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MIXED FORTUNES

AN ECONOMIC HISTORY OF CHINA, RUSSIA, AND THE WEST

VLADIMIR POPOV

Mixed Fortunes

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Jomo Kwame Sundaram, FAO Assistant Director General for Economic and Social Development; UN Assistant Secretary General for Economic Development, 2005–2012.

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Introduction*

Among many puzzles in economic history, the most crucial and intriguing is the 'Great Divergence', the gap in productivity and per capita income between Western and developing countries that started to emerge from the sixteenth century and widened until at least the mid twentieth century. The USSR in the 1920s–60s was the first major non-Western country to experience successful catch-up development and to narrow the gap with the West, although afterwards (1970–1980s) the gap stopped narrowing, and later (1990s) widened. Japan, South Korea, Taiwan, Hong Kong, and Singapore in the 1950–1980s were the only developing states that successfully caught up with the West and became developed. In recent decades, a similar process has been underway in Southeast Asia and China. Together with the recent acceleration of growth of India and some other developing countries, this could mean that we have reached a tipping point in the Great Divergence and that from now on the world will gradually experience global convergence in the level of income.

The goal of this book is to provide a non-technical interpretation of the 'Great Divergence' and 'Great Convergence' stories—the widening of the gap in 1500–1950 and the narrowing of this gap afterwards. The usual explanation is that countries that we now call developed, or the West, acquired in the sixteenth century and beyond some features that were absent in more traditional societies. The list of these features ranges from abolition of serfdom and protestant ethics to protection of property rights and free universities. The problem with this reasoning is that it is assumed that these features emerged initially only in Northwestern Europe and only in the sixteenth–eighteenth centuries. However, in fact, there were many countries before the sixteenth century with social structures that possessed, or were conducive to, many of these same features, but they never experienced productivity growth comparable to that which started in Britain and the Netherlands in the sixteenth century, and later in the rest of Europe (0.2–0.3% a year in 1500–1800 and 1% and more a year afterwards).

* *The opinions expressed herein are strictly personal and do not necessarily reflect the position of organizations with which the author is associated.*

After reviewing the existing explanations in the literature, I present a different interpretation. Western countries exited the Malthusian trap by dismantling traditional collectivist institutions: this was associated with increased income inequality and even decreased life expectancy, but allowed the redistribution of income in favour of savings and investment at the expense of consumption. The elimination of collectivist (community) institutions was a risky experiment that put masses of population below the subsistence minimum and caused a reduction or slowdown of growth of the population, the foundation of the military might (number of people—number of soldiers) in the Malthusian growth regime.

'A great civilization is not conquered from without until it has destroyed itself within'—said Will Durant about the Roman Empire (Durant, 1980), but apparently this diagnosis could explain the collapse of many ambitious civilizations. Early attempts to ensure the priority of the rights of individual over the rights of the community at the expense of collective interests and low inequality (Greece, Rome, Byzantium) led to the impoverishment of the masses, higher mortality, and foreign conquest. Only in Northwest Europe in the sixteenth to eighteenth centuries did this policy somehow succeed for the first time in history.

It is not the abundance of competition or entrepreneurship or ideas for technological innovations that allowed the West to accelerate the growth rates of productivity by an order of magnitude; it is first and foremost the abundance of savings and investment that resulted from growing income inequalities and allowed an increase in the capital/labour ratio and the casting in metal of ideas for new products and technologies. To put it differently, the West became rich not due to its inventiveness and entrepreneurial spirit, but due to the cruel and merciless dismantling of community that previously provided social guarantees to the poorest.

When the same pattern was applied to developing countries (colonialism—Latin America—LA, Sub-Saharan Africa—SSA, or voluntary Westernization in an attempt to catch up—Russian Empire), it resulted in the destruction of traditional institutions, an increase in income inequality, and the worsening of starting positions for catch-up development. This group of countries replicated the Western exit from the Malthusian trap—they experienced an immediate increase in income differentiation, and a rise in savings and investment and in the growth of productivity, but at a price of rising social inequality and deterioration of institutional capacities.[1]

[1] The notion of state institutional capacity is discussed later in the book. It is understood as the ability of the state to enforce rules and regulations and is measured by such objective indicators as crime rate, murder rate, and the share of shadow economy. The weakening of the institutional capacity during the dismantling of collectivist institutions and increase in income inequalities

Other developing countries (East Asia, South Asia, and Middle East and North Africa—MENA) were less affected by colonialism and managed to retain their traditional institutions. This delayed their transition to modern economic growth (Kuznets, 1966) until the mid twentieth century, but allowed them to preserve a good starting position for economic growth—low inequality and strong institutions. Eventually, slow technical progress allowed them to find another (and less painful) exit from the Malthusian trap—increased income permitted a rise in the share of savings and investment in GDP without a major increase in income inequality, without worsening of institutional capacity, and without a decrease in life expectancy.

More Westernized countries of the global South (LA and the Russian Empire) raised their savings–investment rate and exited the Malthusian trap earlier than the rest, in the eighteenth century, but at a price of undermining necessary conditions for future growth—low inequalities and strong institutions. So LA and Russian growth subsequently was not enough to catch up with the West. Colonization of SSA (except for South Africa), unlike colonization of LA and Westernization of Russia, did not result in any considerable transfer of technology and human capital, but only increased inequalities and undermined institutions. So SSA countries were disadvantaged on all counts and had the worst growth record in the world. On the contrary, most of the less Westernized countries of East and South Asia and MENA managed to preserve low inequality and efficient collectivist institutions. Their savings–investment ratios stayed at a level below 10% until the mid twentieth century, so they did not grow before that, but once saving increased it turned out that they had all the preconditions for fast growth. Some of them became economic miracles, rapidly catching up with the West (East Asia), others have sped up their development in recent decades (South Asia), while others (MENA countries) could probably become economic miracles in the future.

To have a closer look at the two trajectories of catch-up development of non-Western countries, I examine in greater detail the differences in institutional and economic development of China and Russia in the long term—the period of socialism and before—and in the short term (since market-type reforms). The roots of the impressive long-term performance of China lie in the exceptional continuity of the Chinese civilization—the oldest in the world, which managed to preserve its uniqueness and traditions without major interruptions. It is argued that institutional continuity (East Asia, South Asia, and MENA) is more conducive to growth than attempts to replace existing institutions with allegedly more advanced institutions imported from abroad (Latin America, Russian Empire, and SSA). Like Russia in 1917,

results from the polarization of the society which is not contained by the community already and is not yet contained by the state.

China re-established collectivist institutions in 1949 as a response to the failure of Westernization. Unlike Russia after 1991, China in 1979–2013 managed to preserve 'Asian values' institutions that are based on the priority of community interests over the interests of the individual. However, the rapid increase in income inequality since 1985 could be a factor leading to a weakening of collectivist institutions, which is the single most important threat to the continuation of fast economic growth.

Socialism in Russia and in China contributed to the restoration of the collectivist institutions—income inequalities decreased and the institutional capacity of the state improved. But, as argued in this book, the centrally planned economy (CPE) could be viable only for 25–30 years because CPEs can make new investment, but cannot replace retiring fixed capital stock efficiently; and because without democracy the leadership lacks control from below. Once physical capital and human capital start to retire, problems emerge and dynamism is lost. In China, 30 years of socialism were allegedly enough to return the country to the trajectory of strong collectivist institutions. In Russia, the CPE and bureaucratic apparatus started to malfunction in the 1960s, but even another three decades of socialism proved to be not enough to return the country to a strong institutional trajectory: once market reforms were carried out in the 1990s, inequalities increased greatly, as did corruption, crime, and the shadow economy.

Whether we try to explain differences in Chinese and Russian economic performance under central planning (China in 1949–79 and Russia in 1917/29–91) or more recently, since the start of market reforms in China (1979) and Russia (1989), various trajectories of institutional development turn out to be the crucial factor. This is not to say that these trajectories totally pre-determine all economic outcomes; other factors, including good and bad policies, certainly do play a role. But, as the saying goes, there is nothing more endogenous than the government policy—it is not easy to have good policies with bad institutions. In practice, there are only so many historical junctions where there is a chance to change policies and to move to a different trajectory of institutional development.

This analysis allows the formulation of the main arguments about the implications of China's rise for the world. Usually these implications are seen in terms of forthcoming geopolitical shifts (China as a new rising superpower, together with, or instead of, the USA), in emerging shortage of resources leading to a new increase of raw material prices, and so on. But there may be less-expected and more far-reaching consequences as well.

First, the rise of China, if it continues, may become the turning point for the world economy because, for the first time in history, a successful economic development on a major scale is based on an indigenous, not Western-type, economic model. Because the Chinese growth model was so successful in ensuring catch-up development, it is no surprise that it is extremely appealing to the developing world. The attractiveness of the Chinese model of economic growth today could be compared with the popularity of the Soviet model of catch-up development in the 'third world' in the 1960s. Even though the Soviet model collapsed, the Chinese model became the logical and natural heir of the Soviet model—it is no longer a centrally planned economy, but it is by no means the model of a liberalized market economy that is recommended by the advocates of Washington and even post-Washington consensus.

Second, the rise of China could lead to the profound reform of world economic order and international relations. Trade protectionism, industrial policy, undervaluation of the exchange rate via accumulation of foreign exchange reserves (also, as argued later, a variety of export-oriented industrial policy), control over the international capital flows (not only short-term, but FDI as well) can become legitimate tools of catch-up development. There may be new regimes of protection of intellectual property rights and technology transfers, new regulations for international trade in energy and resources, new rules for international migration, new agreements about cutting emissions of pollutants (reconsideration of Kyoto protocol), and so on (Montes and Popov, 2011).

In addition, the principles of international relations could change radically as well. The 'Beijing consensus' may not yet be a rigorous term (Ramo, 2004), but it is clear that the Chinese approach to international politics (no interference in domestic affairs, no military interventions, no trade embargoes) provides the developing world with a real alternative of building relations with other countries. China rejects the use of force, embargoes, and sanctions in international politics nearly as a matter of principle. Even in its relations with Taiwan, China always pushed for wider economic and cultural exchanges, while Taiwan authorities resisted. The new rules of the international relations may (1) explicitly limit the use of force to cases of severe violations of non-political rights (i.e. mass repressions, hunger, ethnic violence, etc.) and prohibit the use of force against liberal authoritarian regimes (just for the sake of 'establishing democracy') and (2) prohibit unilateral military interventions (without the consent of the UN).

These 'less-expected' consequences of China's rise are probably already creating more favourable conditions for catch-up development in the South. The result may be the bridging of the gap between the world rich and the world poor, the West and developing countries. Overall, this gap was expanding between 1500–1900, reaching 6:1 ratio in terms of per capita GDP, and it was not closing in the twentieth century—in 2000 the ratio of per capita GDP in the West and in the developing world was still 6:1. Even in the last two decades of the twentieth century this gap was in fact widening for all developing countries as a group, if China is excluded (Wade, 2004). Now, in the twenty-first century, the rise of China could make the dirigisme-based model of catch-up development not only attractive, but also legitimate, and might create a new international economic climate favouring such a catch up. We may well witness 'the triumphal march' of the Chinese model in the South. Not all developing countries have the same institutional capacity as China—the necessary component of the successful non-Western growth model—but many do and those who do not will eventually be compelled to move in the direction of limiting inequality and strengthening institutional capacity.

There could be far-reaching implications for development economics as well. Development thinking of the second half of the twentieth century can hardly be credited for 'manufacturing' development success stories. It is difficult, if not impossible, to claim that either the early structuralist models of the Big Push, the financing gap and basic needs, or the later neo-liberal ideas of the Washington consensus that dominated the field from the 1980s, have provided crucial inputs to economic miracles in East Asia or elsewhere. On the contrary, it appears that development ideas, either misinterpreted or not, contributed to a number of development failures. The USSR and Latin America of the 1960s–1980s demonstrated the inadequacy of the import-substitution model (the debt crisis of the 1980s in Latin America and dead end of the Soviet-type economic model in the 1970s–1980s). Later, every region of the developing world that became the experimental ground for Washington consensus-type theories, from Latin America to Sub-Saharan Africa, to the former Soviet Union and Eastern Europe, revealed the flaws of the neo-liberal doctrine by experiencing a slowdown, a recession, or even a severe depression in the 1980s–1990s.

The policy of multilateral institutions—GATT/WTO, IMF, WB—might have been coherent in its own way: in different periods it was based on a relatively coherent, even though not necessarily the same, set of economic theories (Toye, 2009). But this policy, as well as development theories, cannot be held responsible for engineering development successes, let alone economic miracles. Japan, Hong Kong and Taiwan, Singapore and South Korea, Southeast Asia and China achieved high growth rates without much advice and credit from IMF and the WB (and in case of Hong Kong, Taiwan, and China—without being members of GATT/WTO for a long time).

Economic miracles were manufactured in East Asia without much reliance on development thinking and theoretical background—just by experimentation of strong-hand politicians. The 1993 World Development Report 'East Asian Miracle' admitted that non-selective industrial policy aimed at providing a better business environment (education, infrastructure, coordination, etc.) can promote growth, but the issue is still controversial. Structuralists claim that industrial policy in East Asia was about much more than creating a better business environment (that it was actually picking up the winners),