

- The Harold Clough Lecture for 1998 •

Renewing the Miracle

Economic Development and Asia

Deepak Lal

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About the Author

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Professor Lal delivered the inaugural Harold Clough Lecture to a large audience at The Western Australia Club, in Perth, on 27 July 1998.

About the Lecture

This lecture is named after the founder and Chairman of the Clough Engineering group. Hal Clough has been a leading figure in the Western Australian business community for many years and during that time has been a strong supporter of economic freedom and the Institute. As John Hyde, a former Executive Director of the Institute of Public Affairs, once remarked of Hal Clough:

he has always clearly understood that a liberal social order, including its market economy, is dependent on an ethos, an idea, without which it will not function or survive.

The Institute is proud to host an annual Perth-based lecture in Hal Clough's honour.

Renewing the Miracle

Economic Development and Asia

UNTIL the recent crisis, Asia has been the great success story of economic development. Beginning with the Gang of Four¹ in the late 1960s, the process of outward-oriented development they opted for has been emulated first by various other countries in South-East Asia—particularly those with overseas Chinese—and in the 1980s and early 1990s even by those Asian giants—India and China—who till then had ruggedly held on to their post-War inward-looking development path based on import-substituting, heavy-industry-biased industrialization. The results have been phenomenal. In the Gang of Four countries which first took this outward orientation path, the mass poverty which has been the fate of much of humankind for millennia was wiped out within the lifetime of a generation. Even in many of the late-comers, growth rates have been unprecedentedly high and countries like Indonesia, for instance, had dramatically reduced the extent of their poor before the current crisis hit. So it was not unreasonable for many to expect that the next century would be ‘the Asian century’. There was talk of a new Asian model of development, whose pioneer was Japan. But the recent crisis (with the Japanese pioneer of this model a prime victim) has seemingly soured these prospects. What were the reasons for past Asian success, and for the region’s current economic crisis?

Among the reasons being adduced for past success and affording hope for the future are particular cultural features of the region. Thus it is argued (in an influential article by Hicks and Redding²) that the standard economic explanation for the past ‘miracles’ in the region, namely high rates of savings and investment efficiently deployed through outward-oriented policies, cannot explain the success of the

East Asian edge without taking into account various cultural factors associated with their Confucian heritage. At the same time, many influential voices in East Asia—Lee Kwan Yew of Singapore, Mahatir of Malaysia, and various Chinese and Japanese politicians—claim that Eastern social and political forms are superior to Western ones. Rather than succumb to Western classical liberal values, which have produced decadence amongst prosperity in the West, the East, they argue, should stick by its familial and authoritarian cultural and political values as embodied in Confucianism and neo-Confucianism. Thus, in a neat reversal of Max Weber's famous thesis on the role of Protestantism in the rise of Western capitalism, we now have an Eastern 'religion' being touted as the source of East Asia's success.

The recent economic crisis, in part caused by the 'crony capitalism' that was a feature of this so-called 'East Asian' alternative to the Anglo-Saxon model of capitalism, has rightly brought many aspects of this model into question, but the question raised by these 'culturalists' is more general and relates to the sorely neglected but vitally important question of the relationship of culture to development.

I. The Current Crisis

Before coming to this question—which will be my main concern in this lecture—I need to outline briefly the causes, as I see them, of the current crisis. These are threefold : (i) the exchange rate regime; (ii) the moral hazard in the domestic banking systems caused by the 'Asian model'; (iii) the international moral hazard created by the actions of the IMF.

To elaborate and explain. The first cause was the quasi-fixed exchange rate regimes in many of the countries in the region. It is increasingly becoming clear that, in a world with a globalized capital market, only two exchange regimes are viable: a fully floating exchange rate or a rigidly fixed rate one as in the currency board of Hong Kong. The reason is that these are the only ones which allow automatic adjustment to external and

internal shocks without any need for any discretionary action by the authorities.³ In a world which requires instantaneous responses to the actions of a highly decentralized but integrated world capital market mediating these shocks, the authorities have neither the time nor the means to obtain the requisite information to deal with these shocks in a centrally planned manner. They often end up by being the problem rather than the solution if they try to manage their exchange rates in this volatile and unpredictable world economy, leading to serious misalignments of the real exchange rate.⁴ An automatic adjustment mechanism is therefore preferable to a discretionary one.

The second cause was a systemic flaw in the 'Asian' model of development. A central feature of this model—as seen most clearly in Korea but presaged by the development of Japan—is a close linkage between the domestic banking system, industrial enterprises (particularly the biggest) and the government. Thus in Korea, the government channelled subsidized credit to the *chaebol*, whose performance was then subject to fulfilling explicit export targets.

These *chaebol*, like the *zaibatsu* in Japan, were government creations to deal with an important problem of 'agency' faced by newly industrializing countries. These find that, once they have to move from the simpler manufactures which can be produced by family-owned enterprises to the more complex manufactures requiring large and lumpy investments, they have insufficient agglomerations of private wealth for enterprises to remain owner-managed. To overcome the ensuing 'agency' problem when ownership and management are separated, and domestic capital markets are underdeveloped, they have adopted three routes: the political creation of concentrations of private wealth by encouraging state-subsidized family conglomerates as in Korea and Japan; the placement of such industries in the public sector as in Taiwan and India; the encouragement of direct foreign investment as in Singapore.

The first (Korean and Japanese) route can be fairly effective, as the stick of export targets—which is used to monitor the performance of

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the favoured groups offered the subsidies of cheap credit through the banking system—cannot be corrupted by the actions of local mandarins who have no way of affecting foreign sales of the favoured conglomerates. However, this artificial creation of agglomerations of private wealth is not essential, as is witnessed by the success of Hong Kong, which has relied on the natural forces of growth, and whose performance, as judged by the efficiency of investment, is the highest amongst the Gang of Four.⁵

But the real danger in the Korean way of dealing with this ‘agency’ problem is that, by making the banking system the creature of the government’s will, it creates tremendous moral hazard in the domestic banking system. With the banks having no incentive to assess the creditworthiness of their borrowers or the quality of the investments that their loans are financing, they know that no matter how risky and over-extended their lending, they will always be bailed out by the government. This can lead, in time, to a mountain of bad paper and the *de facto* insolvency of a major part of the banking system, as has happened in both Korea and Japan—not to mention the corruption that is inevitably involved in this type of development. But as the example of the US savings and loans crisis shows, this collapse of the banking system can ultimately be cleared up if there is the political will. Korea does have the will, and should bounce back fairly quickly. By contrast, Japan, which inherited a political system based on institutionalizing political paralysis from the Meiji oligarchs, shows no sign as yet of grasping this nettle, and its prospects must therefore remain a cause for continuing concern.

The problem of moral hazard for the domestic banking system created by this ‘Asian’ model has been aggravated by the actions of the IMF and the entrance of foreign bankers as lenders in the newly liberalized capital markets. Of the three types of capital flows that can be distinguished—direct foreign investment, portfolio investment and bank lending—the income and foreign currency risk of the first two types is shared by both the lender and the borrower, as the ‘invest-

ments' are denominated in domestic currency. By contrast, foreign bank loans are usually denominated in dollars and the interest rate is linked to the London Inter Bank Offered Rate (LIBOR). This means that if faced by a shock which requires a devaluation (in a floating rate regime) the domestic currency burden of the foreign bank debt rises *pari passu* with the changing exchange rate. If this debt is incurred by the private sector, the rising debt burden need pose no problem for the country, for if the relevant foreign banks run, the borrowers can always default on their debt.

But now enter the IMF. The foreign banks faced by a default on their Third World debt have, ever since the 1980s debt crisis, argued that this poses a systemic risk to the world's financial system, and asked in effect for an international bailout to prevent this catastrophe. Since the 1980s debt crisis and most clearly in the Mexican crisis in the early 1990s and the recent Asian crisis, the IMF has been more than willing to oblige. For since the era of the Bretton Woods adjustable peg exchange rate regime—which the IMF was set up to manage—ended with President Nixon's closing of the gold window in the early 1970s, the IMF has been like a character in Pirandello's play *Six Characters in Search of an Author*. The debt crisis of the 1980s provided it one such play, the rocky transition of the Second World from plan to market another, and the Mexican and Asian crises a third. The IMF has increasingly become the international debt collector for foreign money centre banks, as well as an important tool of US foreign policy.

The crisis in Indonesia provides the clearest example of this metamorphosis of the Fund. Before the Thai crisis hit the region, the Indonesian economy had been fairly well managed despite the 'cronyism' of its capitalism. It had provided exceptional growth rates, with a sensible deployment of its oil revenues—unlike many other comparators, for example, Nigeria—so that Indonesia had made an impressive dent in mass poverty. At the time of the Thai crisis, its economic fundamentals were sound: it did not have a massive trade or budget deficit, it had a flexible exchange rate, its debt burden was not onerous and its foreign bank debt was all private.

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When the contagion from Thailand spread, the foreign banks (mainly US and Japanese) which had made these loans to the Indonesian private sector ran, leading to a depreciation of the rupiah and a massive increase in the domestic currency costs of servicing these loans. Many of the borrowers would then have defaulted, and that would have been that. But enter the IMF. Under pressure from the governments of the foreign banks, it deemed that such private-sector defaults would pose a risk to the world's financial system, and under the cover of an IMF programme, the Indonesian government was in effect forced to take on these private debts. The money from the IMF paid off the foreign lenders, and the general taxation of the Indonesian populace will have to repay the IMF. Thus the Indonesian people have, through the aegis of the IMF, bailed out the foreign banks.

These actions of the IMF—ever since the 1980s debt crisis—have generated serious moral hazard in foreign bank lending. With the increasingly confident expectation that they will be bailed out via the IMF no matter what the quality of their lending to Third World countries, foreign banks have no incentive to act prudently in their foreign lending. When this international moral hazard is coupled with the domestic moral hazard associated with the politicized domestic banking systems of the 'Asian' model—as in Korea—a disastrous witches' brew is created. Foreign banks which lend to domestic banks and which know that they will be bailed out, will over-lend, leading to risky investments and an eventual debt crisis for the country.

With measures to remove the domestic moral hazard being widely adopted in the region, the international moral hazard from the IMF's operations would still remain. What is to be done? The best solution would be to shut down the IMF. Its original mandate ended with the Bretton Woods exchange rate system. Since then its continuance, although in the interests of its rent-seeking international bureaucrats, is no longer in the interests of the world economy.

Nor is its role as the tool of US foreign policy without its costs. Soon after the Indonesian acceptance of the IMF's programme, Jakarta

was plastered with pictures of a grinning Managing Director of the Fund standing over a little brown man signing away his country. This understandable nationalist backlash could easily turn into the economic nationalism that has for so long in the past blighted Asia's economic prospects.

What of the future? Apart from Japan and Indonesia, whose prospects are clouded by political uncertainty, the other crisis countries should soon recover, as their fundamentals remain sound. I therefore remain optimistic about the prospects of renewing Asia's miracles. The thrift, enterprise and productivity of open economies which created the initial 'miracles' are still in place, and with the necessary retreat from the flawed 'Asian' to the only viable form of 'Anglo-Saxon' capitalism, I see no reason why they will not regain their economic vigour.

II. Asian Values and Development⁶

This brings me to the second and major theme of this lecture: the relevance of Asian values in explaining the Asian 'miracle'.

In thinking about culture and development and the role of Asian values, if any, in promoting East Asian development, we need to define culture and see its role in development. This is the purpose of the first two sections. I then apply this framework to answering the question of the title of this part, in particular in examining the role of the family and political institutions in the West and the East in development.

1. Culture and Social Equilibria

Culture remains a murky concept. I have found a definition adopted by ecologists particularly useful.⁷ They emphasize that, unlike other animals, the human one is unique because its intelligence gives it the

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ability to change its environment by learning. It does not have to mutate into a new species to adapt to the changed environment. It learns new ways of surviving in the new environment and then fixes them by social custom. These social customs form the culture of the relevant group, which are transmitted to new members of the group (mainly children) who do not then have to invent these 'new' ways *de novo* for themselves.

This definition of culture fits in well with the economists' notion of equilibrium. Frank Hahn⁸ describes an equilibrium state as one where self-seeking agents learn nothing new so that their behaviour is routinized. It represents an adaptation by agents to the economic environment in which the economy 'generates messages which do not cause agents to change the theories which they hold or the policies which they pursue'. This routinized behaviour is clearly close to the ecologists' notion of social custom which fixes a particular human niche. On this view, the equilibrium will be disturbed if the environment changes, and so, in the subsequent process of adjustment, the human agents will have to abandon their past theories, which would now be systematically falsified. To survive, they must learn to adapt to their new environment through a process of trial and error. There will then be a new social equilibrium, which relates to a state of society and economy in which 'agents have adapted themselves to their economic environment and where their expectations in the widest sense are in the proper meaning not falsified'.

This equilibrium need not be unique nor optimal, given the environmental parameters. But once a particular socio-economic order is established, and proves to be an adequate adaptation to the new environment, it is likely to be stable, as there is no reason for the human agents to alter it in any fundamental manner, unless and until the environmental parameters are altered. Nor is this social order likely to be the result of a deliberate rationalist plan. We have known since the time of Adam Smith that an unplanned but coherent and seemingly planned social system can emerge from the independent actions of

many individuals pursuing their different ends and in which the final outcomes can be very different from those intended.

It is useful to distinguish between two major sorts of beliefs relating to different aspects of the environment. These relate to what in my recent Ohlin lectures I labelled the *material* and *cosmological* beliefs of a particular culture. The former relate to ways of making a living and concern beliefs about the material world, in particular about the economy. The latter are related to understanding the world around us and mankind's place in it which determine how people view their lives—its purpose, meaning and relationship to others. There is considerable cross-cultural evidence that material beliefs are more malleable than cosmological ones. Material beliefs can alter rapidly with changes in the material environment. There is greater stability in cosmological beliefs, on how, in Plato's words, 'one should live'. Moreover, the cross-cultural evidence shows that rather than the environment, it is the *language group* which influences these world-views.

This distinction between material and cosmological beliefs is important for economic performance because it translates into two distinct types of 'transactions costs' which are of importance in explaining not only 'market' but also 'government or bureaucratic failure'.⁹ Broadly speaking, transactions costs can be distinguished usefully as those costs associated with the efficiency of *exchange*, and those which are associated with *policing* opportunistic behaviour by economic agents. The former relate to the costs of finding potential trading partners and determining their supply–demand offers, the latter to enforcing the execution of promises and agreements. These two aspects of transactions costs need to be kept distinct.

To see the relevance of the distinctions between the two types of beliefs and the two forms of transactions costs for economic performance, it will be useful to delineate briefly how, broadly speaking, material and cosmological beliefs have altered since the Stone Age in Eurasia.

2. *Changing Material and Cosmological Beliefs*

(i) On Human Nature

Evolutionary anthropologists and psychologists maintain that human nature was set during the period of evolution ending with the Stone Age. Since then there has not been sufficient time for any further evolution. This human nature appears darker than Rousseau's and brighter than Hobbes's characterizations of it. It is closer to Hume's view that 'there is some benevolence, however small . . . some particle of the dove kneaded into our frame, along with the elements of the wolf and serpent.' For even in the hunter-gatherer Stone Age environment, the supremely egotistical human animal would have found some form of what evolutionary biologists term 'reciprocal altruism' useful. Cooperation with one's fellows in various hunter-gatherer tasks yields benefits for the selfish human which can be further increased if he can cheat and be a free rider. In the *repeated* interactions between the selfish humans comprising the tribe, such cheating could be mitigated by playing the game of 'tit for tat'. Evolutionary biologists claim that the resulting 'reciprocal altruism' would be part of our basic Stone Age human nature.

Archaeologists have also established that the instinct to 'truck and barter', the trading instinct based on what Sir John Hicks used to call the 'economic principle'—'people would act *economically*, when an opportunity of an advantage was presented to them they would take it'¹⁰—is also of Stone Age vintage. It is also part of our basic human nature.

(ii) Agrarian Civilizations

With the rise of settled agriculture and the civilizations that evolved around them, however, and the stratification this involved between three classes of men—those wielding the sword, the pen and the plough—most of the Stone Age basic instincts which comprise our human nature would be dysfunctional. Thus with the multiplication

of interactions between human beings in agrarian civilizations, many of the transactions would have been with anonymous strangers who one might never see again. The 'reciprocal altruism' of the Stone Age which depended upon a repetition of transactions would not be sufficient to curtail opportunistic behaviour.

Putting it differently, the 'tit for tat' strategy for the repeated Prisoner's Dilemma (PD) game amongst a band of hunter-gatherers in the Stone Age would not suffice with the increased number of one-shot PD games that will arise with settled agriculture and its widening of the market. To prevent the resulting dissipation of the mutual gains from co-operation, agrarian civilizations internalized restraints on such 'anti-social' action through moral codes which were part of their 'religion'. But these 'religions' were more ways of life as they did not necessarily depend upon a belief in God.

The universal moral emotions of shame and guilt are the means by which these 'moral codes' embodied in cultural traditions are internalized in the socialization process during infancy. Shame was the major instrument of this internalization in the great agrarian civilizations. Their resulting cosmological beliefs can be described as being 'communalist'.

The basic human instinct to trade would also be disruptive for settled agriculture. For traders are motivated by instrumental rationality which maximizes economic advantage. This would threaten the communal bonds that all agrarian civilizations have tried to foster. Not surprisingly most of them have looked upon merchants and markets as a necessary evil, and sought to suppress them and the market which is their institutional embodiment. The material beliefs of the agrarian civilizations were thus not conducive to modern economic growth.

(iii) The Rise of the West

The rise of the West was mediated by the Catholic Church in the sixth to eleventh centuries, through its promotion of individualism, first in family affairs and later in material relationships which included the introduction

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of all the legal and institutional requirements of a market economy as a result of Gregory VII's papal revolution in the eleventh century.¹¹ These twin papal revolutions arose because of the unintended consequences of the Church's search for bequests—a trait that goes back to its earliest days. From its inception it had grown as a temporal power through gifts and donations—particularly from rich widows. So much so that, in July 370, the Emperor Valentinian had addressed a ruling to the Pope that male clerics and unmarried ascetics should not hang around the houses of women and widows and try to worm themselves and their churches into their bequests at the expense of the women's families and blood relations. The Church was thus, from its beginnings, in the race for inheritances. The early Church's extolling of virginity and preventing second marriages helped it in creating more single women who would leave bequests to the Church.

This process of inhibiting a family from retaining its property and promoting its alienation accelerated with the answers that Pope Gregory I gave to some questions that the first Archbishop of Canterbury, Augustine, had sent in AD 597 concerning his new charges. Four of these nine questions concerned sex and marriage. Gregory's answers overturned the traditional Mediterranean and Middle Eastern patterns of legal and customary practices in the domestic domain. The traditional system was concerned with the provision of an heir to inherit family property and allowed marriage to close kin, marriages to close affines or widows of close kin, the transfer of children by adoption, and finally concubinage, which is a form of secondary union. Gregory amazingly banned all four practices. Thus, for instance, there was no adoption of children allowed in England till the nineteenth century. There was no basis for these injunctions in Scripture, Roman law or the existing customs in the areas that were Christianized.

This papal family revolution made the Church unbelievably rich. Demographers have estimated that the net effect of the prohibitions on traditional methods to deal with childlessness was to leave 40 per cent of families with no immediate male heirs. The Church became the chief beneficiary of the resulting bequests. Its accumulation was

phenomenal. Thus, for instance, in France one-third of productive land was in ecclesiastical hands by the end of the seventh century!

But this accumulation also drew predators from within and without to deprive the Church of its acquired property. It was to deal with this denudation that Pope Gregory VII instigated his papal revolution of 1075, by putting the power of God—through the spiritual weapon of excommunication—above that of Caesar's. With the Church then coming into the world, the new Church-state also created all the administrative and legal infrastructure which we associate with a modern polity, and which provided the essential institutional infrastructure for the Western dynamic that in time led to Promethean growth. Thus Pope Gregory VII's papal revolution lifted the lid on the basic human instinct to 'truck and barter', and in time to a change in the traditional Eurasian pattern of material beliefs with their suspicion of markets and merchants. This in time led to modern economic growth.

But it also led to a change in the traditional Eurasian family patterns which were based on various forms of 'joint families' and family values, which essentially removed the lid on the other opportunistic basic instincts which the shame-based moral codes of Eurasia had placed. To counter the potential threat this posed to its way of making a living—settled agriculture—the Church created a fierce guilt culture in which Original Sin was paramount, and morality was underwritten by the belief in the Christian God.

In this context it is worth noting the important difference between the cosmological beliefs of what became the Christian West and the other ancient agrarian civilizations of Eurasia. Christianity has a number of distinctive features which it shares with its Semitic cousin Islam, but not entirely with its parent Judaism, and which are not to be found in any of the other great Eurasian religions. The most important is its universality. Neither the Jews, nor the Hindu or Sinic civilizations had religions claiming to be universal. You could not choose to be a Hindu, Chinese or Jew, you were born as one. This also meant that unlike Christianity and Islam these religions did not proselytize.

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Third, only the Semitic religions being monotheistic have also been egalitarian. Nearly all the other Eurasian religions believed in some form of hierarchical social order. By contrast alone among the Eurasian civilizations the Semitic ones (though least so the Jewish) emphasized the equality of men's souls in the eyes of their monotheistic deities. Dumont has rightly characterized the resulting profound divide between the societies of *Homo aequalis* which believe all men are born equal (as the *philosophes* and the American constitution proclaim) and those of *Homo hierarchicus* which believe no such thing.

The classic statement of this Christian cosmology was St Augustine's *City of God*. His narrative of a Garden of Eden, a Fall leading to Original Sin and a Day of Judgement with heaven for the elect and hell for the damned has subsequently had a tenacious hold on Western minds. Thus the *philosophes* of the Enlightenment displaced the Garden of Eden by classical Greece and Rome, and God became an abstract cause—the Divine Watchmaker. The Christian centuries were the Fall. The Enlightened were the elect and the Christian paradise was replaced by posterity.¹² This seemed to salvage the traditional morality in a world ruled by the Divine Watchmaker. But once Darwin had shown him to be blind, as Nietzsche proclaimed from the housetops at the end of the nineteenth century, the Christian God was dead, and the moral foundations of the West were thereafter in ruins.

But the death of the Christian God did not end secular variations on the theme of Augustine's Heavenly City. Marxism, Freudianism and the recent bizarre eco-fundamentalism are secular mutations of Augustine. Thus, for instance, in Marxism there is a Garden of Eden before 'property relations' corrupted 'natural man'. Then the Fall as 'commodification' leads to class societies and a continuing but impersonal conflict of material forces, which leads in turn to the Day of Judgement with the Revolution and the millennial paradise of communism. Similarly, the deep Christian roots of eco-fundamentalism are shown by Bramwell.¹³ Meanwhile Gellner¹⁴ argues that Freud created a new faith with traditional Judaeo-Christian roots. The

Unconscious becomes a new version of Original Sin. The analysts form a priesthood, offering personal salvation to the faithful through the confessional of the analyst's couch; the priesthood is controlled by a guild of acolytes, who preach a doctrine which, though cloaked in the mantle of science, is like any religion a closed system which is unfalsifiable. It is tailored to the fears of the modern West. With Nature quelled these fears concern personal relationships. With the death of its God the Christian hell has been dismantled. Now in Sartre's words: 'Hell is other people', and the analyst provides a bespoke morality to deal with each person's special circumstances as worked out between the patient and the analyst.

But none of these variations on Augustine's 'City' have succeeded in providing a moral anchor to the West. Such an anchor is of importance to the economy because the 'policing' type of transactions costs associated with running an economy are increased in its absence.

There is also the growing collapse of the Western family. It was presaged by the overthrowing of the traditional family patterns of Eurasian civilizations by Gregory I's individualist family revolution. This would have destroyed the Western family much earlier were it not for the subsequent fierce guilt culture the Church promoted in the Middle Ages, which kept the traditional morality in place. But with the exorcising of both guilt and shame as illegitimate moral emotions in the West, there are fewer moral bulwarks left to shore up the family.

Another consequence of Gregory I's family revolution was that the social safety nets provided by the family in most Eurasian societies were from an early date partly provided by the state in the West.¹⁵

This nationalization of welfare accelerated in this century, leading to vast transfer states. The accompanying erosion of traditional morality in the West is manifest in various social pathologies—such as widespread family breakdown, high levels of illegitimacy and divorce, proliferation of single-parent families, soaring crime rates and the perpetuation of an urban underclass.

3. *The Family*

Since Marx and Engels there has been the view that with modernization the traditional extended family identified with pre-industrial societies is doomed. Modern families will become more and more like Western families: with love marriages, nuclear families and a cold-hearted attitude to the old. There are others who maintain that as the Western style of family seems to go back at least to the Middle Ages in Northern Europe, this modern family pattern was not merely the consequence but the cause of the Western Industrial Revolution. Research by the Cambridge anthropologist Jack Goody¹⁶ casts serious doubts on both these positions.

First, as the historical evidence shows that the Western family revolution predated the Industrial Revolution, clearly the latter could not have caused the former. Second, as Goody shows at length, the purported advantages of the Western system, leading to a greater control of fertility, were to be found in many other Eurasian family systems which, however, did not deliver industrial revolutions.

But that the Western Christian world—particularly in its northwestern outpost—deviated from what had been the traditional family pattern in Eurasia from about the late sixth century seems undeniable. The major difference was that in the West the Church came to support the independence of the young: in choosing marriage partners, in setting up their households and entering into contractual rather than affective relationships with the old. They promoted love marriages rather than the arranged marriages common in Eurasia. Friar Lawrence in *Romeo and Juliet* egging on the young lovers against their families' wishes is emblematic of this trend. But why did the Church promote love marriages?

It has been thought that romantic love, far from being a universal emotion, was a Western social construct of the age of chivalry in the Middle Ages. Recent anthropological and psychological research, however, confirms that this is erroneous—romantic love is a universal

emotion.¹⁷ Moreover it has a biological basis. Neuropsychologists have shown that it is associated with increased levels of phenylethylamine, an amphetamine-related compound. Interestingly, the same distinct biochemicals are also to be found in other animal species, such as birds, which also evince this emotion. However, it appears that this emotion is ephemeral. After a period of attachment the brain's receptor sites for the essential neurochemicals become desensitized or overloaded and the infatuation ends, setting up both the body and brain for separation—divorce. This period of infatuation has been shown to last for about 3 years. A cross-cultural study of divorce patterns in 62 societies between 1947 and 1989 found that divorces tend to occur around the fourth year of marriage!

A universal emotion with a biological basis calls for an explanation. Socio-biologists maintain that in the primordial environment it was vital for males and females to be attracted to each other to have sex and reproduce and also for the males to be attached enough to the females to look after their young until they were old enough to move into a peer group and be looked after by the hunting-gathering band. The traditional period between successive human births is four years—which is also the modal period for those marriages which end in divorce today. Darwin strikes again! The biochemistry of love it seems evolved as an 'inclusive fitness' strategy of our species.

The capacity to love may be universal but its public expression is culturally controlled. For, as everyone's personal experience will confirm, it is an explosive emotion. Given its relatively rapid decay, with settled agriculture the evolved instinct for mates to stay together for about four years and then move on to new partners to conceive and rear new young would have been dysfunctional. Settled agriculture requires settled households. If households are in permanent flux there could not be settled households on particular parcels of land. Not surprisingly, most agrarian civilizations sought to curb the explosive primordial emotion which would have destroyed their way of making a living. They have used cultural constraints to curb this dangerous

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hominid tendency by relying on arranged marriages, infant betrothal and the like, restricting romantic passion to relationships outside marriage. The West stands alone in using this dangerous biological universal as the bastion of its marriages as reflected in the popular song 'love and marriage go together like a horse and carriage'.

The reason for this Western exceptionalism goes back to the earliest period of the Christian Church, as we have seen. But the Church also had to find a way to prevent the social chaos which would have ensued if the romantic passion its greed had unleashed as the basis for marriage had been allowed to run its course in what remained a settled agrarian civilization. First, it separated love and sex, and then created a fierce guilt culture based on Original Sin. Its pervasive teaching against sex and the associated guilt it engendered provided the necessary antidote to the 'animal passions' that would otherwise have been unleashed by the Church's self-interested overthrowing of the traditional Eurasian system of marriage. But once the Christian God died with the Scientific and Darwinian revolutions, these restraints built on Original Sin were finally removed. The family as most civilizations have known it became sick in the West, as the Western humanoids reverted to the 'family' practices of their hunter-gatherer ancestors.

Within Western cosmologies there was, however, another way to deal with the death of the Christian God, rather than rely on these continuing secular variations on Augustine's 'City' to provide the moral cement of its society. These were the views associated with the Scottish Enlightenment—in particular of its most eminent sages: David Hume and Adam Smith.

Hume, unlike the *philosophes*, saw clearly that Reason could not provide an adequate grounding for morality. As Nietzsche was later to say so trenchantly about utilitarianism, any such attempt would be unsuccessful because: 'moral sensibilities are nowadays at such cross purposes that to one man a morality is proved by its utility, while to another its utility refutes it'. Kant's attempt to ground a rational morality on his principle of universalisability—harking back to the

biblical injunction 'therefore all things whatsoever ye do would that men should do to you, do even so to them'—founders on Hegel's two objections: it is merely a principle of logical consistency without any specific moral content, and worse it is as a result powerless to prevent any immoral conduct that takes our fancy. The subsequent ink spilt by Western moral philosophers has merely clothed their particular prejudices in rational form.

By contrast, Hume clearly saw the role of morality in maintaining the social cement of society and that it depended on a society's traditions and forms of socialization. Neither God nor Reason needs to be evoked (or can be) to justify these conditioned and necessary habits. This is very much the view about ethics taken by the older non-Semitic Eurasian civilizations whose socialization processes are based on shame.

However, as this account shows, there is no reason whatsoever for the rest of the world to follow this peculiar and particular Western trajectory. It is not modernization but the unintended consequences of Pope Gregory I's family revolution which have led to the death in the West of the Eurasian family values the Rest rightly continue to cherish. The Rest do not have to embrace this cosmology.

4. Democracy and Development

This leads on to the final aspect of the 'Asian values' case and that is the counter-factual question underlying the West's current moral crusade to legislate its 'habits of the heart' worldwide: is there any necessary link between democracy and development?

A number of cross-sectional statistical studies claim to have found such a relationship. But the statistical proxies used for the political variables in these studies do not inspire much confidence, which are further plagued by the econometric problem of identification. In our recent book¹⁸ Hla Myint and I found no relationship between the form of government and economic performance during the 30-year economic

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histories of the 25 developing countries that we studied. Rather than the polity, the initial resource endowment, in particular the availability or lack of natural resources, was a major determinant of policies which impinged on the efficiency of investment and thereby the rate of growth. This was basically due to the inevitable politicization of the rents that natural resources yield, with concomitant damage to growth performance. By contrast, resource-poor countries, irrespective of the nature of their government, were forced to develop their only resource—their human subjects. Thus the economic performance of resource-poor countries like the Far Eastern Gang of Four tended to be much better on average than that of those with abundant natural resources like Brazil and Mexico. Countries like India and China, whose factor endowments fall in-between these extremes, swerved between following the policies of their resource-abundant and resource-poor cousins, with a resultant indifferent intermediate economic performance. The difference in performance was further explained by the other major determinant of growth—the volume of investment. Thus whilst the efficiency of investment in India and China during both their *dirigiste* and more economically-liberal periods was about the same, China's investment rate has been about twice that of India's, resulting in its growth rate also being twice as high.

If differences in the polity cannot explain differences in economic performance, is there any reason to prefer one type of polity over another—in particular democracy over some authoritarian alternative? As usual, de Tocqueville is both succinct and prescient. In his *Ancien Régime* he wrote:

It is true that in the long run liberty always leads those who know how to keep it to comfort, well-being, often to riches: but there are times when it impedes the attainment of such goods; and other times when despotism alone can momentarily guarantee their enjoyment. Men who take up liberty for its material rewards, then, have never kept it for long ... what in all times has attracted some men to liberty has been itself alone, its own particular charm, independent of the

benefits it brings; the pleasure of being able to speak, act, and breathe without constraint, under no other rule but that of God and law.

Who seeks in liberty something other than itself is born to be a slave.

Democracy, therefore, is to be preferred as a form of government not because of its instrumental value in promoting prosperity—at times it may well not—but because it promotes the different but equally valuable end of liberty. However, as the experience of many countries—not only in the Third World—attests, democracy is a frail flower, and India is unique in having successfully nurtured it in such a vast, diverse and poor country. The assault on it during the Emergency merely succeeded in showing how deeply rooted it had become in the Indian soil.

This success needs an explanation. It is to be found in the political habits of different cultures which have been formed as much by the geography of the territory where the relevant culture was formed than any ideology. Thus, China in its origins in the relatively compact Yellow River valley, constantly threatened by the nomadic barbarians from the steppes to its north, developed a tightly-controlled bureaucratic authoritarianism as its distinctive polity which has continued for millennia to our day. By contrast, Hindu civilization developed in the vast Indo-Gangetic plain, protected to a greater extent by the Himalayas from the predation of barbarians to the north. As I argued in *The Hindu Equilibrium*,¹⁹ this geographical feature (together with the need to tie down the then scarce labour to land) accounts for the traditional Indian polity which was notable for its endemic political instability amongst numerous feuding monarchies, and its distinctive social system embodied in the institution of caste. The latter, by making war the trade of professionals, saved the mass of the population from being inducted into the deadly disputes of its changing rulers. At the same time, the tradition of paying a certain customary share of the village output as revenue to the current overlord meant that any victor had little incentive to disturb the daily business of its newly acquired subjects. The democratic practices gradually introduced by the British

have fit these ancient habits like a glove. The ballot box has replaced the battlefield for the hurly-burly of continuing 'aristocratic' conflict, whilst the populace accepts with a weary resignation that its rulers will, through various forms of 'rent-seeking', take a certain share of output to feather their own nests.

There is no intrinsic reason why a particular *form* of polity should be inimical to development, as long as the rulers adhere to the principles of good government so lucidly set out by the sages of the Scottish Enlightenment—Smith and Hume. A good government on this classical liberal view looks upon the state as a civil association, which promotes opulence through promoting natural liberty by establishing laws of justice which guarantee free exchange and peaceful competition. It should not seek to promote some enterprise of its own or seek to legislate a particular morality.

5. Asian Values and Economic Performance

We can now be brief in assessing the role of Asian values in the East Asian economic miracle. The conventional economic explanation—that this success was due to very high rates of savings and investment efficiently deployed, most importantly by making use of the gains from the international division of labour—is all that is required.²⁰

Moreover, the factor endowment story about the political economy of labour abundant–land scarce countries in Lal–Myint (and briefly outlined above) can explain why these countries adopted outward-oriented policies. On the particular forms of their respective polities, as our above argument emphasizes, there is nothing about authoritarianism or democracy *per se* which can be adduced as necessary for development. This leaves the role of familial values, and in particular of the overseas Chinese and their family-based networks of *guanxi* in explaining East Asia's success.

As regards the success of the overseas Chinese and these purportedly neo-Confucian societies, Jenner is surely right in stating that their

success has little to do with China's past but with 'European economics, commercial law, science and technology'.²¹ It was the interaction of these Western institutions with some inherited Asian values which brought about successful development. In the absence of the

dynamic, alien, Western institutions and forms of economic organization ... that have transformed these other countries the familistic values [of the mainland] are more likely to impede than to support change and development. In particular, China is still under the rule of a thinly disguised, pre-modern imperial bureaucracy, unlike those former colonies.²²

A similar explanation and prognosis for different parts of the Chinese world is provided by Pye.²³ Morishima²⁴ also argues that it is deviations from Japan's Confucian past which in large part explain its extraordinary economic success.

Finally, Vogel's²⁵ argument that the meritocratic bureaucratic tradition of China, based on entrance exams, has been an important contributor to East Asia's success can be countered by two examples. India and the UK established modern meritocratic bureaucracies, with considerable social cachet in the late nineteenth century. They compare favourably on every dimension with those of East Asia. But, nevertheless, these mandarins have not been able to improve the economic prospects of their respective countries.

But the most heated debates surround the role of the Chinese family as the agent of a distinctive and productive familial capitalism in the Sinic world. As Whyte notes²⁶ in an excellent survey of the literature on the role of the Chinese family, there has been a virtual 180-degree shift in views. The traditional view associated with Weber and various modernization theorists was that the Chinese family was a major brake on economic progress because its nepotism, initiative-sapping patriarchy and personal rather than universalistic value system would make enterprises based on it inefficient. Now, by contrast, the same Chinese family is being hailed as the engine of growth in the Sinic

world, based on the undoubted success of the family-based businesses of Hong Kong and Taiwan, and the growth of family-based industry in the non-state sector in China. Many of these arguments in favour of familialism, for instance that the form of ‘cronyism’ that goes under the term of *guanxi* is efficient, are just not persuasive—particularly in a broad comparative framework.²⁷ The argument that Chinese families have always been entrepreneurial but have been “cabin’d cribb’d and confin’d” by predatory states, has more merit. The most important reason for taking the optimistic view about the role of the Chinese family in development is the undoubted success of the family ‘mode of production’ in the Sinic world. This needs an explanation.

Whyte argues that as the Chinese family has changed over the last century, many aspects, for example, the strict patriarchy, have altered. At the same time there has been a change in the nature of production relationships in the world economy which has made particular features of the Chinese family economically valuable in this emerging world division of labour. This particular advantage is the flexibility in switching seamlessly from one activity to another which small-scale family-based enterprise offers.

His argument can be put in a wider perspective. Hicks²⁸ characterized the major feature of the Industrial Revolution as the substitution of fixed for circulating capital, as for instance epitomized by the replacement of the ‘putting out system’ by the ‘factory system’. The ‘putting out system’ was of course largely based on household enterprises. What we are witnessing today is a substitution of human for fixed capital in many aspects of industrial production.

Unlike heavy industry, much of industry supplying consumer goods seems to be going ‘bespoke’. This means that instead of mass-produced consumer goods relying on large production lines—called ‘Fordism’ by some in recognition of the revolution in standardized mass production of consumer durables achieved by Henry Ford—the current tendency is to produce differentiated versions of the same good more closely tailored to differing individual tastes. Variety rather than

standardization is the name of the game, in this 'designer' world of commodities in the affluent West. Shifts in its variegated tastes are increasingly reflected in changes in differentiated products to meet this volatile demand. This has created the need for highly flexible production enterprises which can quickly shift from producing one type or variety of the good to another. With scale economies of less importance in these type of 'designer' goods than in the old standbys of Fordist consumerism, small-scale enterprises which can react flexibly to shifts in tastes (designs) are not only not at a disadvantage, but are likely to have a comparative advantage over more traditional and bureaucratically organized firms.

It is this emerging niche that the Sinic family-based enterprises in both mainland China and its smaller outposts in South-East Asia have filled. It is a modern version of the 'putting out' system, where the 'design' capacity, which is human-capital intensive, is located in 'rich' countries. They then have 'virtual factories', with their production bases spread across the world which, using modern telecommunications, convert these 'designs' into the differentiated 'bespoke' consumer goods increasingly demanded by consumers in the West. These 'design centres' are not a monopoly of the West: witness the transformation of Hong Kong from a manufacturing to a service economy which mediates this fickle affluent consumer economy between the 'designers' in the West and the flexible production lines based on family-type enterprises in southern China. This is an ideal environment to unleash the family-based entrepreneurship of the familial business, and the Sinic family has taken advantage of it in a spectacular manner. But without modern communications, and legal and commercial codes it would come to nought.

The importance of Hong Kong for the development of southern China lies as much in its colonial institutional and legal system which has allowed this late-twentieth-century division of labour to be actualized than in its traditional role as an entrepot and financial centre. Thus, as Whyte rightly emphasized, it is the particular conjunctural circumstances at the end of the millennium, rather than any essential-

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ist Confucian attributes of the Chinese family which have made it an engine of growth today, which it was not in the past.

Where cultural factors may have played a part is in the processes of socialization resulting from the notions of 'shame' associated with Sinic cosmological beliefs. These have provided the cement of their societies, and to the extent that they are based on the ancient veneration of the family in Chinese culture, they can also explain the widespread prevalence of that 'delayed gratification' which has led to unbelievably high rates of savings (and thus investment) in these countries. The more that dynastic family interests govern individual choices, the lower is likely to be the private rate of time preference and hence the higher the savings rate. But equally, the same argument should apply to the 'joint-family' based society—India. But its savings rates have been about half of its Far Eastern neighbours, though with the recent acceleration in growth rates associated with the 1991 liberalization this seems to be changing. More important perhaps is the fact that, as Lee Kwan Yew has rightly noted, these 'family'-based societies can still rely on the social safety nets of the family rather than having to create welfare states like the West, which have paradoxically been both a symptom and an indirect cause for the growing erosion of the cement of societies in the West.

Thus, in conclusion, while there is general worldwide acceptance of the material beliefs underlying the institutional changes underpinning the market resulting from Gregory VII's eleventh-century papal revolution, which promote the modernization sought worldwide, there is no need for the non-Western world to accept the cosmological beliefs promoted by Gregory the Great's papal revolution of the sixth century. It is possible to modernize without Westernizing. Rather than heed Mrs Albright's continuing moral crusade in pursuit of Western 'habits of the heart', which are by no means universal, the non-Western world can rightly invoke the ancient biblical injunction: 'Physician heal thyself'.

Endnotes

- 1 'The Gang of Four' was the name given to the four East Asian countries—Korea, Taiwan, Hong Kong and Singapore—by Ian Little in the 1970s. It was then popularised by *The Economist* and since then other synonyms—'Asian Tigers', 'Little Dragons', etc—have proliferated. But Little's appellation pointedly contrasted the policies of 'China's' Gang of Four and these East Asian economic success stories.
- 2 G.L. Hicks and S.G. Redding (1983): 'The story of the east Asian "economic miracle"', parts I and II, *Euro-Asia Business Review*, volume 2, numbers 3 and 4.
- 3 See D. Lal (1994): *The Repressed Economy*, Economists of the 20th Century series, Edward Elgar, Aldershot, chapter 6.
- 4 The real exchange rate is defined as the ratio of the domestic price of traded to non-traded goods. The price of traded goods will be determined by the nominal exchange rate and this provides the link between it and the real exchange rate. For adjustments to shocks it is the movements in the real exchange rate which are relevant, but these are not under the control of the authorities who can, in a managed exchange rate system, merely affect the nominal exchange rate. For a fuller explication of this modern theory of adjustment in an open economy, see D. Lal: *The Poverty of 'Development Economics'*, 2nd revised and expanded edition, Institute of Economic Affairs, London, 1997, pages 144–7, and D. Lal: *The Repressed Economy*, *op. cit.*, chapter 13.
- 5 See D. Lal and H. Myint (1996): *The Political Economy of Poverty, Equity and Growth: A Comparative Study*, Clarendon Press, Oxford, chapter 2 for details.
- 6 This part is based on D. Lal (1998): *Unintended Consequences: The Impact of Factor Endowments, Culture and Politics on Long Run Economic Performance*, MIT Press, Cambridge Mass.
- 7 See P. Colinvaux (1983): *The Fates of Nations*, Penguin, London. This was the definition adopted in Lal (1988): *The Hindu Equilibrium*, Clarendon Press, Oxford, and in Lal (1998), *op. cit.*
- 8 F. Hahn (1973): *On the Notion of Equilibrium in Economics*, Cambridge University Press, Cambridge.
- 9 D. Lal (1998): 'The Communications Revolution and Economic Performance', paper prepared for Nemetria's VIth conference on 'Ethics and Economics', Foligno, Italy.
- 10 Hicks (1979): *Causality in Economics*, Blackwell, Oxford, page 43.

- 11 See H.J. Berman (1983): *Law and Revolution*, Harvard University Press, Cambridge, Mass.
- 12 See C.L. Becker (1932): *The Heavenly City of the 18th Century Philosophers*, Yale University Press, New Haven.
- 13 A. Bramwell (1989): *Ecology in the 20th century—History*, Yale University Press, New Haven. Also see D. Lal (1995): 'Eco-fundamentalism', *International Affairs*, volume 71, July.
- 14 E. Gellner (1993): *The Psychoanalytic Movement—the Cunning of Unreason*, Northwestern University Press, Evanston, Illinois.
- 15 See A. Macfarlane (1979): *The Origins of English Individualism*, Blackwell, Oxford.
- 16 Jack Goody (1990): *The Oriental, the Ancient and the Primitive*, Cambridge University Press, Cambridge.
- 17 See Jankowiak (editor): *Romantic Passion*; and Fisher: *Anatomy of Love*.
- 18 D. Lal and H. Myint (1996): *The Political Economy of Poverty, Equity and Growth*, Clarendon Press, Oxford.
- 19 D. Lal (1988): *The Hindu Equilibrium*, 2 volumes, Clarendon Press, Oxford.
- 20 See Lal–Myint (1996), Lal (1998) for details and references.
- 21 W.J. Jenner (1992): *The Tyranny of History*, Penguin, London, page 172.
- 22 *Ibid.*
- 23 L.W. Pye (1985): *Asian Power and Politics: The Cultural Dimensions of Authority*, Harvard University Press, Cambridge, Mass.
- 24 M. Morishima (1982): *Why Has Japan Succeeded?*, Cambridge University Press, Cambridge.
- 25 E.F. Vogel (1991): *The Four Little Dragons*, Harvard University Press, Cambridge, Mass.
- 26 M.K. Whyte (1996): 'The Chinese family and economic development: obstacle or engine?', *Economic Development and Cultural Change*, volume 45, number 1.
- 27 See, in particular, A. Greif (1994): 'Cultural beliefs and the organisation of society: a historical and theoretical reflection on collectivist and individualist societies', *Journal of Political Economy*, volume 102, number 5.
- 28 J.R. Hicks (1969): *The Theory of Economic History*, Oxford University Press, Oxford.