On Capitalism

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This book is a product of a conference organized by the Center for the Study of Economy and Society at Cornell University in October 2004 in celebration of the centenary of Max Weber's *The Protestant Ethic and the Spirit of Capitalism*. Having read Weber's work and R. H. Tawney's *Religion and the Rise of Capitalism* years ago, I was looking forward to reading and reviewing *On Capitalism*. When I began to read it, I discovered that the editors and many of the contributors to the book were sociologists. As an economist with scant knowledge of sociological research, reading *On Capitalism* was something of a wilderness experience for me, so it was appropriate that I read the book during Lent. One can gain insight from wilderness experiences, and I certainly benefited from reading *On Capitalism*. It is informative and thought-provoking about the roles of beliefs and institutions in the evolution of capitalism and the process of economic growth. Some of the contributions I found most enlightening are described below.

Weber's thesis was that Calvinism, particularly English Puritanism, played an important role in creating moral and political conditions favorable to the development of capitalism (Tawney, 1926, p. 316). In the introduction to *On Capitalism*, editors Nee and Swedberg state that the enduring legacy of Weber's scholarship is perhaps not so much the Protestant ethic thesis, but that the dynamics of capitalism are rooted in the realm of ideas and institutional structures rather than in capital accumulation. They argue for a revision of the common view in sociology and other social sciences that "institutions are *the* key to what is happening in society in the long run." They claim that to be effective, institutions have to be grounded in the values, attitudes, and norms of society.

Charles Sabel provides a lucid description of the endowment explanation of economic development and an emerging alternative called the process or bootstrapping view. Weber emphasized individual motivation, particularly to entrepreneurial striving fostered by the theology of certain Protestant sects, as a key endowment. The current dominant institutional variant of the endowment notion emphasizes legal rules and systems that encourage investment by protecting property rights. The so-called "Washington Consensus" promulgated by the International

Monetary Fund and the World Bank is an official interpretation of this institutional perspective. Both of these views assume that the features that favor economic development are part of a society's fundamental endowments. Sabel states that recent failures of consensus-based reform programs in Russia, Bolivia, and East Germany and successful heterodox approaches in China, India, Mauritius, and Botswana have supported the process or bootstrapping view of economic development. In this view, economic growth and development depends on successive relaxation of constraints to growth. These constraints may be direct obstacles to market exchange or the absence of support institutions that help potential exporters with marketing, training, quality certification, physical infrastructure, and financing. In the bootstrapping view, economic growth requires continuing social learning. All economic actors, private and public, have limited knowledge and face coordination problems. The goal is to create institutions that can learn to identify and mitigate changing constraints on market activity. Such institutions are as much the outcome as the starting point of development. They cannot be viewed as "a foundation upon which a market order must be built if it is to stand" as in the endowment theory.

Victor Nee and Sonja Opper provide an illuminating description of a type of institutional order they call politicized capitalism that emerged in China in the 1980s. This is a type of mixed economy in which state officials set the regulatory framework and remain directly involved in guiding transactions at the firm level. The defining feature of politicized capitalism is "the overlap of political and economic markets and the absence of clearly defined state-firm boundaries." They offer a fascinating analysis of two types of state intervention at the firm level: (1) state assistance in the firm's external transactions, such as borrowing, and (2) state involvement in corporate governance inside the firm. Their evidence suggests that direct state involvement in decision-making at the firm level has a negative effect on performance, but that firms will not openly reject state involvement because state officials ease resource constraints of China's regulated markets, especially markets for credit and land-use rights. A central question is whether China's politicized capitalism will endure. Nee and Opper predict that political interference in economic life will decline. Rapid growth by the private enterprise sector, they argue, will encourage the state to shift to a custodial role characteristic of East Asian developed economies where the state operates within the framework of an independent legal system which guarantees clear and distinct state-firm boundaries.

Weber thought deeply about the connections between law and capitalism, and international financial institutions such as the International

Monetary Fund and the World Bank now recognize that legal institutions are critical foundations for market economies. Corporate bankruptcy or insolvency law has been of particular interest. Bruce Carruthers and Terence Hallidy trace the policy conversation concerning bankruptcy law leading to the adoption of the United Nations Commission on International Trade Law's *Legislative Guide on Insolvency Law* in 2004. There is widespread agreement that insolvency law should be transparent and predictable, but Carruthers and Halliday point out that the issue of what the law should predictably do remains. The *Legislative Guide* does not specify a single model to follow, but "assists the reader to evaluate different approaches and to choose the one most suitable in the national or local context." Carruthers and Halliday call attention to two overlooked aspects of Weber's thinking on law and capitalism. The first is that the creation of predictable law must involve legal professionals, not just legal texts. Legal predictability requires predictability in implementation, which necessarily depends on lawyers, judges, and other participants in the legal system. The second point concerns the support for legal predictability by the capitalists who benefit from it. Predictability may not be necessary or even desirable under all circumstances. Investors may tolerate or work around unpredictable law. Legal predictability can also pit locals against foreigners. Unpredictable law often means that extralegal considerations (e.g., family ties) affect legal outcomes, and these are usually better understood by locals, giving them an advantage over foreigners. It is not clear who will work to create legal predictability.

For those interested in the impact of corruption on society, Mark Granovetter's excellent chapter, "The Social Construction of Corruption," is highly recommended. He begins by noting limitations in the dictionary definition of corruption: "Perversion or destruction of integrity in the discharge of public duties by bribery or favor." Much corruption involves exchanges between individuals, the legitimacy of which depends on meanings and norms. An exchange described as a gift, favor, or loan in one situation may be interpreted as bribery or extortion under different circumstances. The relative status of parties to social exchange also matters a great deal in understanding corruption. Accepting a bribe is an acknowledgement of social inferiority, like accepting a tip or gratuity. Bribes can flow from those socially inferior to those socially superior, but this requires extensive management and buffering at a higher cost and complexity than simple monetary payments, and may require "corruption entrepreneurs." An example given is that of "Boss Lai," the central figure in a famous corruption scandal in China in 1998. Granovetter also distinguishes between market and nonmarket corruption. Market corruption is the "selling of government goods and services to the highest bidder." Such corruption is impersonal. Nonmarket, or network, corruption occurs where people honor obligations to others they know in ways that are considered illegal, improper, or corrupt. In economies undergoing difficult transitions where wages fell and jobs were insecure, people protected their friends at the expense of strangers. What looks like corruption were the survival skills of people living in uncertain times. An ideology of class solidarity based on friendship and reciprocity can effectively neutralize perceptions of corruption.

In their chapter, economists Robert Barro and Rachel McCleary investigate the two-way interaction between religion and political economy. Key questions addressed include how economic development and political institutions affect religious participation and beliefs, and how religiosity affects individual characteristics and economic performance. They explore these questions using a previously constructed cross-country data set expanded to include measures of religiosity for eighty-one countries. One of their findings is that per capita gross domestic product (GDP) has a significant negative effect on all of the religiosity indicators (attendance at religious services, personal prayer, belief in hell, belief in afterlife, and self-identification as a religious person). This finding supports the secularization hypothesis that religion would decline in response to advances in education and science, as well as the rational-choice perspective of Azzi and Ehrenberg (1975). The United States, however, has maintained a high level of religiosity over time even as incomes have risen, making it an outlier in their results, along with Singapore and Poland. Another finding is that in models of growth in real per capita GDP, belief in hell has a positive relationship with growth, but attendance at religious services is negatively related. These results accord with Weber's view that religion is an influence on individual traits and values. Religion does not appear to operate as a social organization that enhances productive social capital and networking.

Another economist, Robert Frank, writes a chapter in which he argues that "the Protestant ethic was by no mean necessary for capitalism's launch (although it may have helped), but that a revival of the progressive institutions inspired by it may be essential for the system's continued survival." Examples of progressive institutions Frank cites include the progressive income tax system, Social Security, and subsidies for education. I am not sure that progressive institutions were inspired by the "Protestant ethic" which I understand to emphasize disciplined work and thrift, and I did not find much support for the claim that capitalism's survival depends on the revival of these institutions. What I found compelling, however, was Frank's argument that rising inequality is harmful to middle-income families. His argument is based on psychological costs of inequality and what Frank calls "expenditure cascades." Expenditure cascades result when rising incomes and expenditures of the rich change the social frame of reference of what is necessary or appropriate. The costs of inequality raise it as a moral concern beyond how it reflects poverty, which is an emphasis in official social statements of Christian denominations.

In a stimulating chapter, Duncan Watts offers a critique of "rationalist" and "historicist" views of human behavior, and discusses a class of models in which individual decisions generate collective dynamics that are ambiguously related to both individual preferences and contextual variables. Rationalists, according to Watts, contend that historical outcomes result from individual actions based on consistent and timeless human traits and preferences. Historicists, among whom Max Weber would be counted, contend that no such traits and preferences exist, and that all action is historically contingent. Watts argues that a mistake both rationalists and historicists make is to treat collectives of individuals as an individual actor responding to its environment (the representative individual in economics). Watts contends that when individuals make decisions in response to the decisions of others, the relationship between individual preferences and collective action breaks down. An example of a crowd poised on the brink of a riot illustrates the point. Causal relationships meaningful for individual behavior are largely irrelevant to group behavior, and causality at the group level is deeply ambiguous. The implication for policy makers is sobering.

Although there is little on Christian theology and its relationship with economic life, even on Max Weber's understanding of it, I recommend *On Capitalism* to Christian economists and others interested in the roles of beliefs, social norms, and institutions in the process of economic growth and development. I learned much from reading the various contributions, but the chapters are loosely related. Be prepared for a rewarding wilderness experience.

References

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