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Development Doesn't Require Big Government

Poor countries are learning the wrong lessons from the crisis.

By WILLIAM EASTERLY

Financial meltdown will not cause the U.S. to abandon democratic capitalism, but the outcome is less clear for countries deciding whether capitalism is the best system. In many of these countries the choice is not between light and heavy financial regulation, but between relying on creative individuals or government planners to escape poverty.

Some countries are already taking the wrong prescriptions from recent events. Honduran President Manuel Zelaya told the U.N. General Assembly last month that the lesson of the crash was "the market's laws were demonic, satisfying only the few." Paraguayan President Fernando Lugo said the "market mechanism" and "immoral speculation" were a mistake. Brazilian President Luiz Inácio Lula da Silva added that speculators have "spawned the anguish of entire peoples" and Brazilians needed "indispensable interventions by state authorities."

We have been here before. Development economics -- the study of how poor countries can become rich -- was forever cursed by the timing of its birth after the Great Depression. That gave development economics a bias toward relying on governments, rather than markets, to create growth. The early development economists ignored a century and a half of European and North American development through individual enterprise, remembering only that their governments forcefully intervened to stimulate output during the 1930s.

What is widely agreed to be the seminal article in development economics appeared in 1943, calling poor countries "depressed areas." The Economic Journal article by Paul Rosenstein-Rodan, "Problems of Industrialization of Eastern and South-Eastern Europe," concluded that a fourth of the population of these countries was unemployed, and the solution rested in ceding development to the state. Development comes from state-planned investment in all sectors at once, the "Big Push," not reliance on private investors: "An individual entrepreneur's knowledge of the market is . . . insufficient," because he cannot have all the data "available to the planning board."

Similarly, the U.N.'s Depression mindset prompted them to ask an expert commission led by Sir Arthur Lewis in 1950 to prepare a report on unemployment in underdeveloped countries. Its report concluded that "economic progress depends to a large extent upon the adoption by governments of appropriate . . . action," and that political leaders must have a strategy for such growth, reflecting "the facts of each particular case."

Few at the time disagreed. Oxford economics professor S. Herbert Frankel wrote a rare protest in 1952. He believed poor, ordinary people had "peculiar aptitudes for solving the problems of their own time and place," a confidence later vindicated by homegrown success in Botswana, the East Asian tigers, India, Chile, Turkey and China.

Lewis later received a Nobel Prize in Economics. Poor Frankel was basically forgotten.

Development economics still bears the scars of the Depression. A prominent World Bank Growth Commission concluded in May that "fast, sustained growth does not happen spontaneously. It requires a long-term commitment by a country's political leaders," and "each country has specific characteristics and historical experiences that must be reflected" in the leaders' "growth strategy." Some at the U.N. still recommend the discredited Big Push strategy of state-planned investment.

How much poverty has endured because individual entrepreneurs were shunned in favor of the likes of the \$5 billion state-owned Ajaokuta Steel Mill in Nigeria, which never produced a bar of steel? Or because African governments spend their time preparing World Bank-required national Poverty Reduction Strategy Reports instead of freeing space for innovators?

We will never know. But we do know that the free market has a long-run track record of creating prosperity -- even with the occasional crash. The Depression's deceptive intellectual legacy is that development flows from all-knowing states rather than creative individuals. Here's hoping that the backlash to today's crash will not spawn another round of bad economics for the poor.

Mr. Easterly is professor of economics at New York University, and author of "The White Man's Burden," (Penguin USA, 2006).

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