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Can an unwilling horse be made drink?

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Abstract: In his critique of the newer approach in economic development emphasizing institutional reforms, Ha-Joon Chang, in his article titled 'Institutions and Economic Development: Theory, Policy and History', equates New Institutional Economics with the program of liberal reforms for least developed countries (LDCs) and blames the former for the alleged failure of the latter. He argues with some justice that the dominant discourse in New Institutional Economics insufficiently appreciates the complexity of institutions; as a consequence, the difficulty of transplanting institutions is largely discounted. His case, however, is marred by his attempt to push down his ideological biases by marshalling inchoate, highly questionable and often contradictory ideas as facts. Going beyond a critical examination of the New Institutional Economics inspired discourse in development economics, he advocates his own version of beneficial development policies for LDCs – namely, economic democracy and industrial policies. His proposals are not only highly questionable, but they amount to adopting a double standard of exempting himself from the very criticisms he levies against New Institutional Economics – ignoring the difficulty of importing foreign institutions. Presuming to play God, like many development economists, he ignores the essential fact that an unwilling horse cannot be made to drink.

The heyday of massive foreign aid as a panacea for the economic development of least developed countries (LDCs) since the 1950s has largely passed. It was a costly experiment that failed (Bauer, 1986; Easterly, 2002). Massive foreign aid to LDCs tended to have little beneficial effect on economic development; much foreign aid was wasted and a good portion pocketed by LDC leaders. If anything, most aid recipients have become corrupt, politically unstable, and often poorer. A newer approach in economic development, influenced by New Institutional Economics, is to pressure LDCs, through International Monetary Fund (IMF) or World Bank loan conditionality or by various trade rules, to reform institutions to align incentives to productive activities. The newer approach represents a significant change from that of *poor-countries-need-capital-to-grow* to that of *poor-countries-need-better-institutions*. Ha-Joon Chang (2011) is highly critical of the new trend of promoting what he calls the Global Standard Institutions (GSIs), 'typically found in Anglo-American countries … seen as maximizing

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market freedom and protecting private property rights most strongly' (ibid.: 2). He argues that the ideas behind GSIs are wrong and that promoting them is harmful to LDCs.

Chang argues that GSIs are neither necessary nor sufficient for economic development: Anglo-American countries did not practice what they now preach to LDCs when they themselves were developing; rather, they deliberately promoted industrialization in their nation-building phase of history. Chang views 'higher-quality institutions' of developed nations (meaning institutions with greater transparency and accountability) as a kind of luxury-goods, demand for which arose only after these nations became richer. 'Better institutions' (by which Chang means the welfare state and labor protection laws) were obtained subsequently only as the working class became more powerful. In other words, GSIs were neither necessary for economic development, nor are they currently practiced in the form recommended by international agencies. Chang further argues that successful latecomers in recent decades – Singapore, South Korea, and now China – have achieved their success not by adopting GSIs, but by following what developed countries actually did to develop – industrial promotion.

So why do many development economists nowadays advise LDCs to adopt GSIs? Could it be a devious scheme to keep LDCs from developing, as Chang (2002) suggests in his book, *Kicking Away the Ladder*? In Chang (2011) he instead argues that it is economists' faulty understanding of institutions that has led to the idea of GSIs as a complement to liberalization policies, often offered as one-size-fits-all solutions to economic development.

Chang criticizes, rightly, institutional economists' over-simplified and mechanistic view of institutions in which the causality flows from certain desirable institutions to the economic outcome. Prone to the Ricardian vice, economists tend to think that GSIs can be easily adopted. Also well taken is Chang's critique on the shortcomings of cross-sectional studies and problems associated with indexation of the quality of institutions. (But then these are general problems of empirical studies, not unique to institutional studies.) Chang's thesis, however, is greatly marred by *ignoratio elenchi* – a number of red herrings, irrelevant arguments, and highly questionable and often contradictory assertions stated as facts. Let me mention the most egregious few:

(1) Chang declares that a free market is impossible; therefore, GSIs meant to promote a free market are will-o'-the-wisps. What he means by a free market is a libertine state in which anyone can do anything without any restriction whatsoever. Since such a state does not and cannot exist on a sustained basis and all operational free markets have an assortment of legal restrictions – including regulated banking, prohibition of child labor and slavery, patent rights, limits on working hours, taxes, and so forth – which differ from one country to another, there cannot be a definition of a free market that everyone can agree on. Therefore, Chang triumphantly claims that a free market is impossible.

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(2) After declaring that a free market is impossible, Chang proceeds to argue that it is inefficient! Be that as it may, he lists as sufficient the conventional textbook reasons for market failure, such as externalities, monopolies and systemic instability. Faulting the real world for falling short of an 'ideal state' he adopts a Nirvana approach. Obviously, he ignores government failure, amply documented by the Public Choice School.

(3) Chang asserts that economies tend to grow more rapidly with government management of the economy than with liberalizing reforms. He observes that compared with the 1960s and 1970s 'economic growth has fallen rather dramatically in developing countries of Sub-Saharan Africa and Latin America ... [after they] faithfully reformed their institutions in the neo-liberal direction during the last three decades' (Chang, 2011: 11). The devastating effect of liberalization was not limited to LDCs. South Korea too suffered a dramatic decline in growth rate after she was forced to adopt GSIs in the aftermath of the financial crisis in 1997. Most significantly, Chang claims that rich capitalist countries also suffered a decline in the growth rate 'during the ... neo-liberal period (1980–2009)' (ibid.: 12) compared with the Golden Age of Capitalism 'between the end of the Second World War and the rise of neo-liberalism in the late 1970s' (ibid.: 12) when they grew twice as fast, with 'tougher business regulations, heavy restrictions on financial activities, nationalization of industry and finance, laws protecting workers, higher taxes (amounting to expropriation of private property), the welfare state, and so on' (ibid.: 12).

A barrage of unsubstantiated assertions does not make a cogent argument, however. If LDCs and rich capitalist countries did so well from 1945 through to the late 1970s, why did many people in these countries feel compelled to try alternatives, such as greater liberalization? Could it be that slower growth rates in the later period were a consequence of the excesses of the earlier period? The growth rate of the South Korean economy indeed slowed considerably following the financial crisis, but not for the reasons that Chang alleges. One of the main reasons is that the Korean economy had grown from a pauper state in the early 1960s to a middle-income country by the early 1990s, and, as a result, she could not grow as fast as she did at an earlier stage of economic development (when she grew sometimes over 15% per annum). Also important were the adverse consequences of decades-long industrial policies (which not only distorted incentives, but brought the legitimacy of the state into question), creating conditions for financial crisis (Choi, 2000). The conditionality of the IMF rescue package for Korea in the depth of the financial crisis did include certain liberalizing reforms, but they were carried out only half-heartedly. What really contributed to the slowing of the Korean economy so that she did not reach her potential were the 10-year-long leftist governments intent on correcting what was widely perceived as undesirable consequences of the industrial policies of the previous three decades through redistribution, regional re-balance, favoritism for labor unions, and, ironically, greater regulations and welfare provisions. Chang's

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assertion that South Korea grew faster under government-managed industrial policies, and slowed after being forced to implement liberalizing reforms in exchange for an IMF bailout in the aftermath of the financial crisis, is grossly misleading.

(4) Chang (2011) declares that GSIs 'inherently favour the rich over the poor, capital over labour, and finance capital over industrial capital' (ibid.: 3). That is why rich people within LDCs are in favor of adopting GSIs. Others who favor GSIs are 'the free-market ideologues [who are] ... "more Catholic than the Pope"' (ibid: 3). A statement such as this may be greeted with admiration for sagacity in some quarters, but it would not go unchallenged elsewhere. If liberalization slows economic growth, as he claims, why would the rich favor it? Would it be possible that the not-so-rich may also favor GSIs, expecting to benefit from the increased opportunity and mobility made possible by liberalization?

(5) Chang argues that strong protection of private property rights is needlessly restricting, and can even be detrimental to, economic growth. His prime example of how the abrogation of existing property rights can contribute to economic development is the post-Second World War Japanese land reform (during the American occupation) in which large (aristocratic) landholders were forced to sell their property to tenant farmers. It is news to me that the presumed agricultural productivity increase was a significant factor in the post-Second World War Japanese economic development.

The specie of private property rights he is most emphatic about doing away with is intellectual property rights (IPRs), which he feels is onerous to LDCs. It is not clear whether he has in mind all IPRs or some IPRs. The onerousness of many modern-day IPRs (creating thriving legal practices) stems not from IPRs as such, but from the explosion (and degradation) of the rights-creating process, and is not limited to LDCs. By failing to distinguish IPRs as such from particular ways in which IPRs are granted (with detrimental effects), Chang ends up condemning IPRs as such. It is like suggesting throwing out the baby with the bath water.

(6) Chang argues that there are viable alternatives to private-property rights, such as 'communal property rights' (ibid.: 8) and 'township and village enterprise of China' (ibid.), as well as state ownership. Believing that market failure is widespread and significant, he asserts that 'state ownership may be more efficient in certain circumstances' (ibid.). He goes on to observe that state-owned enterprises (SOEs) in Singapore, France, Finland, Norway and Taiwan have 'led their country's economic growth process through technological dynamism and export successes' (ibid.). Again, is one supposed to accept his assertions at their face value? Even if it is true that all the SOEs he has in mind were economic dynamos, which is doubtful, he ignores the inconvenient fact that many more SOEs have failed miserably, or became huge drains on resources. One would be well advised to examine closely the conditions under which some succeeded while many more failed before one extols the virtues of the SOEs.

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If the GSIs recommended by international organizations are not good for LDCs, as Chang insists, what should LDCs do? Though the purpose of his paper is mainly to criticize the dominant discourse in institutional economics, Chang says enough for one to infer what might be recommended to LDCs. He suggests that LDCs should learn the best lessons they can: economic democracy and industrial promotion by government. Developed countries by and large practice economic democracy (whose manifestation is the welfare state), even as they preach GSIs to LDCs. If LDCs are to learn from developed countries, Chang reasons, they should learn the latest (and most advanced) practices of developed countries, not what developed countries might have practiced at an earlier stage in their history and still preach to LDCs.[1] Strangely enough, Chang does not raise the very question that he poses to the promoters of GSIs: Can foreign institutions be grafted onto LDCs? Is economic democracy any easier to import than GSIs? He seems to be oblivious of the fact that even richer countries increasingly find it too expensive.

Chang would also strongly recommend that LDCs pursue industrial policies, perhaps spearheaded by SOEs, because that was the way rich countries became rich in the first place, and successful latecomers have caught up. His version of industrial policies would involve 'aggressive investments and therefore a more relaxed approach to inflation ... and a tougher financial regulation, given that their thin financial markets may be more easily manipulated' (ibid.: 14). He does not seem to be concerned that state-directed investments, with a relaxed view of inflation, entail forced savings on the part of the hapless masses. Nor does he seem to care that many industrial policies have, more often than not, turned out to be costly mistakes. One of the reasons why industrial policies often fail is that policy makers are often politicians or bureaucrats, not entrepreneurs. Of course, political leaders sometimes can act as entrepreneurs, which explains occasional success stories such as in the cases of Lee Kwan-Yew of Singapore (Lee, 2000), or Park Jung-Hee of South Korea (Choi, 1994). But entrepreneurial political leaders are rather rare. Leaders in LDCs can learn lessons from the experiences of others. Lessons can be good or bad. Unfortunately, many learned bad lessons (such as African Socialism, dependency theory, and self-reliance) and their countries suffered. Chang's policy recommendations are of that ilk. Leaders of LDCs would be ill advised to follow Chang's lessons.

A few lucky LDCs learned lessons and their countries prospered. Good lessons consist, in one way or another, of allowing entrepreneurs the freedom to capture profitable opportunities and the successful (the productive) to enjoy

1 One cannot help but notice the double standard of many US economists, who prescribed to other nations the bitter medicine of liberalizing institutional reforms (and forcing many major corporations to bankruptcy) in the aftermath of the 1997 financial crisis, but have now rallied at home behind the massive bailouts at all levels since the sub-prime mortgage crisis of 2007. But Chang is drawing a wrong lesson from the hypocrisy of the US economists.

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the fruit thereof. But these few lucky countries were eager learners, willing to figure out exactly what they needed to do given the circumstances. What they learned and put into practice within the context of the particular institutional milieu, however, is not likely to resemble the formulaic lessons academicians or development experts in the West try to impress on LDCs. Chang mistakenly infers from the successful latecomers that LDCs succeeded by deviating from GSIs.

The crucial factor in successful economic development is the willingness to learn on the part of the learner. There would be no learning without the learner's active participation in the process. No matter how eagerly a teacher tries to teach (assuming that the lessons are generally good), he cannot possibly know what precisely the prospective learner needs to learn. If pressured to learn, the unwilling learner will fake, or play games. We see this in classrooms and in LDCs.

Experts at development institutions are 'playing God' as it were, trying to teach the leaders in LDCs what they think are the good lessons for economic development, how to make their countries prosperous. But even potentially good lessons cannot be taught to unwilling learners. Perhaps this is the reason why the various lessons brought to LDCs by the experts from the rich countries or international organizations bear so little fruit. The predicament of GSIs is not so much that the essential lessons are wrong, as Chang alleges, but that there is a lack of political will to put good lessons into practice. *You can lead a horse to water, but you cannot make it drink*. Is there a way to change its mind?

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