COMMENT BY **Pete Klenow** on

"Why Doesn't Capitalism Flow to Poor Countries"
By Rafael Di Tella and Robert MacCulloch

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Rafael Di Tella and Robert MacCulloch maintain in this paper that capitalism is unpopular in poor countries because voters perceive capitalists as corrupt. Voters see capitalists bribing politicians and therefore favor policies to limit crony capitalism. Thus, Di Tella and MacCulloch propose a causal pathway from voter-perceived corruption to voter approval of anticapitalist policies. I consider this hypothesis highly plausible and fairly novel to the economic literature.

Yet the hypothesis is paradoxical if many anticapitalist policies (for example, the license *raj* in India) facilitate rather than discourage corruption. One can easily imagine this kind of reverse causality, flowing from regulation to corruption. And to the extent that corruption causes regulation, it may be because incumbent firms lobby politicians to grant them monopoly rights. A related hypothesis, advocated forcefully by Stephen Parente and Edward Prescott (2000), is that anticapitalist policies are chosen precisely so as to create or protect the rents of politically connected firms and workers.

Di Tella and MacCulloch first document that developing countries tend to be led by left-leaning parties and to regulate business entry more than other countries do, and that survey respondents in these countries profess greater support for government ownership of industries. These observations are positively correlated with perceived corruption not just across country-years, but also across time within countries (bursts of corruption boost left-leaning parties a few years later) and across individuals within countries (those who perceive more corruption disproportionately favor left-leaning parties and a bigger role for government in running industries).

The time-series and cross-individual evidence supports the case that perceived corruption leads to anticapitalist policies, as opposed to the reverse. But why were there bursts of corruption? And did they occur disproportionately under right-leaning governments in the sample? Perhaps corruption turns voters against incumbent politicians, not capitalism per se. And why do some individuals perceive more corruption than others? Perhaps the personality type that is prone to be outraged by capitalism on ideological or redistributive grounds is also more attuned to instances of corruption by capitalists. See Jaime Napier and John Jost (2008) for related evidence that conservatives report greater subjective well-being than liberals because the former are less troubled by economic inequality.

More important, if voters want to limit crony capitalism, why erect barriers to entry? Don't such barriers favor the corrupt capitalists at the expense of consumers? According to a recent World Bank survey (2008a), entry barriers do in fact limit entry. Of course, such limits could be in the public interest. But Simeon Djankov and others (2002) present a plethora of evidence that these government-imposed barriers reflect "regulatory capture" rather than enlightened corrections of market failures.

If the Di Tella and MacCulloch hypothesis is correct, then voters should be availing themselves of more effective ways of curbing corrupt capitalism. First and foremost would be high-profile prosecutions (fines, asset seizures, imprisonment) of exposed corruption. The elite investigating unit in South Africa known as the "Scorpions" comes to mind. Another possibility would be antitrust policies—the opposite of entry restrictions—to drive down incumbent rents. State ownership of industry, likewise, could limit capitalist corruption. Progressive tax rates on business and household income might be even more effective at limiting the benefits of capitalist corruption. Of course, all of these potential palliatives are themselves vulnerable to abuse. Still, it remains far from clear why restricting business start-ups would be at all effective, much less the method of choice, for punishing corrupt capitalists. If capitalist corruption breeds hostility toward capitalism, do poorer countries pursue these alternatives to entry regulation as well? If not, why not?

A separate question is whether the populace in poor countries is convinced that capitalism maximizes the economic pie (as measured by GDP per capita). Most economists probably believe that it does; World Bank (2008b) is an example of this view. Dani Rodrik is a notable voice of dissent, often citing the disappointment that has followed capitalist reforms in Latin America and the purported success of government industrial policies in East Asia. (See Rodriguez and Rodrik 2001 for a skeptical view of the benefits of openness, for example.) William Easterly and others (1993) and Easterly (2005) argue that there is only a weak relationship between country growth rates and changes in any observed government policies, much less adoption of capitalist policies. Some studies, to be sure, do find large productivity benefits from capitalist reforms. Two examples are Rafael La Porta and Florencio Lopez-de-Silanes (1999) on Mexico's early 1990s privatization wave, and Chang-Tai Hsieh and Klenow (2009) on China's move away from inefficient state-owned enterprises.

If economists do not see the evidence as clear-cut, there is plenty of room for public skepticism about whether capitalism maximizes average incomes. Francisco Buera, Alexander Monge-Naranjo, and Giorgio Primiceri (2009) present a model in which policymakers gradually learn whether "market-oriented policies" or "state intervention" maximize growth in income per capita. These authors use the index constructed by Jeffrey Sachs and Andrew Warner (1995) as a measure of market orientation, and their model allows countries to learn from their own experience and the experience of other countries. They find slow adoption of liberal (that is, pro-market) policies in a large set of countries from 1950 to 2001, because market orientation is associated with only mildly higher average growth rates. They claim that reversals of reforms are easily imaginable given the thin case for market orientation in many countries.

Even if people are convinced that capitalism maximizes *average* income, it may not maximize their own income (or they may not believe it will). This is exactly what Parente and Prescott have in mind when they say that rent seeking results in barriers to competition and entry. But the same point could apply just as well to, say, labor income versus capital income: workers could imagine their share of the pie shrinking even as the overall pie expands in the wake of liberal reforms. Similarly, the subset of the population in a given region, of a given ethnicity, or of a given skill class could suffer from capitalist reforms. Pinelopi Goldberg and Nina Pavcnik (2007) survey the literature and find that globalization (for example, reducing trade barriers) tends to increase economic inequality within developing countries. Of course, if the pie expands enough after capitalist reforms, then even those gaining less than proportionately may nonetheless gain; here an example is the rural population in China in recent decades.

To recap, Di Tella and MacCulloch propose that poor countries are hostile to capitalism because they associate it with ill-gotten gains to corrupt capitalists. They provide some suggestive pieces of supporting survey evidence, even if the evidence is far from airtight. I think this hypothesis should be taken seriously and subject to much further investigation, thanks to their contribution.

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