REVIEWS

Trade Theory Dissidents

Bad Samaritans: Rich Nations, Poor Policies, and the Threat to the Developing World. *By Ha-Joon Chang. London: Random House, 2007. $26.95, cloth. 288 pages.*

The Resistible Rise of Market Fundamentalism: Rethinking Development Policy in an Unbalanced World. *By Richard Kozul-Wright and Paul Rayment. London: Zed Books and Third World Network, 2008. $108, cloth; $36, paperback. 374 pages.*

How the Rich Countries Got Rich . . . and Why Poor Countries Remain Poor. *By Erik S. Reinert. New York: Carroll and Graf, 2007. $26.95, cloth. 365 pages.*

William Milberg

The dazzling economic growth and export performance of China, lifting a quarter of a billion people out of poverty in less than twenty years, has blinded many analysts to the fact that this has been achieved through a variety of unorthodox economic policies: controls on foreign direct investment, a carefully managed exchange rate, a massive state-owned enterprise sector, lax intellectual-property protection, and a plethora of export promotion strategies. Like the Korean and Taiwan miracles of the 1970s and 1980s, the Chinese boom of the 1990s and 2000s has been managed with careful state intervention, regulation, and controls on foreign economic exchange. All these cases would appear to be exceptional from the neoliberal perspective that dominated world politics in the late twentieth century.

Three new books on economic development, however, show that these "miracles" are not exceptional but are very similar to the dynamic of economic development that char-

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acterized the earlier waves of industrialization in the eighteenth and nineteenth centuries in Europe and North America. In these accounts, the neoliberal policy package of free trade, deregulated markets, and austere macro policies bears little resemblance to the policies adopted when the now-developed countries were in the process of industrialization, and to impose such policies on the developing countries today is likely to condemn them to stagnation over the long term. A radical shift in economic development thinking is needed, according to these authors, and each book brings a different emphasis to what amounts to a lively chorus of voices.

Richard Kozul-Wright and Paul Rayment, in *The Resistible Rise of Market Fundamentalism: Rethinking Development Policy in an Unbalanced World,* focus on the need to regulate financial markets and promote a "nexus" between profits and domestic private investment. In *Bad Samaritans: Rich Nations, Poor Policies, and the Threat to the Developing World,* Ha-Joon Chang emphasizes that the policy shift will have to occur against the objection of developed country policymakers who see it as against their interest. And for Eric Reinert, in *How the Rich Countries Got Rich . . . and Why Poor Countries Remain Poor,* the shift requires a reassessment of economic theory and epistemology, away from physics-based, a priori modeling and toward a more experimental model that captures the possibilities for emulating high-productivity industrial economies rather than the static gains from specialization in low-productivity and low-growth sectors.

Together, these books make an impressive case that economic development in the twenty-first century will require a rejection of the neoliberal policies that dominated the economic policy world in the last fifth of the twentieth century and a reliance instead on creative and developmentalist government policies that would closely resemble the industrialization strategies adopted by the developed countries when they themselves were trying to industrialize.

In his previous book, *Kicking Away the Ladder,* Cambridge economist Ha-Joon Chang showed that when the now-developed countries were at the level of development of many of today's developing countries, they were in fact much less open and liberal than today's developing countries are being pressured to be. The point of *Kicking Away* was to show that economic development, even in its first wave in Europe and North America, was driven not by liberalization but by varied forms of state intervention that created, nurtured, and sometimes squelched market activity. *Kicking Away the Ladder* emboldened opponents of the Washington Consensus and brought Chang the Leontief Prize in economics.

In *Bad Samaritans,* Chang has written a popular version of this account. According to Chang, the "official" history of globalization sees economic development in Britain and then in the United States and

elsewhere as the result of free-market policies, first championed by Britain in the late nineteenth century and then, after a few admitted hiccups like the Smoot-Hawley tariffs in the United States, by a broader adoption of liberal policies around the (now) industrialized world. In Chang's version of events, the causality runs in the other direction. Britain and the United States used trade protection, activist industrial policy, and lax intellectual-property-rights regimes to develop.

Only when they had reached a certain threshold of industrialization did these countries find it in their interest to liberalize. Britain was one of the most protectionist countries in the world until the mid-nineteenth century. The United States did not permit foreign banks on American soil until well into the twentieth century. Germany had a clear policy of nonenforcement of its patent laws. In most countries, voting rights were originally based on property ownership. Global integration was largely driven by imperialism, not open markets. These were the true institutional conditions of European and North American industrialization.

But *Bad Samaritans* is not simply "*Kicking Away the Ladder* for undergraduates." The tone is lighter, more freewheeling and personal, but the book is more ambitious than *Kicking Away* and more pointed in its message. For starters, Chang brings the analysis up to the present day, describing his overall project as "rewriting the history of capitalism" (p. 16). Chang shows that the record of economic growth in the neoliberal era (say, since 1980) has been markedly slower than it was in the era of import substitution (1945–1973). According to Chang, "neo-liberal globalization has failed to deliver on all fronts of economic life—growth, equality and stability. . . . The history of economic development in the 19th and early 20th centuries," Chang asserts, "has been rewritten today in order to fit the current neo-liberal orthodoxy" (pp. 26, 28). For Chang, American and European insistence on free market policies in the developing world is hypocritical and self-interested. To Chang (and the others reviewed here), the main beneficiaries of free trade and deregulated markets are those already specialized in technologically advanced, high-value-added sectors, and they in turn make it very difficult for those seeking to become competitive in such sectors. One does not have to dig into ancient history to see this: When Korea suffered a financial crisis in 1997, the international financial institutions called for fiscal and monetary austerity. When the United States suffered a financial meltdown in 2007, the response was a rapid fiscal stimulus and creative and expansionary central bank intervention.

Another the implication of Chang's analysis is that in getting our history backwards, we have also done damage to our theory and especially to our understanding of causality. By Chang's account, in many cases the adoption and promotion of neoliberal polices was made possible—economically and politically—by

successful economic development. Foreign direct investment, often viewed as the panacea of economic development ills, has usually lagged rather than led rapid economic growth. Principles of democracy in politics are also rarely a precondition of economic development, but are one of its wonderful outcomes. Chang's rich treatment of the endogeneity of institutions and policies applies even to culture. He doubts those who assert that some cultures are incapable of economic development. Turning again to history, Chang finds that Germans and Japanese, not too long ago, were considered corrupt (the former) and lazy (the latter), words often applied to severely undeveloped regions today. Chang concludes that culture is not a determinant of economic development (or, as it is often written, of underdevelopment), but that economic development alters culture.

Reinert's *How the Rich Countries Got Rich . . . and Why Poor Countries Remain Poor* is the most ambitious of the books because it seeks an alternative to neoliberalism not just based on the historical facts, which favor his view, but specifically because of its theoretical limitations, especially with respect to international trade. Rooted in Ricardo's principle of comparative advantage, the current theory neglects the possibility that specialization according to relative efficiency leaves many countries producing low-value-added goods or those with slow-growing markets. Ricardo's great error was to ignore the role of increasing returns to scale in production and to focus on the static gains from trade, which, for Reinert, are small in comparison to the dynamic gains from scale and learning. Ricardo's theory is often interpreted as "proving" the optimality of free trade.

Reinert, a professor at Tallinn University of Technology in Estonia, argues that this ignores that such an optimal specialization pattern of global trade will leave some countries specializing in dynamic sectors that have a high growth potential and are eligible for value-enhancing technological improvement. Others would be left with goods that do not have these properties. For these unfortunate countries, free trade can be "primitivizing," that is, it can condemn countries to poverty and stagnation, because the sectors in which they specialize are not prone to productivity growth and do not provide the basis for spillovers to other, new, and high-productivity and high-growth sectors. Thus free trade can produce unequal benefits, since those able to capture scale economies and to benefit from learning and "synergy effects" (cumulative forces that are greater than the sum of their parts and can produce structural change) will see great productivity and market gains. As Reinert puts it, Ricardian trade theory "creates the possibility for a nation to achieve a 'comparative advantage' in being poor and ignorant" (p. 26).

Reinert's purpose is to reintroduce an alternative "canon" of economic thought, based on "experience" rather than physics metaphors, and

in which policy recommendations "depend totally on context and structural issues" (p. 78). He resurrects a number of thinkers from the fifteenth to eighteenth centuries who appreciated the role of technological innovation, increasing returns, and what Reinert calls "emulation" in the development of Europe and later the United States. He goes well beyond the protectionist thinkers—List, Hamilton, Lincoln—that Chang discusses and adds a number of earlier and more obscure figures, including Ernst Ludwig Carl, Antonio Serra, Antonio Genovesi, Philipp von Hornigk, and Wilhelm Roscher. Reinert's review of the economic policies of King Henry VII of England in 1485—including export duties on textiles, tax exemptions for wool manufacturers, the attraction to England of foreign craftsmen—demonstrated to this reader that the strategic trade policy discussions of the 1980s with a focus on imperfect competition, increasing returns to scale, and game theory have a longer heritage than most economists ever imagined!

Of the three books reviewed here, Kozul-Wright and Rayment, two UN economists, provide the most comprehensive proposal for an alternative development policy, bolstered with ample evidence and footnotes to the most recent scholarship. Previous work from these authors is mostly found in UN annual reports in which the deadening UN-ese writing style and the fear of offending member countries has tended to hide the brilliance of the analysis. So this book is a rare moment where they "take off the gloves" and give a sober assessment of the global economy.

After a detailed historical analysis of globalization, in which they use a number of indicators to show that many features of globalization today can be also found in earlier centuries, Kozul-Wright and Rayment offer a rich overview of the actual patterns of economic development over the past half century—a pattern that has been highly uneven geographically, skewed toward the growth of finance rather than production, and characterized by a policy stance that favors inflation-fighting and property rights protection over employment expansion and economic growth.

Neoliberalism has contributed to this state of affairs by limiting the power of the state and by "privileging trade and finance over labour and production" (p. 124). Neoliberalism is underpinned by impressive ethical (radical individualism) and scientific (general equilibrium theory and its applications) foundations, which support a "market fundamentalism" in which markets provide both efficiency and stability, but which ignores the complexity of the development process and especially the dependence of liberalization on capital formation, technological change, and other structural economic changes.

In the real world, the textbook model can mislead. For example, trade liberalization in a country can generate an import expansion without equivalent exports (and thus potentially destabilize the balance of payments), since the country may

have pent-up demand for foreign consumption and capital goods but be unable to compete in export markets. Inward foreign direct investment (FDI) can possibly "crowd out" a developing nation's domestic investment (thus offsetting the employment-creating effect of the FDI) if large and efficient foreign firms are directly competing with domestic entrepreneurs. Global economic integration can lead to excessive entry into manufacturing industries and thus to a decline in developing country terms of trade. This last point is especially important, and Kozul-Wright and Rayment document how developing countries have greatly increased their share of world manufactures exports while their share of world manufacturing value added has remained largely flat.

Among these three books, Kozul-Wright and Rayment have the most comprehensive set of alternative policies that might enter into the new "policy space" created by the abandonment of market fundamentalism. While Chang and Reinert focus mainly on the supply-side issue of technological innovation and the government policies that encourage it, Kozul-Wright and Rayment put aggregate demand (and in particular private domestic investment) at the center of the analysis. They propose a long list of unorthodox policies, organized around a general macroeconomic strategy of building a "nexus" of profits, investment, and exports. The key is the use of government policies of subsidies, low-interest loans, technical support, and—yes—protection from foreign competition that makes production profitable for entrepreneurs and encourages them to reinvest these profits in the pursuit of innovation and global competitiveness. They write:

> We are therefore proposing a development strategy where the central focus is on the creation of local enterprises with a high propensity to invest as a necessary prelude to closer integration with the global economy, and on encouraging the development of a business class that will eventually be able to maintain the dynamic of industrial change and technological upgrading on its own. (p. 305)

The strategy is laid out in detail in the final chapter of the book, beginning with a discussion of the need for financial regulation to diminish the detrimental impact of speculation and financial volatility on output and employment. They propose not only more stringent regulations on banks and hedge funds, but also the use of capital controls and regulation of foreign bank activities. Turning to the nonfinancial sectors, the authors see a need for various forms of industrial policy, the regulation of foreign direct investment, and the use of regional integration to allow the capture of scale economies. Finally, Kozul-Wright and Rayment see a clear role for development aid, using the experience of the Marshall Plan to show how a generous, time-

limited, and well-managed plan can promote development.

For sure, these are three highly critical books—of orthodox economics and of Washington Consensus economic policies. But they are ultimately very optimistic books, all written with the strong conviction that economic development is within the grasp of today's developing countries. By carefully encouraging infant industries, by building skills, technologies, and entrepreneurial activities with adequate incentives and government support along with generous aid and debt relief, and by adopting responsible but expansionary macro policies, developing countries can slowly industrialize and realize the welfare gains that such a transformation has historically brought.

It is only from the perspective of the late twentieth-century policy mindset that these proposals can be considered radical. There is no socialist program here and hardly even a hint of the need for the type of public investment that Keynes called for in the concluding pages of his 1936 *General Theory* in response to inadequate private demand. Instead, we have a vision of capitalist development that is compatible with open markets—after all, integrated markets allow the capture of scale economies—and with well-defined property rights and democracy. While all three books support some form of infant industry protection from foreign competition, they also take the position that eliminating poverty in a sustained way will come only with industrialization and innovation that generates productivity and employment growth. If there is a divide in thinking among progressives in the development world, these books all fall clearly on the side of growth as the best means to poverty reduction.

However, all the authors insist that the now-developed world must take some responsibility for promoting these goals. Conditioning market access and aid on the adoption of strict neoliberal policies that have historically not driven industrialization will not only create obstacles to development, they argue, but will also continue international political tensions over the sharing of the spoils of globalization.

All three books adopt a Schumpeterian perspective, rooting economic development prospects in entrepreneurship and innovation, spurred by industrial policies that are likely to vary across countries based on history, politics, and culture. This perspective is clearly at odds with the Washington Consensus view of the proper role of the state. But some of the criticisms of the World Bank and International Monetary Fund (IMF) heard here have been leveled before. And the banner of Schumpeter, which may be correct, does not provide much detailed guidance for policy. To push the policy discussion forward, these studies would all have benefited from more detail—case studies, even—on how entrepreneurship can best support economic development.

Several questions deserve more at-

tention. First, what types of businesses and business environments have generated the type of reinvestment and innovation that Kozul-Wright and Rayment seek? Second, does innovation leading to improved international competitiveness always and everywhere lead to improved living standards? Third, are higher profits the only way to produce economic development, or is it possible for rising wages to generate the demand needed for growth? And fourth, how does the whole process begin for countries such as Mali, Bangladesh, or even the Democratic Republic of Congo, where capital formation in industry remains very limited? Dipping into the history of the first wave of industrialization for insights on these questions would likely be useful. But the contemporary context of innovation and entrepreneurship in developing countries has new features as well, in particular the emergence of complex supply chains governed by the developed country firms, which would seem to alter the strategic considerations of ownership, management, and labor in the lead firms and for the developing country suppliers.

The neoliberal era may be slowly coming to an end, as borrowing at the IMF window dries up, the Doha Round peters out amid U.S. and EU unwillingness to liberalize agricultural trade, foreign aid practices get attacked from left and right, and, most importantly, as divergence in national growth rates and the persistence of stagnation and high levels of unemployment and poverty in so many countries reveal a deep-seated failure of the Washington Consensus and the need for new ways of thinking about industrialization. Today, even the World Bank has begun to shift away from an emphasis on neoliberalism and toward recognition of the importance of institutions, human capital development, and debt relief.

The simultaneous appearance of these three bold books on the need for a new direction in economic development policy is a clear sign of how the ground is shifting. There is a growing demand for a new model of economic development. The books show in different ways that new ideas can emerge from revisiting some old strategies of economic development and some forgotten economic theories, and from giving each developing-country government policy space to uncover its own mix of markets, regulation, and incentives that best spurs capitalist development. The historically aware and institutionally savvy economists reviewed here have provided resoundingly clear foundations for the cutting-edge development policies that are likely to emerge—in different shapes and forms, no doubt—in the near future.

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