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Book review

The evolution of capitalism, China style

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Linda Lim

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HOW CHINA ESCAPED THE POVERTY TRAP

YUEN YUEN ANG

How China Escaped The Poverty Trap by Yuen Yuen Ang
Ithaca and London: Cornell University Press, 2016

Linda Lim

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The book combines methodological rigour, employing a complexity perspective hitherto unknown in standard political economy analyses, and very clearly charted in causal diagrams throughout, with rich original empirical data drawn from more than 400 interviews conducted between 2006 and 2015.

Illustrative stories drawn from these interviews add considerable colour, and the non-academic reader will probably wish that more were recounted here.

Particularly impressive are the entrepreneurial and leadership qualities shown by so many local bureaucrats and former bureaucrats who successfully transformed collectively owned enterprises into private ones.

But Ang also presents several historical and contemporary cases outside of China where she argues that markets were built with weak institutions, showing that her theory is generalisable to a wide range of countries, including Britain and the United States at earlier stages of their development.

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Is good governance a necessary precondition for economic growth, or does growth itself enable good governance?

This debate among development studies scholars and practitioners is embedded in much of the establishment development policy canon today, informing both "Western and East Asian developmental state" theories of development which emphasise the importance of strong institutions and state capacity, respectively, as necessary precursors or underpinnings of successful growth.

China's historically unprecedented rapid rise from extreme poverty to middle-income status over a mere three-plus decades challenges the conventional view that good governance and successful growth are interlinked (regardless of which causal direction one favours).

Rather, this massive and internally diverse country grew despite highly imperfect governance and institutions.

The reason, argues the Singaporean political scientist Ang Yuen Yuen (my colleague at the University of Michigan), is that China "built markets with weak institutions", in a bottom-up process of "directed improvisation" that allowed markets and institutions to "co-evolve" through different stages of development.

Within broad central government guidelines that changed over time as the economic reform process progressed, the Chinese authorities at each level of a tiered bureaucratic hierarchy were given considerable leeway to meet national goals by devising development strategies that were appropriate to their local circumstances.

These varied from place to place, according to local endowments which included natural resources, geographical location and access to extra-local networks, including offshore diaspora (in Taiwan and Hong Kong). They also varied over time as local (and national and global) conditions changed.

For example, in the early days, many counties employed an en masse "beehive" strategy of attracting any kind of investment that they could, from any source and in any sector, focused on quantity. Targets were assigned to all government agencies regardless of their function, for example, family planning agencies.

Later, once mass investment had led to growth (and its associated problems), professionalised units were set up to target specific investments focused on quality.

As markets evolved, so did institutions to enhance and preserve them - in the parlance of economic strategy, changing locational competitive advantage.

Different localities did not evolve in isolation, but in interaction with one another, and with world markets. For example, as relative resource endowments changed, rising land and labour costs in more prosperous coastal regions pushed labour-intensive manufacturing to relocate to lower-cost inland counties.

This process of dynamic comparative advantage is familiar to and predicted by economists. What Ang's study contributes is detailed discussion of how this happens.

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But Ang also presents several historical and contemporary cases outside of China where she argues that markets were built with weak institutions, showing that her theory is generalisable to a wide range of countries, including Britain and the United States at earlier stages of their development.

"The West" did not have present-day Western institutions when it developed market capitalism centuries ago, any more than China followed an "East Asian developmental state" model to its more recent success, while Nigeria evolved a local film industry which succeeded in regional and global markets despite its notoriously bad institutions.

Convincing as these examples are, one wonders if such bottom- up strategies would work on a national scale in other emerging markets as well as they have in China - chiefly because they would occur without the direction and limitations imposed by China's forward- looking central state authority - that is "improvisation" alone is not "directed improvisation".

It is also less clear how the co-evolution of markets and institutions will work in more developed middle- and upper-income countries, such as China is now, especially where there are domestic political or external market constraints to continued local market and institutional co-evolution.

For example, will dynamic comparative advantage shifts occur as readily across national boundaries, from China to lower-cost foreign countries, when there are no facilitative local relationships as there have been between localities within China? And will such shifts occur, where nationalistic central state authorities might oppose the "transfer of jobs" outside the country?

What if the central state feels politically threatened by the rising market share and thus economic power of private versus state enterprises, and so holds on to the latter rather than permitting privatisation according to market forces?

And what "direction" can a central state provide in an increasingly globalised economy where foreign or multilateral rather than local or national institutions hold sway, and where market forces are defined by increasingly disruptive technological change that cannot be foreseen?

These minor limitations aside, this is an important book with a bold thesis that, at its most ambitious, demands a rethinking of the history and evolution of capitalism, for which China provides a fascinating, and fortunately for scholars, contemporary example.

In terms of policy implications, Ang's thesis has the potential to upend much that the global development establishment holds dear.

Developing countries can rejoice, for this means they can grow their economies without emulating the institutions and governance best practices that evolved in developed countries, West and East. Instead, they can let markets and institutions co-evolve, encouraging bottom-up local enterprise and initiative to devise and pursue development strategies according to ever-changing prevailing local and global conditions.

This is a lesson that is also pertinent for medium- and high-income countries.

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