The Secrets of Intangible Wealth

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A Mexican migrant to the U.S. is five times more productive that one who stays home. Why is that?

The answer is not the obvious one: This country has more machinery or tools or natural resources. Instead, according to some remarkable but largely ignored research – by the World Bank, of all places – it is because the average American has access to over $418,000 in intangible wealth, while the stay-at-home Mexican's intangible wealth is just $34,000.

But what is intangible wealth, and how on earth is it measured? And what does it mean for the world's people – poor and rich? That's where the story gets even more interesting.

Two years ago the World Bank's environmental economics department set out to assess the relative contributions of various kinds of capital to economic development. Its study, "Where Is the Wealth of Nations?: Measuring Capital for the 21st Century," began by defining natural capital as the sum of nonrenewable resources (including oil, natural gas, coal and mineral resources), cropland, pasture land, forested areas and protected areas. Protected, or built, capital is what many of us think of when we think of capital: the sum of machinery, equipment, and structures (including infrastructure) and urban land.

But once the value[s] of all these are added up, the economists found something big was still missing: the vast majority of [the] world's wealth! If one simply adds up the current value of a country's natural resources and produced, or built, capital, there's no way that can account for that country's level of income.

The rest is the result of "intangible" factors – such as the trust among people in a society, an efficient judicial system, clear property rights and effective government. All this intangible capital also boosts the productivity of labor and results in higher total wealth. In fact, the World Bank finds, "Human capital and the value of institutions (as measured by rule of law) constitute the largest share of wealth in virtually all countries."

Once one takes into account all of the world's natural resources and produced capital, 80% of the wealth of rich countries and 60% of the wealth of poor countries is of this intangible type. The bottom line: "Rich countries are largely rich because of the skills of their populations, and the quality of the institutions supporting economic activity."

What the World Bank economists have brilliantly done is quantify the intangible value of education and social institutions. According to their regression analyses, for example, the rule of law explains 57% of countries' intangible capital. Education accounts for 36%.

The rule-of-law index was devised using several hundred individual variables measuring perceptions of governance, drawn from 25 separate data sources constructed by 18 different organizations. The latter include civil society groups (Freedom House), political and business risk-rating agencies (Economist Intelligence Unit) and think tanks (International Budget Project Open Budget Index).

Switzerland scores 99.5 out of 100 on the rule-of-law index and the U.S. hits 91.8. By contrast, Nigeria's score is a pitiful 5.8; Burundi's 4.3; and Ethiopia's 16.4. The members of the Organization for Economic Cooperation and Development (OECD) – 30 wealthy developed countries – have an average score of 90, while sub-Saharan Africa's is a dismal 28.

The natural wealth in rich countries like the U.S. is a tiny proportion of their overall wealth – typically 1% to 3% - yet they derive more value from what they have. Cropland, pastures and forests are more valuable in rich countries because they can be combined with other capital like machinery and strong property rights to produce more value. Machinery, buildings, roads, and so forth account for 17% of the rich countries' total wealth.

Overall, the average per capita wealth in the rich OECD countries is $440,000, consisting of $10,000 in natural capital, $76,000 in produced capital, and a whopping $354,000 in intangible capital. (Switzerland has the highest per capita wealth, at $648,000. The U.S. is fourth at $513,000.)

By comparison, the World Bank study finds that total wealth for the low income countries averages $7,216 per person. That consists of $2,075 in natural capital, $1,150 in produced capital and $3,991 in intangible capital. The countries with the lowest per capita wealth are Ethiopia ($1,965), Nigeria ($2,748), and Burundi ($2,859).

In fact, some countries are so badly run, that they actually have negative intangible capital. Through rampant corruption and failing school systems, Nigeria and the Democratic Republic of the Congo are destroying their intangible capital and ensuring that their people will be poorer in the future. . . .

The World Bank's pathbreaking "Where Is the Wealth of Nations?" convincingly demonstrates that the "mainsprings of development" are the rule of law and a good school system. The big question that its researchers don't answer is: How can the people of the developing world rid themselves of the kleptocrats who loot their countries and keep them poor?