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# Social Capital and the Global Economy

## *Francis Fukuyama*

### A REDRAWN MAP OF THE WORLD

CONVENTIONAL MAPS of the global economy divide the major players into three groups: the United States and its partners in the North American Free Trade Agreement, the European Union (EU ), and East Asia, led by Japan but with the four dragons (South Korea, Taiwan, Hong Kong, and Singapore) and the People's Republic of China catching up rapidly. This three-pronged geography is said to correspond to major divisions in the approach to political economy: at one pole lie Japan and the newly industrialized Asian economies, which have relied heavily on state-centered industrial policies to guide their development, while at the other extreme lies the United States, with its commitment to free-market liberalism. Europe, with its extensive social welfare policies, lies somewhere in between.

This familiar map, while not wrong, is today not the most useful way of understanding global economic geography. The most striking difference among capitalist countries is their industrial structure. Germany, Japan, and the United States were quick to adopt the corporate form of organization as they industrialized in the late nineteenth and early twentieth centuries, and today their economies are hosts to giant, professionally managed corporations like Siemens, Toyota, Ford, and Motorola. By contrast, the private sectors of France, Italy, and capitalist Chinese societies like Hong Kong, Taiwan, and the marketized parts of the People's Re-

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public of China (PRC) are dominated by smaller, family-owned and -managed businesses. These societies have had much greater difficulties institutionalizing large-scale private corporations; their relatively small companies, while dynamic, tend to fall apart after a generation or two, whereupon the state is tempted to step in to make possible large-scale industry.

The reasons for these differences in industrial structure have less to do with level of development than with a key cultural characteristic, what the sociologist James Coleman has labeled social capital—that is, the component of human capital that allows members of a given society to trust one another and cooperate in the formation of new groups and associations. In this redrawn map of the world, Germany, Japan, and the United States are societies with healthy endowments of social capital and thus have more in common with each other than any of them do with low-trust countries like Taiwan, Hong Kong, Italy, or France. The competitiveness literature of the past decade has it wrong when it describes the United States and Japan as polar opposites with respect to individualism and group orientation. In fact, the strong historical propensity of Americans to form voluntary associations is quite similar to that of the Japanese, and it is no accident that these two societies pioneered the development first of the corporate form of business organization and later the smaller, decentralized network.

Virtually all economic activity, from running a laundry to building the latest-generation microprocessor, is carried out not by individuals but by organizations that require a high degree of social cooperation. As economists argue, the ability to form organizations depends on institutions like property rights, contracts, and a system of commercial law. But it also depends on a prior sense of moral community, that is, an unwritten set of ethical rules or norms that serve as the basis of social trust. Trust can dramatically reduce what economists call transaction costs—costs of negotiation, enforcement, and the like—and makes possible certain efficient forms of economic organization that otherwise would be encumbered by extensive rules, contracts, litigation, and bureaucracy. Moral communities, as they are lived and experienced by their members, tend to be the product not of rational choice in the economists' sense of the term, but of nonrational habit.

A number of forms of social capital enable people to trust one another and build economic organizations. The most obvious and natural one is the family, with the consequence that the vast majority of businesses, historically and at present, are family businesses. Family structure affects the nature of family businesses: the large extended families of southern China or central Italy have become the basis for rather large-scale and dynamic enterprises. Beyond the family, there are kinship ties like the lineages of China and Korea that expand the radius of trust.

Families, however, are a mixed blessing with regard to economic development. The most important form of sociability from an economic standpoint is the ability of strangers (that is, non-kin) to trust one another and work together in new and flexible forms of organization. This type of spontaneous sociability is frequently weakened by cultures that emphasize family relationships to the exclusion of all others. In many cultures, there is something of a tradeoff between the strength of family ties and the strength of non-kinship bonds. Moreover, if familism is not accompanied by the strong emphasis on education and work in Confucian or Jewish cultures, for example, then it can lead to a stifling morass of nepotism and inbred stagnation.

## THE SIGNIFICANCE OF SOCIAL CAPITAL

TRUST VARIES from one society to another. Japan is typically portrayed as a highly group-oriented society, while the United States is seen as the epitome of individualism. In fact, both societies are quite similar to one another insofar as they have both historically been relatively high-trust societies. American society has always been characterized by a dense network of voluntary associations—private schools, hospitals, choral societies, literary clubs, Bible study groups, and private business organizations both large and small. Indeed, Alexis de Tocqueville saw this art of association as a key virtue of American democracy, one that served to moderate the political system's inherent tendency toward individualism by schooling people in social cooperation and public-spiritedness. These countries were among the first, both chronologically and within the time frame of their own development, to form large-scale, hierarchical, professionally managed corporations in which ownership was dispersed and separated from management.

The significance of social capital to an economy becomes clear when contrasting a high-trust society like Japan with a low-trust society like China. The industrial structure of capitalist Chinese societies, including

Hong Kong, Taiwan, and the market sector of the PRC, is characterized by small scale. In *Fortune*'s list of the 150 largest Pacific Rim firms, only one—a state-owned petroleum company—is Chinese. Taiwan has a GDP 5 percent as large as Japan's, but its 10 largest companies are only 2 percent as large (by revenues) as Japan's 10 largest. There is a strong cultural resistance in Chinese society to bringing in unrelated professional managers; as a consequence, there are relatively few large, hierarchical, professionally managed corporations of a Japanese variety. While some of these businesses, like the empires of Li Kashing or the late Y. K. Pao in Hong Kong, have grown to be enormous, they remain family-managed at the top and pervaded by kinship ties in their management structures.

The reason for the relatively small scale of Chinese businesses is the centrality of the family in Chinese culture. In sharp contrast to Japan, family relations trump all other social obligations. While the level of trust within families and, to a lesser extent, extended kinship groups like lineages, is high, it comes at the expense of trust between people who are unrelated. Hence the extraordinary difficulty that Chinese firms have in institutionalizing themselves once the founding family passes from the scene. Japanese families, by contrast, are smaller and have exerted a much weaker social pull than their Chinese counterparts. Loyalty to groups not based on kinship has eclipsed family relations since at least Tokugawa times, a practice still reflected in the Japanese manager's willingness to abandon spouse and children in favor of work colleagues evenings and weekends.

The contrast between Japan and China is replicated in other parts of the world. Germany is a high-trust society that since medieval times has been crisscrossed by innumerable intermediate associations. Italy, by contrast, has relatively few large private corporations, all of them clustered in the northern industrial triangle. Italy's GDP is two-thirds that of Germany, but its ten largest private companies are only one-third as large as Germany's top ten. The dynamic part of the Italian economy over the past two generations has been the innumerable small-scale family firms that have cropped up in what has come to be known as la terza Italia, or the third Italy, encompassing the central regions of Tuscany, Emilia-Romagna, and the Marche. In certain regions of Italy, the family remains the principal form of social capital; trust among non-kin, as in Chinese societies, is relatively weak and impedes the formation of large, professionally managed corporations. France has never been family-oriented like central or southern Italy but was subject to ambitious centralizing governments that undermined its civil society and created a deficit of intermediate organizations between the family and the state. The French private sector consequently has always been weaker than its German and American counterparts and for many years has been organized around conservative family businesses.

A society may also have neither strong families nor strong associations outside of kinship—in other words, it may be deficient in social capital across-the-board. Edward Banfield, in his classic analysis of a peasant village in southern Italy, described a culture whose families were nuclear, small, and weak. Family businesses remained marginal, and entrepreneurs failed to build factories because they believed it was the obligation of the state to do so for them. The African-American poor in contemporary American inner cities, where single-parent families predominate and larger social groups are weak, are another case. With the destruction of the mir and other traditional communal organizations after the Bolshevik revolution, the Russian countryside lost any significant associational life outside of the collectivized state farms, and the Russian peasant family was at the same time troubled and weak. One of the reasons that decollectivization of agriculture in China has been so much easier to implement than in Russia is the enduring strength of the Chinese peasant household, which became the backbone of a revitalized countryside after the economic reforms of 1978. It would appear that in many contemporary African cities, older political structures and family ties have broken down with rapid urbanization but have not been replaced by strong voluntary associations outside of kinship. Needless to say, this kind of atomized society does not provide fertile ground for economic activity, supporting neither large organizations nor family businesses.

One notable thread that runs through such societies is that of delinquent community: the strongest community structures tend to be criminal organizations. It is as if there is a natural, universal human impulse toward sociability, which, if blocked from expressing itself through social structures like the family or voluntary organizations, appears in forms like criminal gangs. Indeed, mafias have appeared as a major form of social organization precisely in places like southern Italy, the American inner city, Russia, and many sub-Saharan African cities, which lack social capital.

This map is not immutable. There are indications that the American art of association has been in serious decline over the past couple of generations and that Americans are becoming as individualistic as they have always believed themselves to be. Social capital, just like economic capital, will be depleted if not periodically renewed.

## CORPORATE TRUSTS

IT IS NOT clear that the inability of low-trust societies to create large-scale organizations constitutes a particular constraint on rates of aggregate economic growth, at least in the early phases of industrialization. What small companies give up in terms of financial clout, technological resources, and staying power, they gain in flexibility, lack of bureaucracy, and speed of decision-making. Throughout the 1980s, Italy's economy and those of other familistic Latin Catholic societies in the EU grew faster than Germany's. Those who, like Max Weber, argued that Chinese familism would impede economic modernization were simply wrong. Indeed, it is likely that small Chinese and Italian family businesses will prosper more than large Japanese or German corporations in sectors serving fast-changing, highly segmented consumer markets. If the only objective of these societies is the maximization of aggregate wealth, then they have no particular need to move beyond relatively small-scale family businesses.

The primary impact of spontaneous sociability would appear to be not on growth rates but on industrial structure—that is, the number and importance of large versus small corporations in a national economy and the ways in which they interact. Culture inhibits the growth of large companies in some societies, permits it in others, and stimulates the emergence of new forms of economic enterprise, such as the Japanese network organization, in still others. Industrial structure, in turn, determines the sectors of the global economy in which a country participates. The purpose of large corporations is to exploit economies of scale in sectors that are capital-intensive, involve complex manufacturing processes, or require extensive distribution networks. Small companies, on the other hand, tend to be better at organizing more labor-intensive activities and cluster in sectors demanding flexibility, innovativeness, and speed in decision-making. A society hosting giant corporations will gravitate toward automobiles, semiconductors, aerospace, and the like, while those inclined toward small businesses will tend to concentrate in industries like apparel, machine tools, and furniture.

In the absence of a wide radius of trust and an inclination for spontaneous association, a society has two options for building large-scale economic organizations. The first has been exploited from time immemorial: use of the state as a promoter of economic development, often directly in the form of state-owned and state-managed enterprises. Taiwan, for example, has always had a large state sector, which at one time accounted for almost 30 percent of GDP. While declining in importance over time, the state sector was critical to Taiwan's ability to develop industries requiring large scale, like petrochemicals, aerospace, and defense. The Italian and French states have had to step in repeatedly to shore up failing large private companies and the employment they created. The state was particularly critical to France's drive to be a player in certain high-tech fields where scale was important. In low-trust societies like Taiwan, France, and Italy, the absence of private, large-scale firms leads to a saddle-shaped distribution of enterprises, with numerous dynamic small firms at one end of the scale and a small number of large, state-supported companies at the other.

Large organizations in a low-trust society may also be built through foreign direct investment or joint ventures with large foreign partners. This route has been taken by many of the fast-developing states of Southeast Asia: a list of the largest companies in countries like Singapore, Malaysia, or Thailand will often include, besides state-owned companies, local subsidiaries of major multinationals. This pattern also holds true in much of Latin America and seems to be developing in parts of the former communist world as well.

One might argue that because the failure to generate large-scale economic organizations in the private sector can be overcome either by the intervention of the state or through foreign investment, the whole issue of spontaneous sociability is, in the long run, not important. In some sense that is true: France, despite the weakness of its private sector, has still managed to achieve front-rank status as a technologically advanced power through its state-owned and subsidized companies. There are, however, important caveats to this line of argument. State-run companies are almost always less efficient than their private counterparts: managements are constantly tempted to base decisions on political rather than market criteria, and strategic state investment may be misdirected because of simple miscalculation. In some cultures state-run companies can be better managed than in others, and mechanisms exist to shield them from political pressures. But though parastatals in Singapore and Taiwan may have been run better than those of Brazil or Mexico, they still have tended to be less efficient and dynamic than their private-sector counterparts.

Foreign direct investment causes problems of a different sort. The technology and management skills brought in by foreign multinationals ultimately diffuse into the local economy. But that can take many years. In the meantime, countries whose leading companies are subsidiaries of foreign corporations face problems starting competitive businesses owned and managed by locals. Many of the fast modernizers in Asia like Japan, Korea, and Taiwan permitted inflows of foreign capital but constrained direct investment by foreign multinationals in order to give native businesses a chance to ramp up to global standards.

## THE CONFUCIAN COMPLICATION

GIVEN THE sharp contrasts between the economic cultures of China and Japan noted above, there is no single Asian model of economic development and no unified Confucian challenge to the West. There are, of course, aspects of culture common to virtually all East Asian societies. Among these is respect for education, which has been shared equally by Japanese, Chinese, Koreans, and the other cultures touched by Confucianism in a significant way. Similarly, all East Asian cultures share a strong work ethic. All these societies have come to terms with the legitimacy of worldly labor; aristocratic or religious values disdaining commerce, money-making, and the dignity of everyday work have largely disappeared. Finally, in most Asian societies, the state has played a rather large and active role in shaping the direction of economic development. That is far from a universal characteristic of Asian development, however. There is wide variation in the degree of state intervention throughout East Asia, from the hyperactivity of the Korean state in the Park Chung Hee period to the almost totally laissez-faire administration of the British colonial government in Hong Kong.

In terms of sociability, however, there are major differences between Japan, China, and Korea, differences that have resulted in distinct industrial structures, management practices, and forms of organization. Many Americans and Europeans tend to see Asia as more homogeneous than it actually is, with Taiwan, Singapore, the PRC, and other states in Southeast Asia rising fast and following the same development trajectory as Japan, only on a later schedule. This view has been reinforced by promoters of the concept of a Confucian challenge from East Asia.

The reality is that Asian countries have been segmented into different sectors of the global economy and are likely to stay there for some time. Japan and Korea, with their large corporations, have moved into areas like automobiles, consumer electronics, and semiconductors that are directly competitive with large North American and European industries. Those sectors are not, however, a natural strength of most Chinese societies, which do better in sectors where flexibility rather than scale is important. There are in fact two rival economic cultures arising in Asia, one Japanese and the other Chinese. Each of these cultures is unified in a literal sense by large network organizations based, characteristically, on generalized social trust in the Japanese case and on family and kinship in the Chinese. These networks obviously interact with each other at many points, but their internal wiring diagrams proceed along very distinct paths.

The difficulties experienced by Chinese societies in establishing large, private, professionally managed corporations are likely to have long-run economic consequences. In sharp contrast to the first half of the twentieth century, when most people believed industrial modernity required gigantic enterprises, the fashion today has swung in the opposite direction, toward the belief that small is beautiful. The latter view, however, drawn largely from the fast-changing computer industry, may well be overdrawn: the future may belong to neither large nor small companies per se, but rather to those societies that can innovate and create the appropriate organizations to meet the needs of 21st century businesses. Japan, Germany, and the United States all have vigorous small companies in addition to their giant corporations. They are more likely to adapt to new organizational requirements than a society like China, in which kinship ties and a deficit of trust continue to act as a constraint. Unforeseen technological developments may restore the prestige of large enterprises, which would create special problems for China.

Moreover, many countries believe that the acquisition of industries in certain key strategic sectors is a good thing in itself, either because they believe that they know better than the market where the best long-run returns will be or else because they are seeking noneconomic ends like international prestige or national security. France and Korea are prime examples, and China is likely to follow suit. The lack of a spontaneous tendency toward large organizations may create particular pitfalls for China because of the problematic character of the Chinese state. The Chinese economy is currently bifurcated into an old, inefficient, and declining state sector (that boasts, among other things, the world's least efficient automobile manufacturing operation) and a new market sector composed mostly of small family businesses or joint ventures with foreign partners. What does not exist in China today is a modern, efficient, private large-company sector. China's astounding rate of aggregate growth in recent years (some 13 percent per year in 1992 and 1993) has been fueled largely by the capitalist small business sector and by foreign investment. These rates of growth have been made possible by the introduction of market incentives into a hugely inefficient command economy. At the moment, China is too poor to worry about the sectoral distribution of its industries; everyone is grateful enough that they are growing at such a rapid rate. There are many basic problems that have yet to be worked out, such as the establishment of a stable system of property rights and commercial law.

But China will face major problems if it catches up to the current per capita income of Taiwan or Hong Kong in the next generation or two. China watchers are familiar with a litany of potential problems that may brake the country's future growth, such as inflationary pressures, absent infrastructure, and bottlenecks from too-rapid development; vast disparities in per capita income between the coastal provinces and the hinterland; and a large number of environmental time bombs that will explode in another generation or two. In addition to facing these problems, however, China will need to develop large, modern, professionally managed corporations. While Taiwan or Singapore might be willing to leave certain high-prestige forms of manufacturing to others while they grow faster along more market-directed lines, the same is unlikely to be true for mainland China. China as a great power is not going to want to be left out of the high end of industrial modernity. China's very size dictates that it eventually develop a balanced economy, including both capital- and labor-intensive sectors; it cannot expect to reach a high level of overall development as a niche player like the small states of East Asia.

The shift from family business to modern corporations is going to be more problematic for the PRC than it was for Japan or the United States, and the state will have to play a larger role. China needs, at a minimum, political stability born of a basic legitimacy of its political institutions and a competent state structure prone neither to excessive corruption nor outside political influence. China's communist political structure, however, lacks legitimacy and, increasingly, competence. It is not at all clear to most observers whether China's political institutions will survive the enormous socioeconomic pressures its headlong industrialization has created, or whether there will even be a unitary state by the 21st century. An unstable China, or a China ruled by a nervous and capricious government, will not be a propitious environment for wise economic policymaking. Nor will an economic environment in which a strong state is constantly required to step in to guide development be favorable to the growth of Chinese democracy.

The contrast between Japanese and Chinese economic culture has important implications for Japan as well. With the latter become an economic superpower in recent years, there has been talk among certain Japanese of a Japanese model for the other nations of Asia, if not other parts of the world. And indeed, the Japanese have a great deal to teach other nations of Asia (not to mention competitors in North America and Europe), which have already benefited greatly from Japanese technology and management skills in the recent past. In terms of industrial structure, however, there is a wide gap between Japan and other Asian cultures and some reason for thinking that it will be difficult for Sinitic societies to adopt Japanese practices. The *keiretsu* system, for example, would seem to be very difficult to export to a Chinese society. Chinese firms and entrepreneurs are too individualistic to cooperate in that fashion and in any case have their own kinship networks to fall back on.

## THE POVERTY OF ECONOMIC DISCOURSE

THERE IS a cautionary tale embedded in the analysis of the ways in which different societies came by their relative endowments of social capital. A common condition applies to many familistic societies experiencing a low degree of trust between non-kin. China, France, southern Italy, and other low-trust societies all went through a period of strong political centralization, when an absolute emperor, monarch, or state deliberately set out to eliminate competitors for power. In such societies, the social capital that existed in the period before absolutist centralization was depleted. Intermediate social structures like the French guilds were first placed in the service of the state and then, after the Revolution, abolished altogether.

By contrast, those societies experiencing a high degree of social trust, such as Japan, Germany, and the United States, never experienced a prolonged period of centralized state power. With political power more dispersed—as in the Japanese and German feudal periods, or as a deliberate result of constitutional structure in the United States—a rich profusion of social organizations could flourish without interference and become the basis for economic cooperation. In Germany, for example, the guilds were never abolished but rather modernized in such a way that they eventually became the basis for that country's much-admired apprenticeship system of industrial training.

The foregoing suggests that societies that rely on a powerful and all-encompassing state to promote economic development run a double risk. Not only will state-supported companies be less efficient and risk breaking national budgets in the short run, but the very intervention of the state may weaken the society's underlying propensity for spontaneous sociability in the long run. France, which enjoyed a dense web of civil associations at the end of the Middle Ages, saw them systematically undercut more than 500 years ago by a modernizing monarchy. To this day, despite countless efforts to decentralize political life and energize the private sector, the French continue to have great difficulties associating with one another spontaneously, outside the framework of centralized, bureaucratic, rule-bound authority.

Awareness of the importance of social capital illuminates the poverty of contemporary economic discourse. For the past decade, the central debate over the global economy has taken place between the neomercantilists and orthodox neoclassical economists. The former group, represented by writers like James Fallows, Clyde Prestowitz, and Chalmers Johnson, have argued that neoclassical economists have ignored the central role of the state in promoting Asian economic development, a role they claim invalidates standard models of market-oriented development. The neoclassicists, for their part, argue that Asian development happened despite state intervention, and they point to failures on the part of Japan's Ministry of International Trade and Industry and other planning ministries.

What both sides in this debate miss is the role of culture. For all their awareness of the peculiarities of Asian development, the neomercantilists are as universalistic in their policy prescriptions as the neoclassical economists. They argue that America's unwillingness to implement an Asian industrial policy is harming its global competitive position. It is clear, however, that both the need for an industrial policy and the ability to implement one effectively are dependent on cultural factors like