

Capitalism and its struggle in developing countries assignment



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Capitalism and its Struggle in the Developing Countries Since the development of civilization, more than 5000 years ago, some type of economic system has always been applied. Resources have been scarce and people always have had to decide how to allocate their resources in the best manner. To this day, people have tried many different systems. However, systems as feudalism and mercantilism belong to the past. During more recent times there have been two competing systems, the capitalist system of the west and the communist system of the east.

But with the collapse of the communist regimes in Eastern Europe in the late 1980's and early 1990's there now is only one system still standing. Today there is no argument that capitalism, even if it is not perfect, still is the best economic system to allocate resources, promote economic growth and grant individual liberties. Also, if we look back in the history, the result of capitalism in the west is remarkable.

In 250 years we have gone from a society where most people lived on, or just below subsistence level, to the present day where we live in nice homes, drive cars, go for vacations and have a vast array of different goods to choose from. In this perspective, the economic growth of the Western economies is nothing less than astonishing. However, if we turn our eyes to the developing countries the reality is completely different. Two thirds of the world's population is economically under-developed. More than a billion (1. billion 2004) people live in extreme poverty, meaning that they have less than a dollar to live on per day and almost three billion (2. 7 billion 2004) live on two dollars a day (Global Issues, poverty facts and stats). One may argue that a dollar has a greater buying power in those countries, but still, for <https://assignbuster.com/capitalism-and-its-struggle-in-developing-countries-assignment/>

these people their daily situation is more a struggle for survival than a fulfilling of life. The governments in many of these countries realize as well as anybody else that there are no alternative to capitalism, and they are trying to embrace free enterprise.

They are abolishing trade restrictions, trying to balance their budgets and attract foreign investments as well as through judicial means promote free enterprise. They are getting advice from experts from Western capitalist countries and are getting aid and loans from the IMF. One would expect that with all their effort, and the advice and help they are getting from the Western countries the economic development would be significant. That the third world and the developing countries would take part in sharing the fruits of free enterprise and narrow the gap between the rich countries and the poor.

However, the reality is very depressing. Since the 1960's, for almost every period and every region, the OECD countries have had the greatest growth of all. A few exceptions are China in the recent years and South East Asia some years earlier (Weeks, John 2001). In some parts there has even been a decline. After the collapse and split of the Soviet Union, many of the new countries embraced free enterprise with open arms and applied something that later would be described as “ shock therapy”, to mould their countries into the form of capitalist ones.

However, a decade later in 2000, four of five former soviet countries had declined their output since 1989, an output which from the beginning was fairly modest (Berggren, Niclas 2003). The contrast is remarkable. It is

evident that the capitalistic system has generated considerable wealth in Western Europe and the U. S. but at the same time it is very difficult for the capitalistic system to succeed in the rest of the world. Why? Is it so that entrepreneurship solely exists in the Western culture, and that it is completely strange for the rest of the world?

Obviously not, capitalism has succeeded in different cultures such as the Japanese and the American as well as it struggles in completely different countries in Eastern Europe, South America, The Middle East and Africa. If you visit these countries you certainly see a lot of business activities in marketplaces and vendors in the streets. Also, immigrants from these countries hardly have any trouble to adapt western capitalism upon arriving here. The problem is not the lack of effort of the developing countries or any cultural differences.

The problem lies elsewhere. Economic development is a complex process. In classical economical terms economic growth is defined as increases in four factors; capital, labor, human capital and technology. The objective is therefore to apply an economic policy that generates the greatest increases in these factors. There have been many different theories applying to this, but economists generally agree that economic freedom is essential.

Economic freedom is a relatively vague term.

But it can be defined as when it is possible to enter into voluntary agreements, which are upheld by a strong and predictable rule of law which also protects people's private property. There have been attempts to measure economic freedom. The most ambitious is the Economic Freedom

Index (EFI) which is reported every year in Economic Freedom of the World, going back as far as 1970. This research is an attempt to describe and measure different countries level of economic freedom.

EFI measures 37 different categories divided into 5 groups: size of government, legal structure and security of property rights, access to sound money, freedom to exchange with foreigners and regulation of credit, labor and business. Each category is measured from zero to ten where ten is full economic freedom. Each country gets an index using arithmetic averages of the scores in the different categories. (Berggren, Niclas 2003). Table 1. The table shows that at the top one finds Hong Kong, Singapore and the Western capitalist democracies.

Lower are the South American states, the East European republics and in the bottom, not surprisingly, many African countries. Looking in a longer perspective, since 1990 the fifth of the countries with the highest degree of economic freedom have had considerably faster economic growth than the others. Also the fifth with the least amount of economic freedom, have had the least amount of growth, in fact they have had a negative development. Studies have shown that some categories of economic freedom are more important than others.

Three categories distinct themselves as crucial: The first is the economic structure and the use of markets. The second factor is a functional free market, with free enterprise, privatization, and flexible contract law and less regulations. The final aspect of importance is a strong judicial system, which upholds contracts and agreements, and protects private property. An

efficient economic policy, besides distributing income, protecting the environment and securing human well-being should thus be concerned in promoting the three previously mentioned characteristics.

Or at least be very restrictive in terms of reducing the economic freedom (Berggren, Niclas 2003). Many governments of the developing nations know all this and are trying to apply the knowledge. In the countries of South America and Eastern Europe there have been plenty of efforts trying to establish free enterprise, with privatizations and less restrictions. Also in many of the developing countries there already exist judicial systems that strongly try to protect private property. Then why do these countries not succeed?

One leading theory presented by the economic researcher Hernando de Soto and his team, is that the most important factor in the struggle of the developing countries, is that a large part of their economy is illegal or outside the government supervision because people lack a clear title of ownership. The right to private property is one of the cornerstones that capitalism stands on. The problem for the developing countries is that the legal institutions fail to include the property of the poor. Even though they may be poor, they are not entirely without resources.

Though some may live in sheds, they still own them. Some perhaps have some cattle or a piece of land; others perhaps have a small workshop. They are poor, but they have their labor, their creativity and their will to improve their conditions. The vast majority of the poor are not the ones we see on television in the war zones and the famine disasters, on the very edge of life

and in desperate need of aid, but they are the ones you find in shantytowns in Brazil and Indonesia and in the streets of Delhi and Cairo. De Soto and his team studied four countries: Egypt, Peru, The Philippines and Haiti.

He shows that the people hold an enormous amount of property. However, the property lacks a legal title and is hence as he call it “ dead”. He estimates that in The Philippines 57% of the urban population and 67% of the rural live in “ illegal” houses. In Peru, the comparable percentages are 53 and 81 respectively. The ratio in Haiti and Egypt are even higher. According to the survey, 68% of the people in urban Haiti live in these “ illegal” houses and just about everybody in the rural parts (97%); in Egypt 83% of the urban population and 92% of the rural live in houses that could be referred to as “ dead capital”.

Even though these houses individually are not worth much money, the fact that they are so many makes the total value of all the houses incredibly large. In fact, according to the study, all these houses together are worth more than the value of the rich people’s total assets combined in these countries. The estimated value of all the “ illegal” houses in just Haiti is 5. 2 billion dollars which is about four times the combined value of all the companies acting legally in the country. In Peru the estimated value of all the “ illegal” houses is about 74 billion dollars.

This number is eleven times the value of all the government-owned companies in the nation. If we instead turn to Asia and look at the Philippines we find that the estimated value of all the “ illegal” houses is 133 billion, which is also more than seven times the value of the deposits made in all the

commercial banks in the country. If we look at Egypt the estimation of the value of all the houses that could be referred to as “ dead capital” is about 240 billion, or 55 times the value of all the foreign investments in Egypt.

An estimated value of all the “ illegal” houses in the whole third world and the former communist countries is 9. 3 trillion, which is about the same as the value of all the companies listed on the most important stock markets in the 20 most developed countries (de Soto, Hernando 2000). But what is it that prevents the people from getting a clear title of their property? The problem is the complex bureaucracy and the huge expense necessary to make the registration. As an experiment, the researchers tried to open fabric shop in Lima, Peru.

They worked with the registration process for six hours every day. Still it took them 289 days, with a total registration fee of \$1231. This amount is perhaps not terrifying in our eyes, but in the perspective of the poor it is 31 times the monthly minimum salary in Peru. It is more or less the same in other situations and in other countries. For instance, in Egypt to acquire and register a lot on government owned desert, you need to go through 77 different steps in 31 government and private authorities, together lasting between five and fourteen years.

In Haiti to settle on government owned land one first needs to rent the property for five years and then afterwards buy it. Just to obtain the lease it required 65 steps, together lasting an average of two and a half years, and all this just to lease it for a five year period. To later buy the property, one has to appeal, a process that overall takes twelve years (de Soto, Hernando).

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To us, this bureaucracy is incomprehensible, but it is a familiar sight in many of the developing countries. The people moving in to the cities are not trying to break the law, but the bureaucracy forces them to withdraw from the legal system and thus the shantytowns are created. This huge informal economy is devastating for the economy. Clear and defined property rights are crucial for the economic development. One may not realize it, but imagine a society lacking clear titles of property, thus almost any society in the third world. If you do not have a clear title of your house it is impossible to get bank loans with your house as collateral. Hence you cannot use your property to acquire more capital (Davis, Kevin E. 001). Another problem is that it makes it a lot more difficult to enter into contracts. Since there is no clear title you do not know if your contract partner really owns what he tries to sell. Also, since the economy is informal, there is nowhere to turn if he fails to meet the obligations of the contract. This prevents a diversified and widely spread commerce since you are forced to trade with people you know and trust. Also it makes it more difficult since you have to spend more time trying to obtain information about contract partners and their goods.

For instance if you want to buy a house of someone, you first have to ask the neighbours if he really owns the house and you have to get their acceptance to move in there. Another important feature is that a clear title of ownership makes people responsible. If someone breaks an agreement you can go after their assets, which is impossible without a clear title. Hence it gives an incentive to keep the obligations of the contract (Manji, Ambreena 2006).

The people who are in the informal economy are not there by their own choosing.

In fact they want to be a part of the legal economy. Not perhaps of any moral reasons, but because it is expensive to stay outside. You need to bribe officials and many times you need to buy protection from mafia groups, and you have nowhere to turn if someone breaks a contract with you. The people want to be a part of the legal economy just as much as the government wants them to be, so there should not really be a problem. However, the task is not easy. In some cases the informal economy is bigger than the legal one. To change this in an instant is impossible.

Instead, it is a process in many steps. The bureaucracy needs be lessened, it must to be easier and cheaper to start businesses. Also the government needs to go out to the poor and ask the people to see who owns what. It is a complicated process, but it has been done before. Western Europe, America and Japan have all gone through this process during various times in turning into capitalist countries. Economic development is a complicated process. It has been agreed on that economic freedom and the protection of private property are crucial for economic growth.

However, many of the developing countries fail to include the poor in their economy. It is difficult for them to start businesses and they lack a clear title of property. This means that the poor cannot use their capital to improve their conditions; hence a huge amount of capital is bound up, and cannot be allocated to the most efficient use. To include the developing countries in our prosperity we need to promote economic freedom on all levels, including the poor. References Berggren, Niclas. (2003) “ The Benefits of Economic

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