had fundamentally misunderstood the keys to prosperity." Part of the blame, he argues, falls on the region's political, religious, military, and business elites, under whom governmental corruption flourishes and people operate outside the law. But the values of these elites often reflect their society's norms, for "a large percentage of Latin Americans either nurture or tolerate relationships in which personal loyalty is rewarded and merit is substantially ignored." The Catholic clergy-especially proponents of liberation theology-still attack poverty while condemning "the profit motive, competition, and consumerism," undermining the psychology of success.

The general point is not that some societies are completely impervious to commercial incentives or international influences such as trade, investment, technology, or even property rights. It is that some cultures accept these ideas more readily than others, and that different cultures often promote commerce and enterprise differently. This was certainly true in Asia, as the Harvard scholar Dwight Perkins notes in another essay in this volume. Close personal relations and family ties there helped foster economic development, he argues. They created the very same security and trust needed for trade relationships that laws and an independent judiciary had fostered in the West. In the postwar era, the reliance on family-dominated firms meant that many Asian nations "did not have to wait until they had a well-developed commercial law system before growth could accelerate."

The problem, Perkins says, is that Asia outgrew this system. One-time strengths became the weaknesses that contributed to the 1997-98 Asian financial crisis. As economies expanded, intimate family-business ties bred intimate business-government ties. On the one hand, this faith in government helped promote a high rate of investment. On the other hand, it inspired excessive risks that ultimately threatened entire economies. Companies took for granted that they could rely on government help if necessary, so they increasingly pursued shaky investment strategies.

What does exist-in the real world, not textbooks-is cultural economics. People around the globe respond to rewards and penalties, but the rewards and penalties vary among different cultures. Economic incentives and cultural imperatives are constantly interacting and colliding with each other. This is what makes economic development such a fascinating and frustrating subject: no two countries are exactly alike. Even within countries, different regions and different groups have different experiences. A central characteristic of African culture, for example, is the individual's subordination to the community. As the Cameroonian scholar Daniel Etounga-Manguelle writes,

African thought rejects any view of the individual as an autonomous and responsible being. The African is vertically rooted in his family, in the vital ancestor, if not in God; horizontally, he is linked to his group, to society.

If all this seems too abstract, consider the personal story of an American nurse who spent several years in Malawi in the 199os as a Peace Corps volunteer. In a letter to this reviewer, she described how individual accountability seemed a largely alien concept:

Malawians are a lovely people who value social relationships above all else. Myjob was to teach Western-style management skills to the nursing and administrative staff [of a local hospital]. As part of a management skills training course, I instituted the disciplinary process that was on the books but unused since the British left in 1964. After a week, the supervisors returned and flatly refused to try and better supervise their employees using a disciplinary process. Why? The employees had put a "curse" on them, and they were frightened.

Culture modifies de Soto's sweeping conclusions. His is a "single bullet" theory of development, when the process is far murkier. Property rights are not the be all and end all of progress but a simple reflection of the larger culture. Consider de Soto's appraisal of America as a case in point. He argues that many developing countries today resemble the United States before the Civil War. Many nineteenth-century Americans owned property without clear legal title. Settlers were often squatters, and miners frequently made property claims that lacked the force of law. In these cases, elaborate informal networks and associations arose to catalogue and legitimize informal property rights. America's genius lay in its eventual merging of informal and formal property rights. Over time, Congress enacted laws that gave legal status to informal but verifiable claims. People could borrow and build on success, and economic development flourished.

The challenge for many developing countries now, de Soto contends, is to imitate this example. If they can somehow convert informal property rights into legal property rights, they too can enjoy the benefits of more rapid economic development. This prescription may be correct. But de Soto never asks why the United States accomplished this feat, whereas so many developing countries have not. What is more likely is that American culture-the enthusiasm for material advance, the faith in democracy, and the belief in the sanctity of property-created a climate in which change was possible. In turn, these same beliefs and values (along with rich natural resources) explain U.S. economic success and suggest that the story of property rights is only an interesting sideshow

The world today lacks a consensus on how to create economic growth because the proven way-capitalism, even modified by the welfare state is a peculiar creation of Western culture. It is an approach that, if not inherently alien to other cultures, is at least unfamiliar and unnatural. But this does not mean that it cannot be adopted or altered elsewhere to generate large economic gains. Forty years ago, after all, much of Asia was considered a basket case. Asia's success offers at least the hope that capitalism is sufficiently malleable to be made compatible with different cultures-even if the process is neither predictable nor preordained.

[Author note]

ROBERT J. SAMUELSON writes a column for Newsweek and the Washington Post Writers Group. A collection of his pieces will be published in the forthcoming book Untruth: Why the Conventional Wisdom Is (Almost Always) Wrong.