

# Why Doesn't Capitalism flow to Poor Countries? Capitalism and Beliefs

Rafael Di Tella  
*Harvard Business School*

Robert MacCulloch  
*Imperial College*

## 3 point summary

- Fact: Capitalism doesn't flow
- Explanation: Legitimacy of Business

Empirically, corruption causes socialism

Theoretically, corruption causes socialism

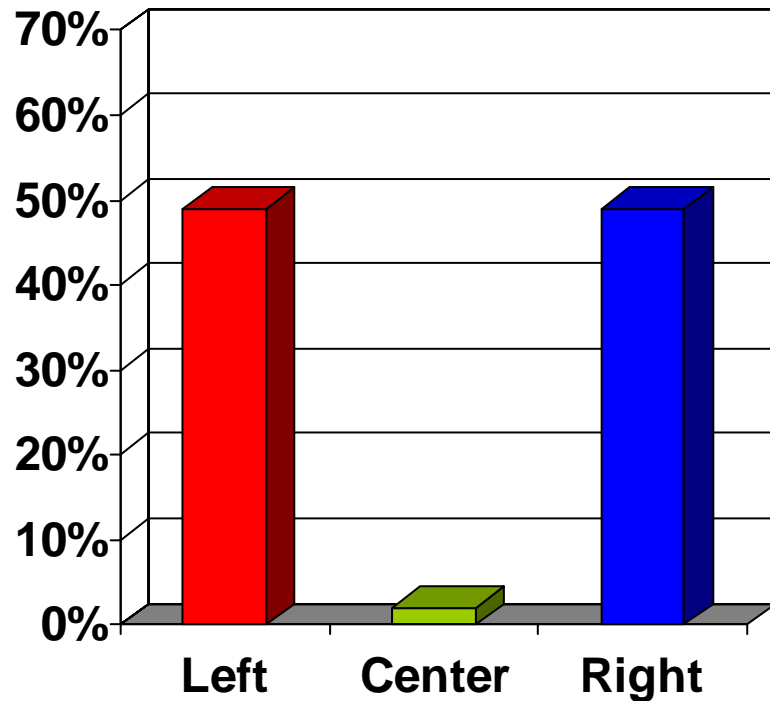
Fact (obvious): Capitalism does not Flow

You can see a lot by just looking

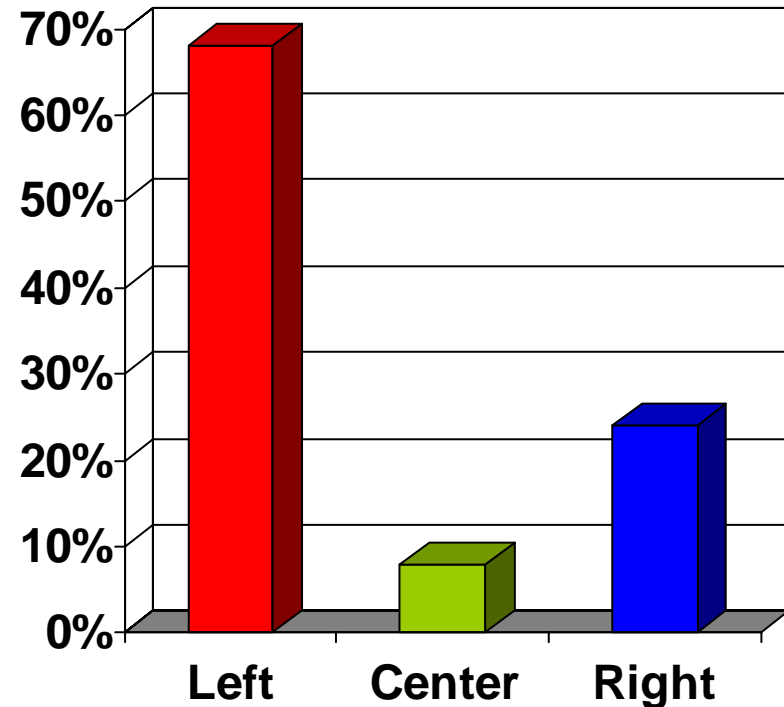
Political scientists are formally asked to watch more TV...

# Fact (formal): Capitalism does not Flow

## Rich Countries, 1997

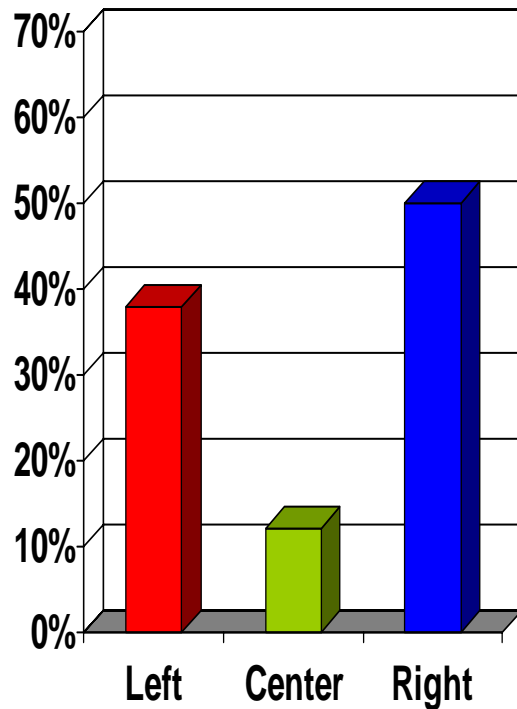


## Poor Countries, 1997

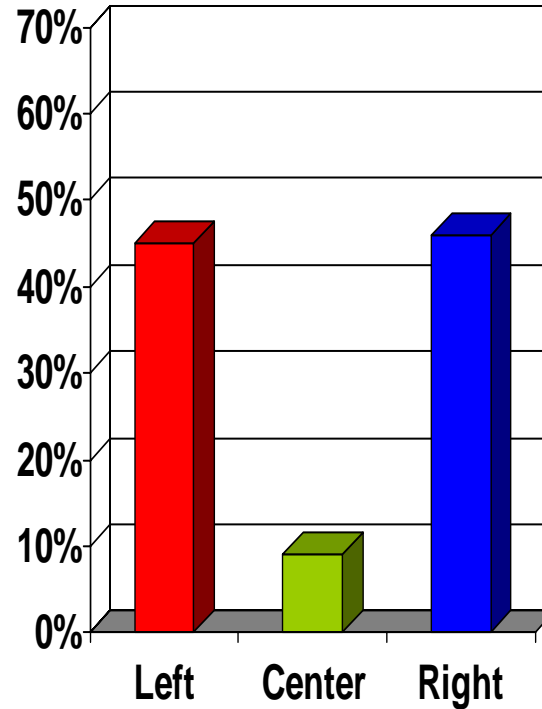


# Fact (formal): Capitalism does not Flow

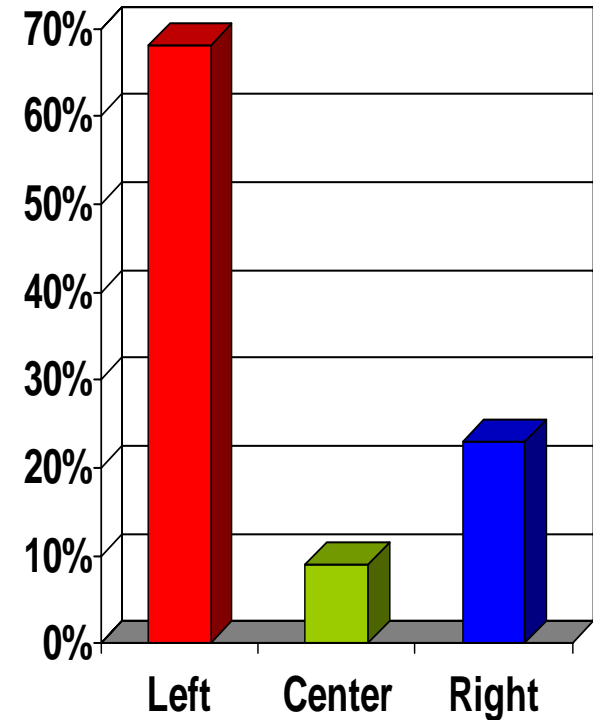
Rich, 1975-97



Middle Income

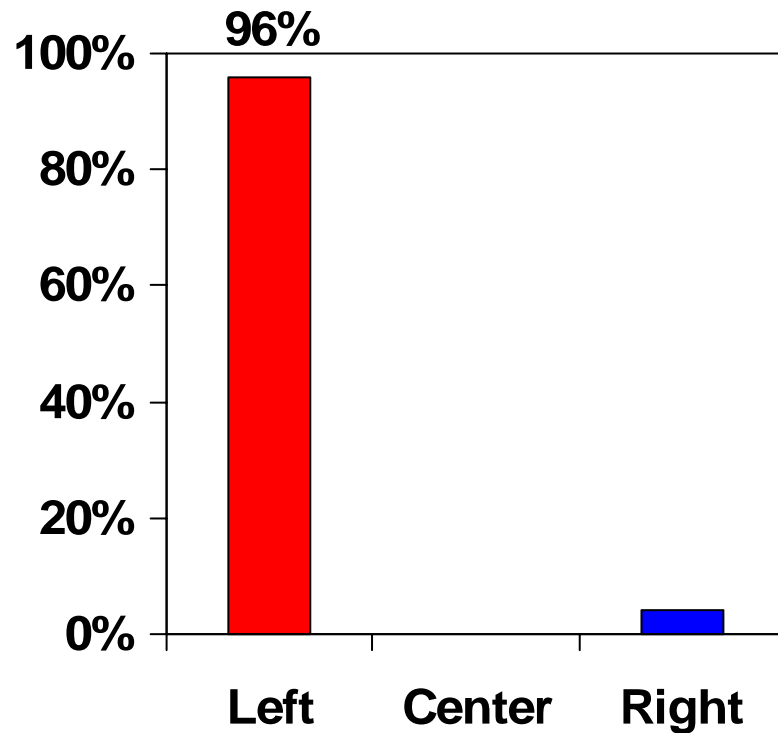


Poor, 1975-97

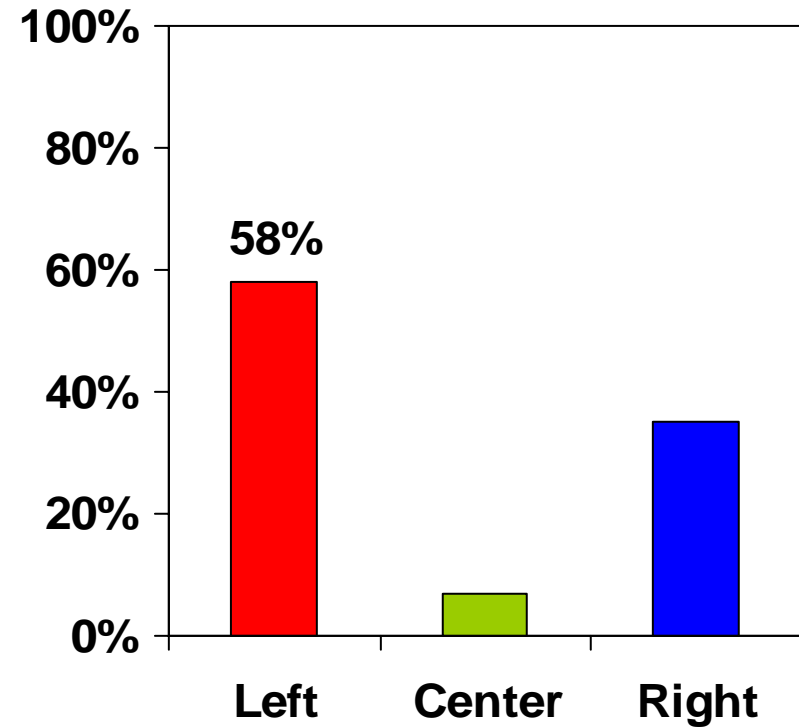


# False explanation: It Must be Inequality...

Equal (and poor) Countries



Unequal (and poor) Countries



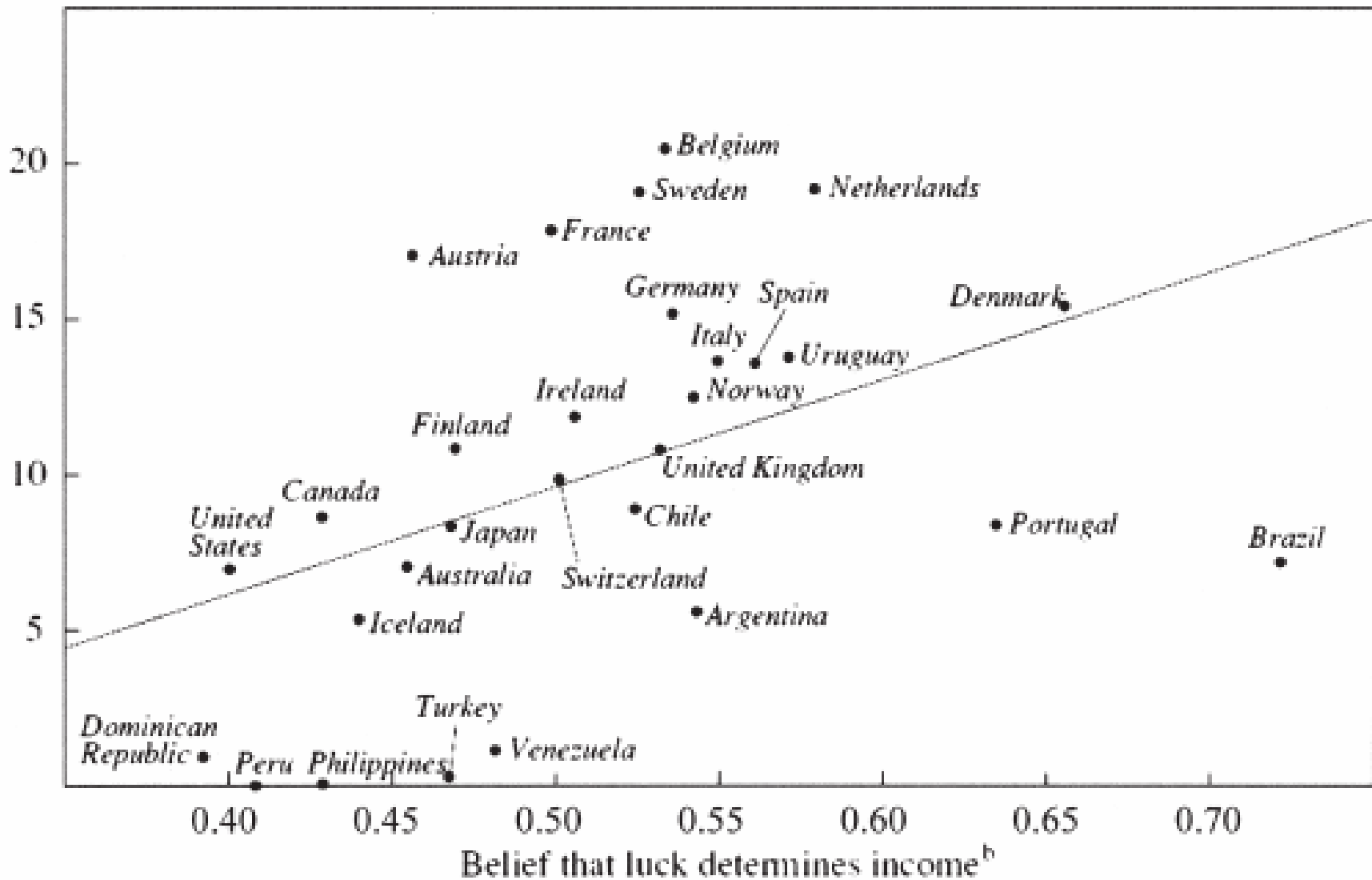
# Real Explanation for the US France

- The US is **more** unequal than France .... and they distribute **less** not more.
- Why?
- Beliefs :
- Americans think the poor are Lazy  
(the French think they are unlucky)

What belief is the relevant one?

Which one drives for differences between rich vs poor countries

Social spending (percent of GDP)<sup>a</sup>



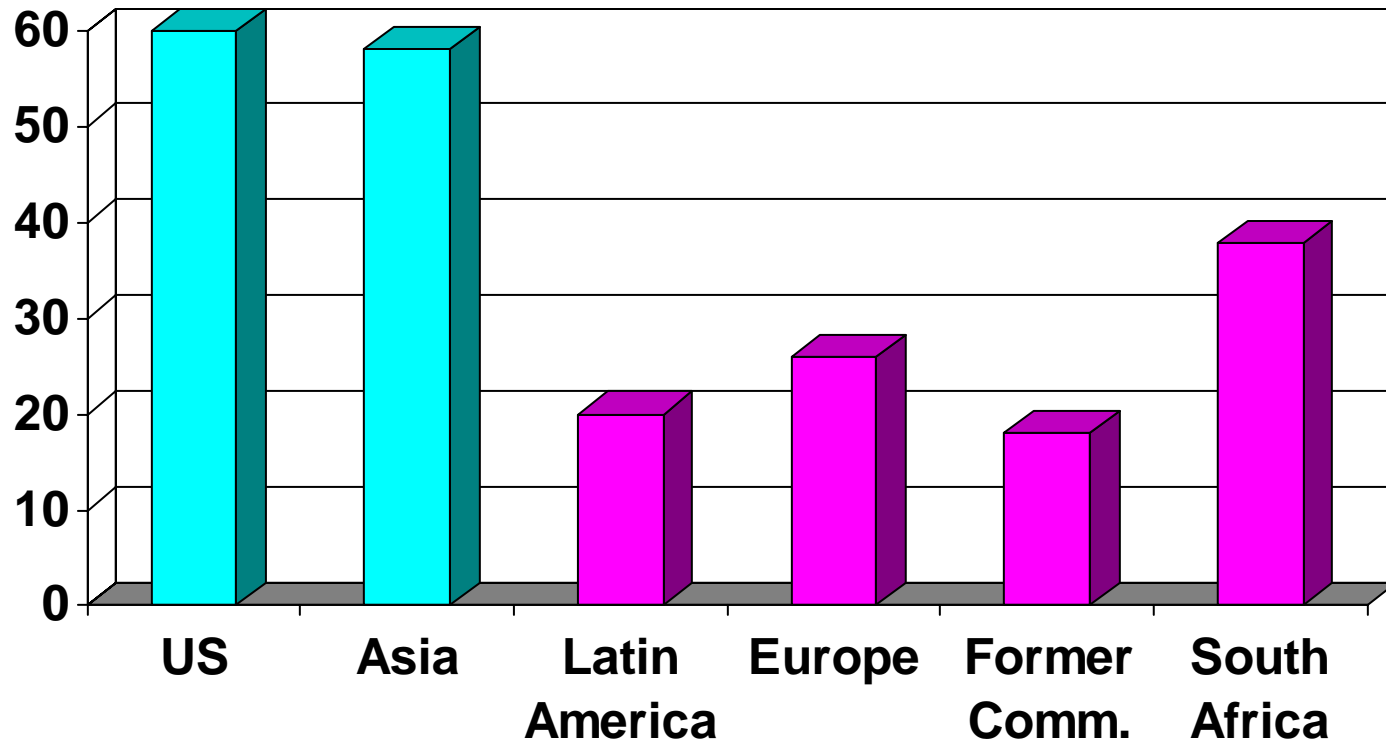
From Alesina, et al 2001. Social spending data for 1960-98. Belief “Luck”<sup>8</sup> measured as average for the country over 1981-87.

# Size

- In the US and Europe beliefs are MORE important in determining preferences for redistribution than income or education.

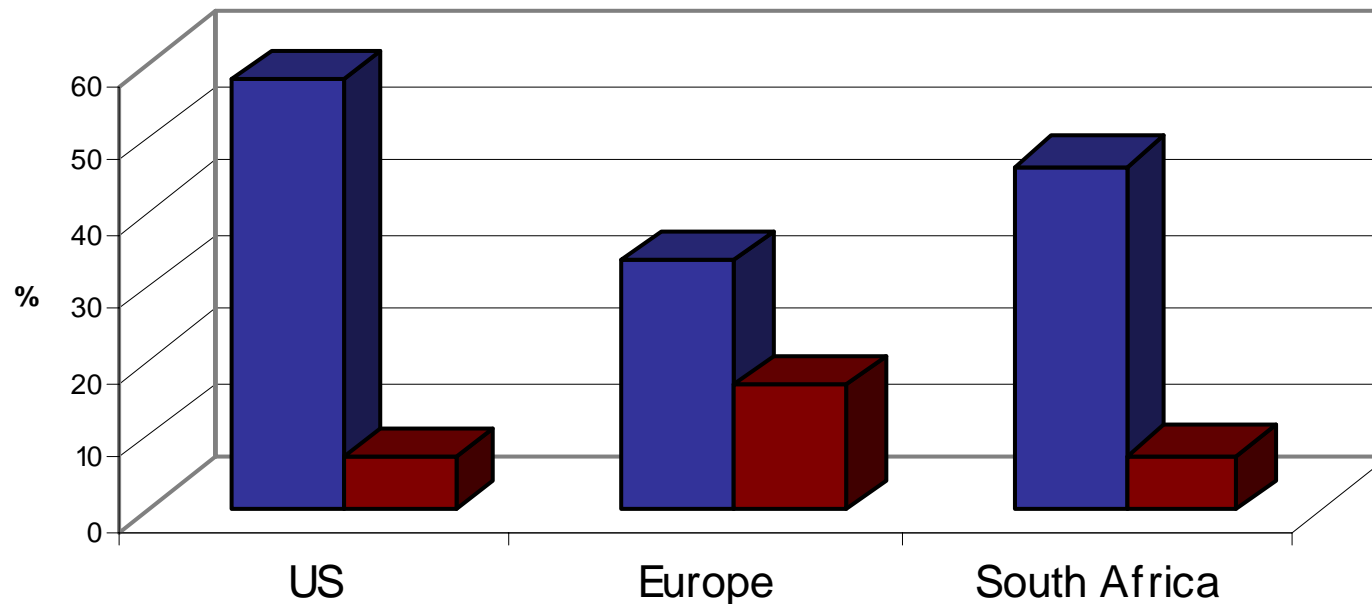
# So it's Beliefs....

**Belief: The Poor are Lazy (rather than unlucky)**



# One particularly important belief concerns capitalists

**Belief: How business and industry should be managed**



- Owners should run their business
- Employees should own the business

# What Drives Beliefs?

- Belief in the “American Dream” of effort pays (poor are lazy) depends on
- Shocks (oil, recession makes people left wing)
- Property Rights (titles turn people left)
- Emotions (corruption turns people left)

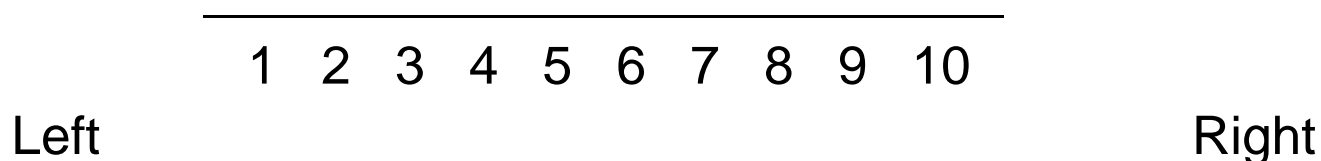
## Explanation: corruption (evidence)

- Shleifer et al observe that regulation is higher in countries where there is a lot of corruption
- Interpretation: regulation causes corruption (Tollbooth theory)
- Alternative: corruption increases the demand for regulation
- We find in a panel, that corruption precedes left wing parties
- Key evidence: Within countries, those that observe corruption want more intervention

## Evidence on the Role of Corruption

World Values asks 51,810 people in 48 nations (1995-97) two questions:

1. ***"In political matters, people talk of "the left" and "the right". How would you place your views on this scale, generally speaking?"***



2. ***"How widespread do you think bribe taking and corruption is in this country?"***

*Almost no public officials are engaged in it*

*A few public officials are engaged in it*

*Most public officials are engaged in it*

*Almost all public officials are engaged in it*

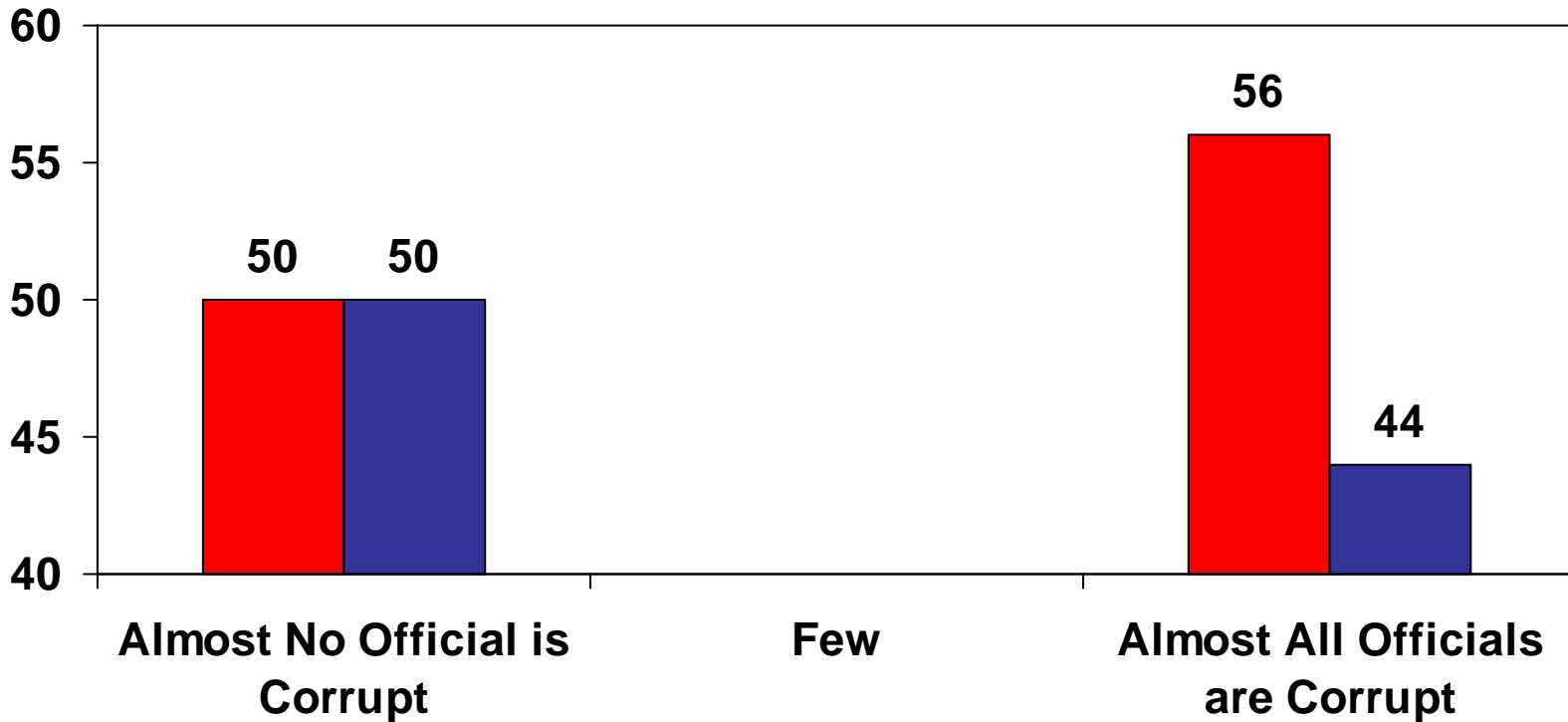
Table C1: Corruption Perceptions and Ideology (48 countries)

Dependent Variable: Right Wing	(1)	(2)	
		Coefficients	Std. error
Perception of Corruption			
- Few officials	-0.029	-0.040	(0.030)
- Most officials	<b>-0.068**</b>	<b>-0.091**</b>	(0.030)
- Almost all officials	<b>-0.127**</b>	<b>-0.141**</b>	(0.031)
<i>Personal Income Quintile</i>			
- Second		<b>-0.032*</b>	(0.015)
- Third		-0.007	(0.017)
- Fourth		<b>0.042*</b>	(0.019)
- Fifth (top)		<b>0.116**</b>	(0.022)
<i>Work Status</i>			
- Unemployed		-0.003	(0.020)
- Self employed		<b>0.097**</b>	(0.019)
- Retired		<b>-0.057**</b>	(0.023)
- Student		<b>0.054*</b>	(0.024)
- Housewife		<b>0.109**</b>	(0.020)
- Other		0.045	(0.039)
<i>Marital status</i>			
- Married		<b>0.031*</b>	(0.016)
- Divorced		0.014	(0.031)
- Separated		-0.017	(0.040)
- Widowed		<b>0.070**</b>	(0.028)
Age		<b>-0.006**</b>	(0.002)
Squared Age		<b>9.5e-5**</b>	(2.5e-5)
Male		<b>0.040**</b>	(0.011)
<i>Age Finished School:</i>			
12-14 years old		0.012	(0.031)
15-18 years old		-0.039	(0.030)
19-21 years old		-0.040	(0.032)
> 21 years old		-0.082	(0.031)
No of Observations	51,810	40,028 (43 countries)	
Pseudo R <sup>2</sup>	0.02	0.02	

Note: Country Dummies Included. Ordered Probits. [2] Standard errors in (). \*-bold =5%; \*\*-bold=1%. Size of the Effect: From 50 50, to 44 56 split

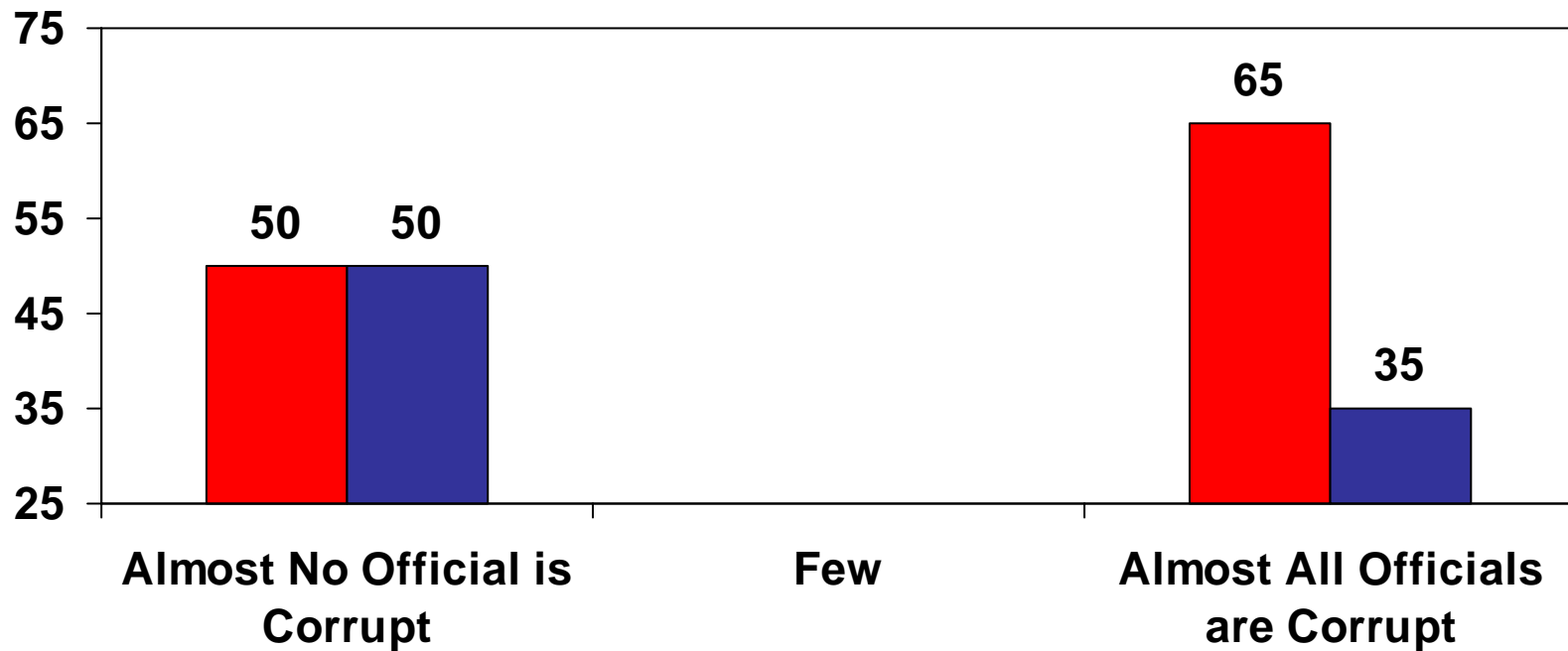
# Result: Corruption moves the electorate left

**Left wins by 12% in Corrupt Countries**



Result: Corruption moves the electorate left when the country is run by the right wing party

**Left wins by ~30% in Corrupt Countries run by Right Wing Parties**



# Hypothesis: Legitimacy of Business

- Even more extreme pattern if we condition on belief that “country run for few big interests”.
- Notion of Capture vs Extortion. Compare “corruption” in the 1980’s ...with “corruption” in the 1990’s. Marketing battle....
- Still it is interesting that on average the effect moves people left. Maybe morally more critical of rich firm being corrupt than a poor bureaucrat.
- **Causal. Fixed trait: NOT an Issue**
- **Lazy:** Why, in your opinion, are there people in this country who live in need? Here are two opinions: which comes closest to your view? 1. They are poor because of laziness and lack of willpower, or 2.They are poor because society treats them unfairly.
- **Escape:** In your opinion, do most poor people in this country have a chance of escaping from poverty, or there is very little chance of escaping? 1. They have a chance or 2. There is very little chance.
- **Government:** Do you think that what the government is doing for people in poverty in this country is about the right amount, too much, or too little? 1. Too much or 2. About the right amount, or 3. Too little.
- **Fair Pay:** Imagine two secretaries, of the same age, doing practically the same job. One finds out that the other earns considerably more than she does. The better paid secretary, however, is quicker, more efficient and more reliable at her job. In your opinion, is it fair or not fair that one secretary is paid more than the other? 1. Fair or 2. Not fair.
- **Business:** There is a lot of discussion about how business and industry should be managed. Which of these four statements comes closest to your opinion? 1. The owners should run their business or appoint the managers, 2. The owners and the employees should participate in the selection of managers. 3.The government should be the owner and appoint the managers, 4. The employees should own the business and should elect the managers.
- Not true for Political Beliefs (Environment, Homosexuality, Technology, NOT correlated with corruption)

**Table C2: Corruption Perceptions and Economic Attributes of Ideology**

<i>Dep. Variable has L (R) extension if higher numbers mean more Stereotype Left (right)</i>	Poverty			Production	Incentives
	(1) Not Lazy-L	(2) Escape- L	(3) Govern. Poor-L	(4) Business Own-L	(5) Fair Pay- L
<b>Perception of Corruption</b>	<b>0.168**</b>	<b>0.264**</b>	<b>0.372**</b>	<b>0.047*</b>	<b>0.134**</b>
<i>1 = almost no official</i>	<b>(0.040)</b>	<b>(0.036)</b>	<b>(0.041)</b>	<b>(0.020)</b>	<b>(0.021)</b>
<i>4 = almost all officials</i>					
<b>Personal Controls</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>
<b>No of Observations</b>	<b>37,864</b>	<b>43,673</b>	<b>39,995</b>	<b>41,184</b>	<b>44,392</b>
<b>Pseudo Rsq</b>	<b>0.087</b>	<b>0.110</b>	<b>0.114</b>	<b>0.049</b>	<b>0.092</b>

## At the country level, corruption perceptions precede Socialism

Political Color and lagged Corruption within 80 Countries: 1975-1997

	<i>Color of Chief Executive</i>	Color Largest Gov't Party	Color of 3 Main Gov't Parties
<i>Corruption (t-3)</i>	-0.07 (0.04)	-0.08* (0.04)	-0.11** (0.04)
Country Fixed Effects	Yes	Yes	Yes
<i>Adjusted R<sup>2</sup></i>	0.66	0.69	0.67
<i>Number of observations</i>	843	843	843

# An Explanation that will NOT do

## Geese with Golden Eggs

We do not want to tax firms too high because there will be less investment, and we will then have fewer tax collections (don't kill the geese with golden eggs)

## Geese with Copper Eggs

- But if they are corrupt, it means that when we want to tax them they bribe the inspectors and we don't get taxes anyway (as if the Geese had Copper Eggs)

We may as well tax them

Not an explanation because it does not pass the Vargas Llosa test.  
(A credible anti corruption candidate like him would be elected)

# Hypothesis: Legitimacy of Business

- Ideological Externality: Visibility of Bad businesspeople gives a bad name to all capitalists.
- Eliot Spitzer: Punishing bad capitalists is a service to capitalism (avoids taxation). Vargas Llosa does not punish (General Park)
- Private goods: White limousines, beaches
- Trap: potential for ideological traps where all the regulations and taxes mean that ALL entrepreneurs (good and bad) end up evading taxes and misbehaving. Cannot sell the idea of capitalism to voters.

Making his most extensive public remarks since his arrest in October, Mr. Khodorkovsky also wrote that...

Russia's largest companies needed to ... accept higher taxes on natural resources specifically in order to legitimize the privatization deals of the 1990's.

His remarks represented an important shift in his position on at least that significant issue. Only a year ago, as chairman of Yukos Oil, he lobbied extensively against higher oil taxes in what was widely seen as a rebuff to Mr. Putin's Kremlin.

*New York Times, 2004*

Maybe calculated....but maybe he is right

# A model where capitalists have a “trait” (honest, productive, etc)

## **Proposition 1:**

1. The observation of corruption increases desired taxes on account of fairness considerations (as it reduces the belief that firms are altruistic towards workers).
2. Countries where firms are productive and government is small have less corruption
3. If the party of low taxes credibly promises to control corruption, its appeal may still be lower than that of the high tax party.
4. There is a negative externality from corrupt entrepreneurs to honest entrepreneurs.
5. Under high taxes corruption leads to little updating (it's more “justifiable”)

# Ultimatum Experiment

- Sum of money given to two persons. One decides, the other can only accept or reject
- Overwhelming: even splits. Economists can't explain
- General knowledge quiz to assign roles. Meaner offers, more accepting.
- Computers decide, all accept.
- Emotions + legitimacy

# Conclusions

**Fact: There is Some Evidence that Capitalism doesn't flow to poor countries**

Rhetoric, Correlations of Color of government

**An Explanation based on Corruption is Appealing**

**a. Data: People who perceive corruption to be high are left wing**

Also less likely to think poor are lazy or to want private ownership

**b. Theory: Corruption erodes the legitimacy of Capitalism**

Fairness (capitalists are nice people? Intelligent? Deserving?)

Same with Colonialism, Dictatorship when associated with capitalism

Efficiency, corruption reveals private sector is not that productive

**Implications**

Externalities (how can we discipline bad firms? Eliot Spitzer? Jockey Club? Status?)

# Survey Description

- All of the surveys were carried out through face-to-face interviews, with a sampling universe consisting of all adult citizens, aged 18 and older. The countries surveyed in the 1995-7 wave (data on both corruption and ideology) include: Argentina, Armenia, Australia, Azerbaijan, Bangladesh, Belarus, Bulgaria, Bosnia-Herzegovina, Brazil, Chile, Colombia, Croatia, Dominican Republic, Estonia, Finland, Georgia, Germany, India, South Korea, Latvia, Lithuania, Macedonia, Mexico, Moldova, Nigeria, Norway, Peru, Philippines, Poland, Puerto Rico, Russia, Moscow, Slovenia, South Africa, Spain, Andalusia, Basque, Galicia, Valencia, Sweden, Switzerland, Taiwan, Turkey, Ukraine, United States of America, Uruguay, Venezuela, Serbia-Montenegro.
- **Personal Income Quintile:** This heading refers to a set of 4 dummy variables which take the value 1 depending on which income quintile the respondent's family income belongs to. The base category is the lowest income quintile.
- **Work Status:** A set of dummy variables taking the value 1 depending on the respondent's employment status: "Unemployed", "Self-employed", "Retired", "Student", "Housewife" or "Other". The base category is "Employed".
- **Marital Status:** A set of dummy variables taking the value 1 depending on the respondent's marital status: "Married", "Divorced", "Separated" or "Widowed". The base category is "Never Married".
- **Age:** A set of dummy variables corresponding to the respondent's age: "Middle" which corresponds to 26-50 years old, "Old" which corresponds to greater than 50 years old. The base category is "Young" which corresponds to less than 26 years old.
- **Male:** A dummy variable equal to 1 if the respondent is male and 0 otherwise.
- **Age Finished School:** This heading refers to a set of dummy variables which take the value 1 depending on the age at which the respondent finished full-time education: up to "12-14 years old", "15-18 years old", "19-21 years old" or up to "more than 21 years old". The base category is education up to, but not including, 12 years old.

## Evidence from a Shantytown in Argentina

joint paper with Galiani and Schargrotsky

- In 1981 the Catholic Church organized a group of 1000 landless families to occupy a piece of land “owned by the state.
- In reality, 13 owners. Confiscation ensued and 8 surrendered, 5 challenged.
- As a result, 400 families own, 600 squatter

# The effect of property on pro-market beliefs

