

# The Market for Capital

## Social, Financial and Environmental

**The Well-being of Nations:  
The Role of Human and  
Social Capital**

Tom Healy and Sylvain Côté  
OECD, Paris, 2001, 118pp  
ISBN 92 64 18589 5

**THE STUDY** of social capital was one of the great intellectual fashions of the 1990s, with hundreds of books and articles being written. This useful OECD book surveys the social capital literature, integrates it with the more established field of human capital, and says something about what the two mean for the 'well-being of nations'.

In their section on social capital, the authors show that it crosses the social sciences, with four main disciplinary approaches.

The first, which they designate 'anthropological', but which overlaps extensively with another of the 1990s intellectual fashions, evolutionary psychology, examines natural instincts for association. The book that made this link most explicitly was Francis Fukuyama's *The Great Disruption*, but James Q. Wilson's *The Moral Sense* and Matt Ridley's *The Origins of Virtue* were also important.

The second discipline is sociology. Though Robert Putnam is actually a political scientist, his 2000 book *Bowling Alone: The Collapse and Revival of American Community* is the single best survey of changing social association, though it is mainly limited to the American experience. While they are not mentioned in this

book, the Centre for Australian Community Organisations and Management in Sydney, and the Australian Institute of Family Studies in Melbourne, are both doing interesting sociological work on social capital in Australia.

The third discipline is economics. While there are no stand-out books using the 'social capital' terminology, economists have analysed cooperation extensively using self-interest assumptions, and considered what kinds of interactions will give rise to what others call social capital.

The fourth discipline is political science. Again Robert Putnam is most prominent here, for his 1993 book *Making Democracy Work*, which provides an empirical case for what de Tocqueville argued in *Democracy in America*, that voluntary associations make a big difference to how democracy works.

While it is not covered in this book, perhaps because it uses different terminology and lacks an empirical edge, social capital also inter-connects with debates about individualism and community going on in philosophy and political theory.

This volume is not based on any original research, but its synthesis highlights connections obscured in the more specialist literature, and may be useful for policymakers who need to be concerned about the underpinnings of the 'well-being of nations'.

This takes us into debates on how national well-being is measured, and

an appendix on various composite indexes, such as the 'Genuine Progress Indicator', peddled locally by the Australia Institute. The authors report on, but seem a little sceptical of this enterprise, and their main text makes little effort to add human and social capital.

More interesting than trying to add human and social capital is attempting to work out the dynamic between them. They seem to be mutually supportive. The authors describe several studies that find level of education is an important predictor of economic, social and political involvement, and Australian data suggests that the situation is similar here. On the other side of the equation, Putnam finds that children in high social capital families and communities do better at school. There is a 'virtuous cycle' (to use a Putnam phrase) between the two.

There are several reasons why education might be important. It can provide skills that both make individuals feel they can contribute, and encourage others to facilitate their involvement. The educational process can improve social skills and provide social opportunities. At least at the tertiary level, all this is more likely to be true in the US than Australia. There, many colleges require applicants to do community service, more are residential, and there is a greater pastoral care ethos.

In turn, high social capital creates a supportive environment for students,

and makes studying more enjoyable. In Australia, 'emotional health' is the most commonly cited reason for first year university students considering deferring, a statistic almost certainly linked to the large minority with no close friends on campus. Higher levels of social capital on campus would minimise the loss of human capital suffered when students drop out. Appendix C of this book describes some of the research on social capital and schools.

Though the OECD's book misses the important Australian social capital literature, it does refer to Eva Cox's skippable writings, and—to my surprise—an article I wrote for *Policy* in 1998. Unfortunately, they raise this article to disagree with its suggestion (in turn taken from David Green) that the welfare state crowds out voluntary provision of welfare services. Historically, I think Green is right to say that the welfare state took away much of the friendly societies' role, and caused their decline as community organisations.

While this is an historical consequence of the welfare state, its effects in recent decades may be more mixed. Economic theory predicts that if the price of something goes down more of it will be consumed. In that sense if government subsidy of welfare organisations, a major trend over the last few decades, lowers the costs or burdens of involvement, it may encourage volunteering. Certainly, in recent years the welfare state and volunteering have both grown.

The great gap in the social capital literature has been policy proposals. It is not all that surprising then, that in an overview book, the section on policy suggestions is very short. The authors nominate support for families and for voluntary initiatives, community involvement in decision making-processes, use of ICT, and helping ill elderly people stay closer to their families. They could easily have added, given the importance of education,

continuing efforts in that area.

This is all very unexciting, because—with the partial exception of community involvement in decision-making—it simply reflects longstanding policy orthodoxy, not innovative new directions.

Such conclusions are frustrating for policy wonks, but it is (thankfully) difficult for governments to influence social capital directly. Social connection for the sake of it requires a sociability, and perhaps emotional commitment, that has to come from within, whatever prompting others might give. Other forms of social connection occur as incidental to activities carried out for another reason, and unless that reason is persuasive no social capital will be generated. At the margin, governments can through its other policy functions facilitate social capital creation, and avoid its unintentional destruction. A specific social capital policy, however, is almost certain to fail.

*Reviewed by Andrew Norton*

***In Defense of Free Capital Markets: The Case Against a New International Financial Architecture***

By David F. DeRosa  
Princeton, New Jersey  
Bloomberg Press, 2001, US\$27.95  
230 pp, ISBN 1 57660 036 X

***The Volatility Machine: Emerging Economies and the Threat of Financial Collapse***

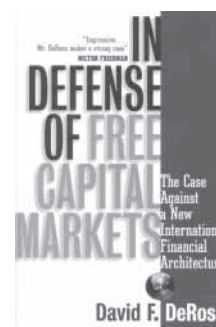
By Michael Pettis  
Oxford-New York Oxford  
University Press, 2001, US\$45.00  
245 pp, ISBN 0 19 514330 2

IT IS FASCINATING to see what two different authors—with different professional backgrounds, networks and different bodies of knowledge—discover when they examine the same

problem. The two authors come up with differing conclusions, which are, I believe, compatible. David DeRosa and Michael Pettis looked at the increasing crises in international financial markets, from the Mexican crisis of 1994-95, the Asian 'meltdown' of 1997 to Russia's end-of-millennium debt default. DeRosa argues that national economies must not be squeezed into regulatory corsets, whereas Pettis advocates an internal bone structure that keeps national economic corpuses in crisis-resilient shape. Let me explain.

DeRosa, academic and journalist with the gilt-edged Bloomberg news service, also looked at the crises that shocked Europe's Exchange Rate Mechanism in the 1980s and at the financial side of Japan's protracted 'economic torpor'. He asked what might be achieved by regulation of international financial and capital markets (dubbed 'The New Financial Architecture'), which anti-market observers, ranging from Fred Bergsten, Eisuke Sasikabara and George Soros to UN bodies, and meddle-happy politicians, such as Clinton, Schröder and Mahathir, have been demanding, as before them *dirigiste* politicians such as Roosevelt.

DeRosa shows through well-documented, insightful case studies that all monetary crises started with wrong-headed policies and mismanagement at home. Capital market interventions and exchange-rate fixes postpone gradual adjustment, so that the unravelling of politically-created market disequilibria comes as an abrupt crisis. Politicians then blame foreign exchange markets rather than their own blunders and market interventions. DeRosa also



Capital markets perform the same functions as the money market. It provides a link between the savings/investors and the wealth creators. The funds will be used for productive purposes and create wealth in the economy in the long term. One of the important functions of the capital markets is to provide ease of transactions for both the investors and the companies. Both parties should be able to find each other with ease and the legal aspect of things should go smoothly. Now let us take a look at the two major types of capital markets. Primary Market. The most important type of capital market is a capital market in which long-term debt (over a year) or equity-backed securities are bought and sold. Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments. Financial regulators like Securities and Exchange Board of India (SEBI), Bank of England (BoE) and the U.S. Securities and Exchange Commission (SEC) oversee capital markets to protect investors against fraud, among Capital market is referred to as a place where saving and investments are done between capital suppliers and those who are in need of capital. It is, therefore, a place where various entities trade different financial instruments. There are two types of capital market: Primary Market. Secondary Market. Capital market is where both equity and debt instrument like equity shares, preference shares, debentures, bonds, etc. are bought and sold. Functions of Capital Market: It acts in linking investors and savers. Facilitates the movement of capital to be used more profitably and productively to Capital markets primarily feature two types of securities – equity securities and debt securities. Both are alternative forms of capital that provide investors with different returns and risks and provide users of capital with different obligations. 1. Equity Securities. Equity securities are traded on the stock market and are essentially securities of ownership into a business or venture. When you own equity securities of a company, you essentially own a portion of that company and are entitled to any future earnings that the company brings in. However, the money that you invest in equity sec Capital markets consist of the primary market, where new securities are issued and sold, and the secondary market, where already-issued securities are traded between investors. The most common capital markets are the stock market and the bond market. Understanding Capital Markets. In this realm, the capital market is where investable capital for non-financial companies is available. Investable capital includes the external funds included in a weighted average cost of capital calculation – common and preferred equity, public bonds, and private debt – that are also used in a return on invested capital calculation. Capital markets in corporate finance may also refer to equity funding, excluding debt. Financial Services.