“Harness Non-Best Practices to Escape Poverty Traps”

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Executive Summary

Conventional wisdom believes that establishing “best practices” (such as rule of law, strong property rights protection, formal labor regulations) are necessary for economic growth and escaping poverty traps. Poor countries, however, are often unable to implement best practices in the first place because they are poor and lack capacity. Hence, development experts and practitioners are stuck with a chicken-and-egg problem: Which comes first in development—economic growth or good/strong institutions?

Contrary to popular wisdom, my research reveals that the first essential step out of poverty traps is to harness *non*-best practices—rather than Western-style best practices—to build markets. Poor countries typically lack all of the desirable institutions found in wealthy democracies; instead, what they have in abundance are *non*-best practices (such as patronage ties, informal relationships, piracy). Rather than dismiss non-best practices as obstacles to development, I show that they may be creatively adapted to mitigate constraints and kick-start new industries in traditional, low-income countries.

I highlight four policy takeaways:

- Non-best practices may be repurposed to mitigate constraints and build markets in poor economies. Understanding this possibility will expand the toolbox of development assistance,

which has thus far centered on replicating “best practices” found in wealthy economies.

- Close personal networks, diaspora, migration, and new communication technology can play especially useful roles in this mode of development.

- It must be emphasized, however, that the institutions and strategies for escaping poverty are not the same as those needed to sustain development. In other words, *building* markets is not the same as *preserving* markets. Development experts must apply different bundles of strategies that fit different stages of development.

- The idea of “Doing Development Differently” through iterative adaptation is quickly spreading in the development community. My message builds on but goes beyond this agenda by pointing to a neglected source of raw material for adaptation in poor economies: institutions that appear weak, wrong, or backward.

The Chicken-and-Egg Problem of Poverty Traps

Poor countries face a chicken-and-egg problem. In order to escape poverty, it is believed that they must first establish desirable institutions and best practices that are necessary for economic growth, such as rule of law, eradication of corruption, formal labor regulations. Yet in order to implement such best practices, rather than merely copy them in formality, some level of economic development also appears necessary.

In other words, poor countries are poor because they are weak, and they are weak because they are poor. This, in essence, is the nature of "poverty traps."

How is it possible to escape poverty traps? This is the BIG problem of development that has been debated for decades. There are three existing theories, but none are satisfactory.

(a) *Good institutions should come first*: The most popular belief is that good institutions must precede economic growth. The problem with this approach is that it doesn't explain how poor countries can acquire the capacity to establish good institutions in the first place.

(b) *Economic growth should come first*: This is also known among political scientists as modernization theory. The problem with this approach is that it doesn't explain how to jump-start economic growth in poor, backward countries.

(c) *History determines the existence of good institutions*: This argument, exemplified in the best-selling book *Why Nations Fail*, argues that historical experiences (such as colonial legacies) determines the existence of good institutions, which in turn determines economic outcomes. If that were true, it implies that poor countries that lack the right history are doomed. Historical determinism explains how poverty traps form but does not point a way out of them.

In short, after decades of debate and practice, we still lack a solution to the chicken-and-egg problem of escaping poverty traps.

My proposed solution: harness non-best practices to build markets

My research identifies a solution to escaping poverty traps that flies in the face of conventional wisdom: harness non-best practices to build markets. I demonstrate the mechanisms of this approach in my book, *How China Escaped the Poverty Trap*.[1]

Low-income economies have an abundance of non-best practices, i.e., institutions that are inconsistent with Western-style best practices and hence interpreted as weak, wrong, backward, or corrupt. Concrete examples documented in my book include:

- State agencies that do not perform specialized functions (China);
- Getting government officials to use personal connections to perform public duties (China);
- Allowing state agencies to take a direct cut of revenue they collect, also known as prebendalism (China);
- Widespread piracy of intellectual property (Nigeria);
- Communal—rather than private—property rights (late medieval Europe; China in the 1980s);
- Risky, non-transparent methods of public financing (antebellum United States; China in the 2000s to present).

This list, if viewed in isolation, will look like a sure recipe for failure. In fact, they were ingredients for kick-starting manufacturing in China, Nollywood (the world's third largest film industry) in Nigeria, regional trade in medieval Europe, and major infrastructure projects that connected regional economies in America.

This may sound quite incredible. But the historical facts exist, and I have systematically laid them out in my research.

To be clear, non-best practices or corruption do not by themselves lead to economic growth. Rather, it is the ways in which state and/or

[1] Yuen Yuen Ang. *How China Escaped the Poverty Trap*. Cornell University Press, Cornell Studies in Political Economy. 2016.

social actors repurposed existing institutions or practices to fit their tasks at hand that kick-started development.

An Illustration from China

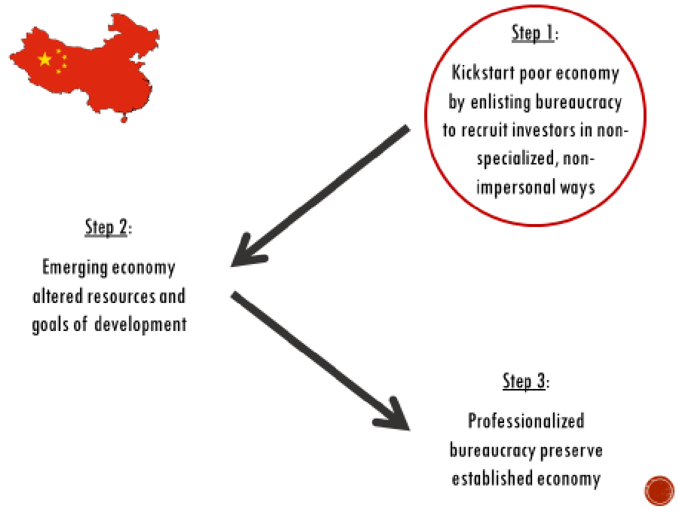
Let me provide an illustration of my findings from China's recent history.

Looking back at the past of wealthy coastal cities in China today, did they escape poverty by first establishing formal property rights, eradicating corruption, and hiring technocratic officials, like in Singapore?

No, they did not. Instead, these places launched development by making the best use of their resources at the time: communist officials with family and friends. Hence, entire bureaucracies, regardless of nominal functions, were dispatched like bees in eager search for investors. In addition, civil servants were tasked to deploy their personal connections to recruit investors, who set up factories and employed workers. Bureaucrats who performed were rewarded with generous bonuses, and those who failed were shamed or slapped with financial penalties. Personal connections between government officials and investors substituted for formal property rights protection at a time when rule of law was weak.

Then as local economies grew, the goals of development evolved: from desiring any investor to quality investors only. These changes subsequently prompted local governments to recruit professionals and formally protect property, such that developed regional economies like Shanghai, today feature both prosperous economies and government agencies that approximate best practices. They did not, however, start out this way.

In other words, development occurred in a three-step, coevolutionary sequence, summarized in the figure below.



What about in the rest of China, which do not enjoy favorable conditions on the coast? Their escape from poverty came much later, and for many, it is only happening now or has yet to occur. Where it has occurred, this late development was triggered by several factors.

First is the migration of labor-intensive, low-wage industries from the coast as their markets saturated. This trend began in the mid-2000s as wages on the coast rapidly rose, and it is still continuing. By 2011, domestic investments that flowed into five central provinces in China reached three-quarters the value of total foreign direct investment to China.

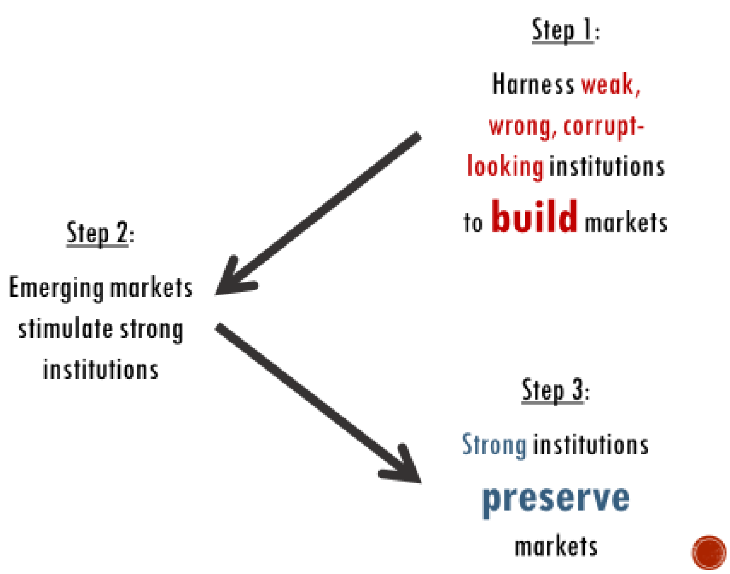
TABLE 6.4 Domestic investment in five central provinces (billion yuan)

	HUBEI	JIANGXI	HUNAN	HENAN	ANHUI	TOTAL DOMESTIC INVESTMENT IN FIVE CENTRAL PROVINCES	TOTAL FDI INFLOW TO CHINA
2008	95	110	123	185	323	836	1,045
2011	338	258	209	402	418	1,624	1,706
Change from 2008 to 2011	+355%	+234%	+170%	+217%	+130%	+194%	+163%

Another factor is the return of migrant workers from the coast to their native towns in central and western China. These workers present an invaluable source of "returnee investments," bringing not only capital but also skills and experience from years of work in coastal cities. Their advantage over non-native investors is that as natives, they know the local language and culture. Moreover, they possess personal networks that help them navigate challenging institutional environments in central and western locales. Their affective ties to their hometowns attract them to make long-term, productive investments.

Development in three interactive steps

Expressed in stylized terms, development is a coevolutionary (mutually interactive) process that occurs in three interactive steps, pictured below.



My theory draws a sharp distinction between two basic stages of development: *building* markets vs. *preserving* markets. The task of building new markets from scratch is not the same as preserving markets that already exist, just as operating a start-up and a large, established company is evidently different.

Given that the tasks of building and preserving markets are different, the institutions that fit each of these tasks must also be different. Facing the first step of escaping poverty, it is sensible to make use of existing non-best practices to mitigate constraints and stimulate entrepreneurship. This lesson can be summed up in one sentence:

Spark change in poor societies
by leveraging what they
already have…not with what
we wish they can have.

What's critically missing in our study of development is knowledge of *how* to spark change by leveraging what exists. Because such instances are so little documented or completely unnoticed, we cannot imagine that it is possible to build markets *with* non-best practices. Understanding this possibility will expand the toolbox of development assistance.

A review of my findings at the World Bank Development Blog expresses optimism about this new approach. Yongmei Zhou writes, "That a poor country can harness the institutions they have and get development going is a liberating message. Nations don't have to be stuck in the 'poor economies and weak institutions' trap. This provocative message challenges our prevailing practice of assessing a country's institutions by their distance from the global best practice and ranking them on international league tables. Yuen Yuen's work, in contrast, highlights the possibility of using existing institutions to generate inclusive growth and further impetus for institutional evolution."[2]

We do not have to throw away all best practices. They work at solving technical problems. But escaping poverty is an economic, social, and political problem for which best practices from already developed economies often don't fit. That is why we have much room for growth by leveraging existing institutions in poor, traditional societies.

[2] Book review of *How China Escaped the Poverty Trap*, by Yongmei Zhou, at World Bank Development Blog, January 2017.

Summary of lessons

- Lesson 1: Harness non-best practices to build markets

To reiterate, the first lesson is that it is possible to harness non-best practices to build markets. Poor societies may leverage their own unique, indigenous features, even if these features are inconsistent with best practices, to jump-start development, rather than blindly import templates from elsewhere, be it from Western countries or China.

- Lesson 2: Escaping poverty ≠ sustaining growth

It must be emphasized that escaping poverty is not the same as sustaining growth, just as what it takes for an individual to escape poverty is not the same as what it takes to become extremely wealthy. Hence, it is critical in development practice to differentiate among strategies that work at different stages of development. One size does not fit all.

- Lesson 3: Informal networks, diaspora, and migration are useful ingredients for escaping poverty.

In addition to repurposing non-best institutions, my research suggests that informal networks, diaspora, and migration are also useful ingredients for escaping poverty. The Chinese diaspora in East Asia was key to sparking China's early growth on the coast; later on, migrant workers from the coast returned to their inland hometowns and brought new investment opportunities and skills. They dynamics worked in tandem with efforts by the government to leverage non-best practices to stimulate entrepreneurship at early growth stages.

Application to labor and employment

Potential application of this study's insights to labor and employment may take several forms. Conventional policies tend to focus on promoting manufacturing jobs in low-income countries, while service industries are relatively neglected. This reflects the historical process of development in industrialized economies, which started in manufacturing and then progressed to services.

Today, I believe it is possible for poor economies to leapfrog to services, which has potential to create many good jobs, especially in creative industries (like in Nigeria's Nollywood) and industries that apply new information technology (like in Cambodia's mobile applications industry).

Fostering services in low-income economies often requires harness non-best practices to build markets. For instance, the film industry emerged in Nigeria through local filmmakers' partnership with pirates as marketing and distribution agents.

Development policies may also benefit from leveraging migrant workers as potential sources of entrepreneurship. The United Nations has evidently paid attention to "migrant entrepreneurship," that is, entrepreneurship by migrants. [3] Here, however, I refer to entrepreneurship by migrants who return to their hometowns. This can include not only the return of highly educated migrants from developed economies to developing countries (such as China and India), but also migrant workers within developing countries.

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[3] For example, see http://www.un.org/esa/population/migration/turin/Turin_Statements/ZLOTNIK1.pdf.