Bloomberg

What the Rest Really Should Learn From the West

By Pankaj Mishra - Dec 15, 2013

In “Free to Choose,” Milton and Rose Friedman first posed the binary of private markets versus state intervention, which would come to underpin World Bank and International Monetary Fund reports, policies and prescriptions for the next two decades. According to the Friedmans, places such as Japan, South Korea, Taiwan, Hong Kong and Singapore had succeeded due to their reliance on “private markets.” India, China and Indonesia had stagnated after “relying heavily on central planning.”

Indeed, the rise of East Asia by the late 1980s appeared to vindicate free traders everywhere. In “The End of History and the Last Man,” Francis Fukuyama claimed that East Asia’s economies, by “repeating the experience of Germany and Japan in the late nineteenth and early twentieth centuries, have proven that economic liberalism allows late modernizers to catch up with and even overtake” the West.

Alarm bells should have rung at Fukuyama’s references to Germany and Japan, two solid exemplars of state-led modernization and economic protectionism. As it happens, the story of East Asia that he and others recounted had only a tangential relationship with the historical record.

In recent years, such economists as Alice Amsden, Sanjaya Lall and Ha-Joon Chang have helped clarify the economic history of the West as well as that of the East. In “Kicking Away the Ladder: Development Strategy in Historical Perspective,” Chang demonstrated how the state in countries now called “developed” -- the U.K., the U.S., France, Germany -- initially sheltered domestic industry through high tariffs and other protectionist policies, and they continued to invest in research and development long after opening up their economies to free trade.

Chang, who was born in South Korea, has criticized these countries for trying to impose policies on developing nations that they had themselves rejected during the early phases of their industrialization. Now the work of clearing cobwebs has received a major boost with the publication of Deepak Nayyar’s “Catch-up: Developing Countries in the World Economy.” Nayyar, one of India’s most distinguished economists, has a better sense of history than most of his compatriots and a suspicion of grand cultural explanations for economic success and failure.

Summarizing much recent scholarship, Nayyar shows that the world economy in the 17th and 18th centuries was defined by Asia’s export of manufactured goods such as porcelain and silk to Europe. India and China accounted for the bulk of this trade, contributing 50 percent of world industrial production as late as 1820.

This pattern was reversed in the 19th century. Parts of Western Europe industrialized, shifted a large proportion of their rural population to productive urban jobs, and found new markets and resources around the world. Advances in transport technologies broke open the small domestic markets that traditional crafts and industries had enjoyed in places such as India and China. The Western state's brute power was also ready, most vividly during the Opium Wars, to protect European "free traders" in Asia.

This was the beginning of the "Great Divergence" whereby some countries produced and exported industrially manufactured goods and the rest became, or were forced to become, exporters of primary commodities. Like Chang, Nayyar unearths an unflattering history of free trade that "locked developing countries into an international division of labour which was not conducive to industrialization or economic growth."

With no structural change possible in their economies and their sovereignty compromised by Western powers, the "Rest" became dependent on industrializing countries "not simply for markets and finance but also as their engines of growth." Revealingly, Latin America, walled off by high tariffs in the late 19th and early 20th centuries, not only escaped de-industrialization, but it also substantially increased its share of world gross domestic product from 1870 to 1950.

It was the bitter experience of "free trade" under the auspices of imperialism that led most postcolonial countries in Asia after 1950 "to start with import substitution in the manufacturing sector." For the most successful of these economies in East Asia, "development was more about the visible hand of the state rather than the invisible hand of the market." And "industrialization," Nayyar adds, refuting Friedman's popular binary, "was not so much about getting-prices-right as it was about getting-state-intervention right." Specific strategies and solutions mattered, such as "the use of borrowed technologies, an intense process of learning, the creation of managerial capabilities in individuals and technological capabilities in firms, and the nurturing of entrepreneurs and firms in different types of enterprises."

Indeed, those countries in Latin America, Eastern Europe and sub-Saharan Africa that swallowed whole the remedies of free-marketeers performed worse than before in the 1980s and '90s. Nayyar identifies 14 countries -- Argentina, Brazil, Chile, Mexico, China, India, Indonesia, Malaysia, South Korea, Taiwan, Thailand, Turkey, Egypt and South Africa -- that have advanced furthest in the process of catching up with the West. In 2010, the share of developing countries in world manufacturing value added was "close to the level that existed around 1850."

Still, Nayyar refuses to subscribe to mechanical theories of a Great Convergence, or a shift of power from the West to the East. Much can still go wrong. Wary of unsustainable generalization, Nayyar rightly points to "different models of industrialization," as well as the great unevenness of growth and deepening inequalities between and within these countries. It is certainly not enough for a developing country to become integrated into global value chains.

It must be "able to make a transition from imports through absorption, adaptation and diffusion." Technological innovation is crucial. This, in Nayyar's sober verdict, remains the final frontier that South Korea and Taiwan managed to cross, but India, China and Brazil have yet to reach.

(Pankaj Mishra is the author of "From the Ruins of Empire: The Revolt Against the West and the Remaking of Asia" and a Bloomberg View columnist.)

To contact the writer of this article: Pankaj Mishra at pmashobra@gmail.com.

To contact the editor responsible for this article: Nisid Hajari at nhajari@bloomberg.net.