

Book Reviews

Sung-Hee Jwa. *A General Theory of Economic Development—Towards a Capitalist Manifesto*. Cheltenham, UK: Edward Elgar Publishing. 2017. x+215 pages. Price UK £ 67.50 (Hardback).

1. INTRODUCTION

A General Theory of Economic Development is yet another attempt to demystify the underlining causes of underdevelopment and economic stagnation, and to offer a theory of economic development, which has proved to be an elusive quest for most of the world economies. Apart from a handful of developed economies, most of the other world economies are merely also-rans in the quest for economic development. In fact, even those economies that have been growing at respectable rates over the last decade or two, such as China, cannot yet claim to be developed countries. It is in this backdrop that Sung-Hee Jwa has written this book that offers a theory of economic development. It is a daring attempt as it departs from the standard growth models and development theories and challenges the conventional wisdom. The theory put forth in the book, according to the author, is not only applicable to the developing, or underdeveloped, countries, but is equally applicable to the developed countries, hence meriting the word ‘general’ in the title.

The ideas presented in the book are the culmination of the author’s work on the South Korean economy in which he has traced the development experience of South Korea, which started in the earnest in 1960s. In fact, his other book, *The Rise and Fall of Korea’s Economic Development: Lessons for Developing and Developed Economies* (2017), may be treated as a companion volume to this piece of work. In that book, the author has applied his general theory to the case of South Korea to trace the success of the South Korean economy under President Park, and its recent stagnation. In short, the theory presented in the book is a result of the author’s keen observations and painstaking review of the South Korean economy in particular and some of the other economies of the world in general.

2. A GENERAL THEORY OF ECONOMIC DEVELOPMENT

The book is composed of nine chapters, each serving as a building block for the author’s general theory of economic development. The book begins with the claim that economic development is a relatively recent phenomenon as the developed countries began to progress around the 1850s even though the history of mankind dates back to at least 2.5 million years. Immediately thereafter, the author criticises the economics profession for its detachment from reality and irrelevance for policy-making: “Theory

and policy are now detached more than ever, mostly because, on the one hand, theories have lacked reality from the standpoint of policy-makers of developing economies; and on the other hand, there has been an absence of consensus regarding the theory for actual policy-making and implementation” (p. 2). He also questions the usefulness of the Marxist approach because the policies based on the Marxist ideas call for ‘balanced growth’, which, according to him, have proved to be futile. The author also cites several myths (such as ‘economic development is achievable by all nations’, ‘economic development requires balanced growth’, ‘democracy is a precondition of development’, ‘industrial policy is unfair practice’, etc.) that have wrongly been presented as facts of development in the mainstream growth literature. These alleged myths are dispelled one by one in the following chapters, which serves as foundation to the development of his general theory.

Chapter 2 discusses the nature of development. Simply put, the author envisages economic development as a complex phenomenon. He argues that it goes beyond the question of efficient allocation of resources with which the neoclassical economics has long been preoccupied. He contends that economic development is essentially a complex phenomenon, which, through non-linear interactions among agents, results in qualitative change: “While the issue of linear quantitative growth is still important in understanding development, its fundamental nature consists of increasing complexity created in the evolutionary transformation process from the coach, to railway, to automobile, to aeroplane, to spaceship economy” (p. 17). Rejecting the myth that ‘markets are the elixir of economic development’ (p. 7), the chapter is concluded by asserting that markets alone cannot lead to economic development because of numerous imperfections, including externalities and transaction costs.

In order to present a new theory, it is essential that one points out the flaws and lacunae in the existing theories, a task accomplished by the author in the third chapter. He critiques mainly the neoclassical approach to economic growth and development. The author’s criticism centres on the claim that neoclassical theory is not a realistic depiction because it does not take into account non-linearities, increasing returns, and transaction costs. According to him, the mainstream approach has failed to provide a plausible theory of the firm, which is central to his general theory of economic development. The author also criticises the mainstream approach’s rejection of an active role of the government and the role of industrial policy in economic development. The author contends that the New Institutional Economics (NIE), which is gradually moving away from the mainstream theory, can solve many of the development puzzles. He says, “New Institutional Economics has the capacity to encompass the complexity as well as evolutionary approaches appropriate for dealing with the development of a complex economy” (p. 56). However, the author is of the view that NIE misses the point by focusing too much on the property rights institutions and economic freedom. He claims that the institutions touted as enabling institutions (for economic development) can only do their part if they are aided with the principle of ‘economic discrimination’. Economic discrimination is a term coined in the book by the author, which means ‘treating the differences differently’.

The subject of the next two chapters, i.e. Chapters 4 and 5, is the development experiences of the West and the Northeast Asian countries, mainly Japan, South Korea,

and China. The author terms the development in the West 'extended' because it took a long time for the Western economies to develop. On the other hand, he terms the development in the Northeast Asia 'condensed' because it was achieved in a relatively short period of time (p. 63). It is generally believed that the development process in the West was markedly different from that in the Northeast Asia. In the former region, the economic development is thought to be driven by markets whereas in the latter region, the economic development was a result of active government intervention and directed industrial policy. However, according to the author, in both the regions, it was the synergy among three players, namely the market, the government, and the corporation, which lead to their economic development. As discussed below, these three players are the cornerstone of the author's general theory of economic development.

In Chapter 6, the author appraises the role of the corporation in economic development. He argues that markets have always existed, even in the agrarian economies, but what distinguishes the agrarian economy from the modern economy is the corporation. He criticises the Coasian theory of firm, which, according to Coase, replaces the market. The author, on the other hand, argues that the corporation extends the role of the market, rather than to replace it and, thereby, contributes to economic development.

Having set the stage in previous chapters, the author presents his general theory in Chapter 7. The main purpose of his theory is to overcome the shortcomings of the existing theories that explain the process of economic development. The main idea of the general theory of economic development is 'economic discrimination'. By economic discrimination, the author means providing selective incentives to superior performers in the market. In his words, economic discrimination is "[...] an action of treating economic differences differently, or treating the better economic performers favourably" (p.117). The theory builds upon the idea of the so-called 'holy trinity' of development. The holy trinity comprises the market, the government, and the corporation. The market, in the author's view, discriminates among actors in the sense that it picks winners and favours those who are better performers. This conception of the market contrasts with the conventional view of market, which sees the market as an institution that efficiently allocates resources. According to the author, if market merely played the role of efficient resource allocation, it would not lead to economic development. The author, however, stresses that markets alone cannot lead to economic development and the government should actively aid the market in performing its 'discrimination function', i.e. government should create and reinforce market's discrimination function because market leaders are hampered by the problem of free-riding. In his theory, an active industrial policy is also advocated. The author argues that since the market, if left on its own, picks winners only with insufficient rewards, the government should select better performing industries, or regions, based on their performance in the market. At the same time, he warns that the industrial policy should also keep an eye on the handpicked industries to monitor their performance. The synergies created by the interaction of the holy trinity of economic development lead to non-linear transformation of the economy.

In addition to providing a general theory of economic development, the author also provides a theory of political economy in Chapter 8. He calls his political economy theory a positive theory, which "[...] aims at establishing the analytical framework of the political economy through the lens of economic discrimination" (p. 151). Unsurprisingly,

the author's theory of political economy is also based on the principle of economic discrimination. He argues that political order and ideology should be such that they reinforce the economic discrimination function of the market. He also asserts that political leadership is very important in promoting economic development, of course by aiding and abetting the economic discrimination function, and it should not be "[...] slave of ideology, history and culture" (p.155). Giving the example of South Korea under President Park, the author claims that the policy regime in South Korea was such that it helped those who 'helped themselves', which "[...] helped to transform Koreans into 'self-help people, removing the previous ideology, tradition and culture from them'" (p. 156). The last chapter is a recap of the main points presented in the preceding eight chapters. The author reiterates that smooth functioning of the holy trinity of the market, i.e. the government, and the corporation, aided by the principle of economic discrimination, is must for economic development.

3. CRITICAL EVALUATION

In a way, the general theory presented in this book may be seen as extending the works of various economists who have contributed significantly to our understanding of the economic development process. The author advocates the economic discrimination function to promote unbalanced growth, an idea also put forth by Albert Hirschman, who argued that by creating unbalanced growth, the vicious circle of poverty can be broken down. Similarly, the use of selective industrial policy, to promote best performers, has been advocated by structural macroeconomists and development economists. Ha-Joon Chang (2004, 2002), in his historical analyses of the economic development of Western economies, has also shown that many developed economies used active industrial policy to spur development.

3.1. Main Contributions

The general theory of economic development is an ambitious attempt to provide a new perspective on the process and intricacies of economic development. One of the contributions of his general theory is to recognise the process of development as necessarily complex. He brings into the focus the ideas from the theories of complexity economics, evolutionary economics, behavioural economics, and the NIE to chalk out a holistic view of economic development. The author's general theory breaks away from the traditional view of the economy in which atomistic agents compete against each other, with the belief that self-interest maximising individuals would lead to the overall welfare of the society. The author points out that such a conception of the economy is linear. In this way, economic development is conceptualised as an emergent phenomenon in which agents combine in synergistic interactions to produce economic development. Therefore, synergies among the market, the government, and the corporation make $2+2 > 4$ possible, which is non-linear transformation as opposed to the linear transformation implied by the traditional theory.

Another notable contribution of the author's general theory is expanding the reach of the NIE. The NIE seems to be fixated on the idea that it is the property rights institutions that matter most for economic progress. However, the author, while recognising the role of NIE in enhancing our understanding of the process of economic

development, shows that the institutional framework required for development is much broader than the property rights institutions alone. He argues that those institutions, along with the property rights institution, are important that ensure smooth functioning of economic activities, mitigate transaction costs, and justly reward the better performers through the economic discrimination function of the market. By incorporating the contributions of NIE in his theory, he extends the scope and reach of his general theory. He correctly asserts that when the role of institutions is brought into the picture, something which is absent from the neoclassical theory, economic development becomes a context-specific, or economy-specific, phenomenon. Therefore, one-size-fits-all neoclassical theory cannot be applied to all the economies without distinction. The theory, taking cue from the NIE, also explicitly considers the role of political leadership, as well as the role of ideology and self-help ethos, in economic development.

A strength of the general theory of economic development is the recognition of the active role of the government in economic development. Neoclassical theory, in contrast, allows government intervention only in the event of market failures. The general theory, on the other hand, sees government as an institution that extends the scope of the market by promoting the principle of economic discrimination. The general theory also puts the corporation at the forefront of the economic development process. It acknowledges that the role of the firm as an institution is not merely to organise factors of production and maximise profits, which is an example of linear transformation, but the general theory gives it due credit as an institution that actively engages in innovation, which is the hallmark of a dynamic economy. In fact, it is the firm that makes non-linear transformation possible and helps transform an economy from a coach economy to a space economy.

3.2. Limitations

The theory presented in the book is innovative, compelling, and holds promise as a framework for economic development, both for undeveloped and stagnant developed economies. Nevertheless, the theory outlined by the author displays a few inconsistencies and is problematic in certain respects. Generally, economic development is considered a broader concept than economic growth as economic development does not only mean increasing incomes, but it also means improvement in the standard of living, such as the improvement in education, health, and economic opportunities. Although, the author's general theory alludes to improvement in social conditions, one cannot help but note that he is mainly concerned with the increase in incomes. For example, author attributes "economic polarisation and growth stagnation" to egalitarian educational policies (p. 171). He even argues for the application of the discrimination function to social empowerment policies (p.188). Amartya Sen, in numerous places [see, for example, Sen (2002)] has argued that real development is enhancing individuals' capabilities; and education, along with other means of empowerment, is one of the ways to increase an individual's capabilities.

One of the main conclusions of the general theory of economic development is that economic inequality is a natural outcome of economic development. The author argues that economic inequality spurs competition in the economy and motivates individuals to get ahead of the others because discrimination engenders the self-help

ethos. The empirical evidence, however, shows otherwise. Shin (2012) has shown that income inequality, especially in the early stage of economic development, hampers economic growth. While relatively lower levels of economic inequality could be beneficial for economic growth as it creates healthy competition, extreme inequality retards economic growth because it reduces opportunities of the already disadvantaged sections of the society. Cingano (2014) has also observed that there is a negative association between inequality and economic growth. And we must not forget Hirschman's 'tunnel effect' [Hirschman and Rothschild (1973)], which explains that due to uneven growth, people might initially tolerate increased inequality, and even take pleasure in other's improved economic status, in the hope of catching up; when they fail to catch up, their delight turns into envy and despair [Flehtner (2013)]. Economic inequality can only be acceptable if level playing field is provided to all the agents in the society; only then any resulting inequality may be deemed natural.

Although, the general theory of economic development has broadened the scope of the NIE, the constitution of the complex economy (p. 58) presented in the book, which builds upon the NIE, appears to be linear and unidirectional. The author argues that political leadership is an exogenous institution that determines all other institutions (p. 58). However, economy- and society-wide social interactions are highly complex and endogenous systems, in which it is hard to determine the direction of causality. For example, political leadership in caste-based societies would most likely be different from the political leadership in caste-free societies. Therefore, informal institutions, such as the caste system, can influence the type of political leadership. However, this does not imply that political leadership cannot affect informal institutions. And this leads to the role of political leadership in economic development, which is ascribed a very important role in the author's general theory of economic development. He argues that the right kind of political leadership that can harness popular support and promotes the economic discrimination principle, along with the ideology prevailing in the society and self-help ethos, is a crucial factor for economic development. However, he is silent on how such leadership, ideology, and ethos can be cultivated. Without outlining how this can be achieved, the author's theory is incomplete.

Finally, the author seems to have attributed every problem that has hampered economic development to egalitarian policies, including the financial crisis of 2008 (p. 139). The author's attribution of economic stagnation to egalitarian policies is also noted in another review of the book [Lee (2017)]. Lee (2017) argues that developed economies began to stagnate after the 1970s due to the oil price shock, and not due to egalitarian policies. Furthermore, he also points out that many economies adopted egalitarian policies after the World War II but still developed at respectable rates (pp. 652-653). As far as the financial crisis of 2008 is concerned, many economists have attributed it to excessive financial deregulation and not to the egalitarian policies, as alleged by the author. In fact, when financial giants were about to collapse, it was the government that bailed them out of the crisis. It is an application of the economic discrimination principle, based on size and power rather than market performance.

4. CONCLUDING REMARKS

Any theory cannot be a complete picture of reality but despite a few limitations and lacunae, the general theory of economic development is a step in the right direction.

The author rightly points out that the current policies based on the conventional thinking have borne no fruit and what is needed is an innovative approach to development, which this theory in its essence is. There are many policy prescriptions based on the theory that can be useful for the developing countries, such as Pakistan. For example, the industrial policy in Pakistan should be such that it handpicks better performers and stop supporting those industries that have not been able to perform admirably despite being supported and protected by the government for a long time. Pakistan's exports have stagnated, and the industrial policy based on the economic discrimination principle of the general theory of economic development can help boost exports of the developing countries, Pakistan included.

The author correctly points out that often the political leadership, especially in the developing countries, bow to the pressure of masses and adopt those policies that are 'development unfriendly'. They are myopic in the sense that wanting to be elected, or re-elected, they adopt those policies that appeal to the masses and are not conducive to development. This is where the role of building up of development friendly ethos figures, but the problem is that there is no easy way to build such mindset. Ideologies, self-help ethos, and other such informal institutions are built up over a long period of time and cannot easily change in a short span of time.

Lastly, some of the leading economists of the world, such as Stiglitz and Sen, have called for rethinking development by going beyond merely focusing on the material wealth. Although the material wealth in the world has increased at an unprecedented rate over the last two centuries, but so has deprivation. In such a state of affairs, we cannot wait for the trickle-down effect to take place, as warned by late Mahbub ul Haq. Indeed, for the sake of fairness and help bring the deprived segments of the society out of the vicious circle, egalitarian policies cannot be completely discarded. Combined with the discriminatory industrial policy, egalitarian social policies are needed to be adopted to help people 'help themselves'. At the same time, to safeguard the interests of the corporations, which undertake the innovation and make non-linear transformation of the economy possible, the economic and political institutions need to be strengthened so that they aid the process of economic growth and development. To this end, the author's general theory of economic development, enriched with the lessons from the complexity, behavioural, and evolutionary theories, and the NIE, can take the discourse on economic development forward.

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