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The Poor Man's Burden

By William Easterly

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Eighty years ago, a depression changed the way we think about poverty. It took decades for the world to recover and to remember that if people are given freedom, they will prosper. Now, in the wake of another massive meltdown, the fear that shocked us into depending on government to fix poverty is spreading once again—and threatening to undo many of the gains we've made.



Illustration by Dan Page for *FP*

Will Richard Fuld, the disgraced CEO of the now defunct Lehman Brothers, go down in history as the father of Bolivian socialism? If we learn the wrong lessons from the global financial Crash of 2008, he very well could.

That's because the crash arrived at a crucial moment in the global fight to reduce poverty. For Bolivia—and so many other countries like it—the crash represents much more than a temporary downturn; it could mean the end of one of the greatest openings for prosperity in decades. Amid today's gloom, it is easy to forget we have just witnessed half a century of the greatest mass escape from poverty in human history. The proportion of the world's population living in extreme poverty in 2008 (those earning less than a \$1 a day) was a fifth of what it was in 1960. In 2008,

the income of the average citizen of the world was nearly three times higher than it was in 1960. But those tremendous gains are now in peril. For this crash hit many poor countries from Asia to Africa to Latin America that are still experimenting with political and economic freedom—but have yet to fully embrace it and experience its benefits. For decades, these countries have struggled tremendously to realize the potential of individual creativity as opposed to the smothering hand of the state. And it even seemed that the power of individual liberty might be winning.

It wasn't happening because experts had handed out some blueprint for achieving economic growth to governments and then down to their people. What happened instead was a Revolution from Below—poor people taking initiative without experts telling them what to do. We saw such surprising success stories as the family grocer in Kenya who became a supermarket giant, the Nigerian women who got rich making tie-dyed garments, the Chinese schoolteacher who became a millionaire exporting socks, and the Congolese entrepreneur who started a wildly successful cellphone business in the midst of his country's civil war. Perhaps not coincidentally, the share of countries enjoying greater levels of economic and political freedom steadily and simultaneously shot upward.

Then came the crash.

Today, global economic calamity risks aborting that hopeful Revolution from Below. As India's Prime Minister Manmohan Singh warned late last fall, "It would be a great pity if this growing support for open policies in the developing world is weakened" because of the crash. Singh understands that the risk of a backlash against individual freedom is far more dangerous than the direct damage to poor countries caused by a global recession, falling commodity prices, or shrinking capital flows. We're already seeing this dangerous trend in Latin America. In Bolivia, President Evo Morales has openly crowed about the failure of Fuld's Lehman Brothers and other Wall Street giants: The capitalist "models in place are not a good solution for humanity . . . because [they are] based on injustice and inequality." Socialism, he said, will be the solution—in Bolivia, the state "regulates the national economy, and not the free market." The leaders of Argentina, Bolivia, Brazil, Ecuador, Nicaragua, Honduras, Paraguay, Venezuela, and even tiny Dominica to varying degrees align with these anticapitalist pretensions, all seemingly vindicated by the Crash of 2008. And it's not confined to Latin America: Vladimir Putin blamed the U.S. financial system for his own populist mismanagement of Russia's even more catastrophic crisis. A spreading fire of statism would find plenty of kindling already stacked in the Middle East, the former Soviet Union, Africa, and Asia. And there are many Western "development" experts who would eagerly fan the flames with their woolly, paternalistic thinking.

To Jeffrey Sachs, perhaps the foremost of these experts, the crash is an opportunity to gain support for the hopelessly utopian Millennium Development Goals of reducing poverty, achieving gender equality, and improving the general state of the planet through a centrally planned, government-led Big Push. "The US could find \$700 billion for a bailout of its corrupt and errant banks but couldn't find a small fraction of that for the world's poor and dying," he wrote in September. "The laggards in the struggle for the [goals] are not the poor countries ... the laggards are the rich world." To Sachs and his acolytes, poor people can't prosper without Western-country plans—and the crash only serves to turn Western governments inward. Therefore, progress on poverty is bound to suffer. To governments of poor countries that have failed to give their people the freedom needed to prosper, the neglect of Western governments is an easy excuse. So the gospel of Sachs and his disciples, though terribly condescending and wrongheaded, could attract many converts in the coming months.

A DEPRESSING HISTORY

At least we've been here before—and we have a chance to avoid the philosophical traps we fell into after the last calamity that did so much harm to our economic system. But so far, there have been strikingly similar reactions to the crashes of 1929 and 2008. In both cases, when stocks registered some of their largest percentage declines on record, highly leveraged firms and individuals who had placed large bets using complex financial securities that few understood lost everything. The failure of gigantic financial firms spread panic. Complaints about the greedy and reckless rich escalated; a shift toward protectionism and government interventionism appeared inevitable even where free markets once reigned supreme. Authoritarian populists abroad mocked the U.S. system. The catastrophe seemed to threaten democratic capitalism everywhere.

The difference is today we know that after a long and scary Great Depression, democratic capitalism did survive. And the U.S. economy returned to exactly the same long-run trend path it was on before the Depression.

We also know that, for another important part of the world, democratic capitalism did not hold up so well. In many ways, that failure stemmed from a misguided overreaction on the part of a new, influential field of economics that was highly skeptical of capitalism, was deeply traumatized by economic calamity, and considered much of the world “underdeveloped.” Born in the aftermath of the Depression, “development economics” grew on a foundation of bizarre misconceptions and dangerous assumptions.

This approach to poor-country development, promulgated by the economists who took up its cause in the 1950s, had four unfortunate lasting consequences, the effects of which we're still reckoning with today in the midst of the latest big crash.

First, seeing Depression-style unemployment in every part of the world led these economists to assume that poor countries simply had too many people who were literally producing nothing. A U.N. report in 1951, produced by a group of economists, including future Nobel laureate Arthur Lewis, estimated that fully half of the farming population of Egypt produced nothing. The insulting assumption that poor people had “zero” productivity led these economists to think that individual freedoms for the poor should not be the foundation for wealth creation, as they had been during the Industrial Revolution, when the state had played a secondary, supportive role. And because governments seemed to successfully take on a larger role during the Depression, development economists assumed that granting extensive powers to the state was the surest path to progress. A 1947 U.N. report on development gave equivalent approval to state action in democratic capitalist countries like Chile, enslaved Soviet satellites like Poland, African colonies of the British and French, and apartheid South Africa, ignoring the vast differences in individual liberty between these places.

Second, these thinkers lost faith in bottom-up economic development that was “spontaneous, as in the classical capitalist pattern” (as a later history put it), preferring instead development “consciously achieved through state planning.” After all, the Five-Year Plans of the 1930s Soviet Union had avoided the Depression, at an appalling but then ignored cost in lives and human rights. This thinking was so universal that Gunnar Myrdal (who would later win a Nobel Prize in economics) claimed in 1956: “Special advisors to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problem . . . all recommend central planning as the first condition of progress.”

Third, these economists grew to believe that the most important factor in reducing poverty was the amount of money invested in the tools to do so. After all, if there were simply too many people, they reasoned, the binding constraint on growth must be the lack of physical equipment. As a result, this line of economic philosophy would forever stress the volume of investment over the efficiency of using those resources; would be stubbornly indifferent as to whether it was the state or individuals who made the investments; would always stress the total amount of aid required to finance investment as the crucial ingredient in escaping poverty; and would ignore the role of a dynamic financial system in allocating investment resources to those private uses where they would get the highest return.

Fourth, the collapse of international trade during the Depression made development economists skeptical about trade as an engine of growth. So in Africa, for example, they pushed for heavy taxes on export crops like cocoa to finance domestic industrialization. In Latin America, Raúl Prebisch pushed import-substituting industrialization instead of export-led growth. This strategy was supposed to help developing countries in Africa and Latin America escape a presumed “poverty trap.” But the only “trap” it kept them out of was the greatest global trade boom in history following World War II, which fueled record growth in Asia, Europe, and the United States.

By the 1980s, the state-led plans had clearly failed. The wreckage of unsuccessful state enterprises, bankrupt state banks, and inefficient hothouse industries behind protectionist walls—all of which culminated in African and Latin American debt crises that destroyed growth—became too obvious to ignore. These factors, plus East Asia’s rise to power in global markets, finally fueled a counterrevolution in development thinking that favored free markets and individual liberty. By the new millennium, the long record of failure of the top-down development experts triggered a well-deserved collapse of confidence in top-down planning. It had taken nearly 50 years for the world to recognize the damage that the state-led, expert-directed, antifreedom agenda had done to the world’s poor. Today, the only remaining holdouts among the top-down experts are so utopian that they are safely insulated from reality.

A 5(0)-YEAR PLAN

Today, just when we were getting over the long, toxic legacy of the Depression and its misguided emphasis on statist plans to fight poverty, this financial crash threatens to take us back to the bad old days. To avoid such a return, we must keep some principles in mind.

First, we must not fall into the trap of protectionism—neither unilaterally nor multilaterally, neither in rich countries nor poor. Protectionism will just make the recession spread further and deeper, as it did during the Depression.

Second, when changing financial regulations to repair the excesses of the past several years, don’t strangle the financial system altogether. You can’t have a Revolution from Below without it. This lesson is especially salient as Washington bails out Wall Street banks and failing industries and intervenes in the U.S. financial sector to an unprecedented degree. This bailout might turn out to be the bitter medicine that saves “finance capitalism” from a stronger form of anticapitalism, but in developing countries, open economies are still an open question.

Third, keep slashing away at the enormous red tape that is left over from previous harebrained attempts at state direction of the economy. Learn from the combined dismal track record of state-owned enterprises but also from the unexpected success stories: Private entrepreneurs are far

better than the government at picking industries that can be winners in the global economy. Although fierce opposition will be inevitable, to adopt these policies would be to turn the bad hand we've been dealt into an outright losing one.

Fourth, don't look to economists to create "development strategies," and don't back up such experts with external coercion like IMF and World Bank conditions on loans. Such efforts will be either a waste of local politicians' time or positively harmful. Jeffrey Sachs alone can take partial credit for the rise of two xenophobic rulers hostile to individual liberty—Evo Morales and Vladimir Putin—after his expert advice backfired in Bolivia and Russia. If like-minded experts couldn't get it done in the 50 years after the Great Depression, they can't do it in the next 50 years. Nothing in the current crash changes these common-sense principles.

DRIVING THE RIGHT WAY

In the coming months and years, the world's economists, politicians, and average consumers could find it incredibly easy to fall again for the wrongheaded policies of the past century. But if we are truly to continue the miraculous exodus from poverty that was under way before this traumatic crash, we ought to keep in mind stories like that of Chung Ju-yung.

The son of North Korean peasant farmers, Chung had to leave school at 14 to support his family. He held jobs as a railway construction laborer, a dockworker, a bookkeeper, and a deliveryman for a rice shop in Seoul. At 22, he took over the rice shop, but it failed. He then started A-Do Service garage, but that failed, too. In 1946, at age 31, Chung tried once again to start an auto repair service in Seoul. At last, his enterprise succeeded, largely through the contracts he won to repair U.S. Army vehicles. As his success continued, Chung diversified into construction, and his company kept growing rapidly. In 1968, he started manufacturing cars.

He named his company Hyundai. It became one of the largest companies contributing to South Korea's rise. His first effort to export cars to the United States in 1986 brought ridicule because of the cars' poor quality. The Asian crisis of 1997-98 led to a partial breakup of the Hyundai Group, but the Hyundai Motor Company continues to thrive. Chung died in 2001, but his dreams for the U.S. market came true. By 2008, Hyundai cars had received awards in the United States for the highest level of quality from *Consumer Reports*.

However terrifying the latest crash may be, let's never forget that it is the Chungs of the world that will end poverty—not the Depression-inspired regression into statism.

William Easterly is professor of economics at New York University.