

Benjamin Powell (ed): Making Poor Nations Rich: Entrepreneurship and the Process of Economic Development

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Since Adam Smith economists have been preoccupied with the task of making poor countries rich, while at the same time most have ignored the crucial role of the men and women who have played the most important role in the process of economic development—entrepreneurs. The intellectual bankruptcy of the mainstream economics of development with its apology of central planning and rejection of property rights was so obvious to Austrian School economists since these theories were first proclaimed by Joan Robinson, Harold Laski, John Kenneth Galbraith, and the like.

Making Poor Nations Rich is a serious attempt to further develop the theory of entrepreneurship. Fourteen chapters of the book cover the most important issues of our time: wealth and poverty of nations, the role of entrepreneurship in economic and human development, economic performance of transitional economies with the stories of both winners and losers. Authors tackle an important question of how institutions affect economic outcomes, and how “with the death of the countries of ‘really existing socialism,’ the harder socialist panaceas based on the plan were seen to be dead ends, but a softer version based on the desire to have ‘capitalism with a human face’ still survives” (p. xiv).

Written by famous specialists in the field there is a combination of Austrian and “new growth” economists: George Ayittey, William Baumol, Scott Beaulier, Peter Boettke, Christopher Coyne, James Dorn, Randall Holcombe, Dan Johansson, Deepak Lal, Peter Leeson, Robert Lawson, Alvaro Vargas Llosa, Mancur Olson, Benjamin Powell, Parth Shah, Renuka Sane, and Frederic Sautet. The book is a must to be read and discussed in any serious upper-level international economics and political economy class.

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Part One of the book is devoted to theoretical issues of institutions and entrepreneurship with the lead chapter “Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Other Poor” by Mancur Olson, Jr. (1932–1998). An eminent American economist and social scientist, Olson made serious contributions to institutional economics on the role of private property, taxation, public goods, collective action, and contract rights in economic development.¹

In this chapter, written in 1996, Olson focused on the logical basis of the Chicago School approach to economic development based on the Coase theorem.

The literature growing out of the Coase theorem... suggest that even when there are externalities, bargaining among those involved can generate socially efficient outcomes... rational actors in the polity have an incentive to bargain politically until all mutual gains have been realized, so that democratic government, though it affects the distribution of income, normally produces socially efficient results. (p. 26)

In another words it does not matter whether we observe *laissez-faire* capitalism, central planning, or rampant interventionism since we are already in the most efficient of all possible worlds! He quotes Becker, Coase, Stigler, Wittman, Breton, Thompson, and Faith as advocates of this absurdly erroneous, from his point of view, concept.

Olson offered a radically different account of the extraordinarily uneven allocation of capital across the countries of the world and “the strong relationship between capital mobility and the economic policies and institutions of countries, the stock of capital—as he insisted—cannot be taken to be exogenous in and reasonable theory of economic development” (p. 39). Logical application of the Coase theorem to the process of economic development should result in Pareto efficiency across the globe and “capital should be struggling at least so hard to get into the Third World as labor is struggling to migrate into the high-wage countries” (p. 38).

Following his seminal *Logic of Collective Action* Olson theorized that only a separate and selective incentive would stimulate a rational individual in a social group to act in a group-oriented way, that they would act collectively to provide private goods, but not to provide public goods.

He concludes that

if spontaneous Coase-style bargains, whether through the *laissez faire* or political bargaining and government, eliminated socially wasteful predation and obtained the institutions that are needed for a thriving market economy, then there would not be so many grossly inefficient and poverty-stricken societies. The argument presented here shows that the bargains needed to create efficient societies are not, in fact, made. (p. 48)

Olson rejects the explanation that “differences in access to the world’s stock of productive knowledge or to its capital markets, by differences in the ratio of population to land or natural resources, or by differences in the quality of marketable human capital or personal culture” (p. 44). The true reasons for economic

¹ I had the privilege to work with Professor Olson at the US Institute of Peace in 1990–1991 and had interesting discussions with him on issues of transitional economics and institutional change raised by the collapse of the Soviet Empire.

backwardness and poverty are socialist laws and government policies, collectivist attitudes, and the anticapitalist mentality that are debilitating creativity and entrepreneurship.

Randall G. Holcombe devoted his chapter to genesis and evolution of the theory of entrepreneurship from Adam Smith, David Ricardo, and Thomas Malthus to Friedrich August von Hayek and Israel Kirzner. Based on the firm ground of Austrian methodology Professor Holcombe concludes:

Incorporating entrepreneurship into the framework of economic growth adds to growth theory by showing the nature of increasing returns to scale, knowledge externalities, and the role of human capital. These processes appear as a black box in mainstream growth theory, but when they are depicted as a part of the entrepreneurial process, it becomes apparent that the engine of economic growth is entrepreneurship, not technological advances or investment in human capital per se. This focus on entrepreneurship pushes growth theory in a direction that emphasizes the institutional setting within which growth occurs, and away from a neoclassical growth theory that focuses on inputs into the production process. (p. 73)

It took over two centuries of empirical evidence, writes Robert A. Lawson in his chapter “Economic Freedom and Property Rights: The Institutional Environment of Entrepreneurship,” to validate Adam Smith’s conclusion that economic freedom generates economic growth. Lawson shows that entrepreneurs in countries that are at the top of the Economic Freedom Index (e.g., Hong Kong, Singapore, New Zealand, Switzerland, and others) have created wealth for themselves and their people, whereas countries that have reduced economic freedom (e.g., Zimbabwe and Venezuela) are poorer than they were a generation ago. “After more than a decade of research, the empirical evidence is overwhelmingly clear: societies that organize themselves with private property, rule of law, and free markets outperform, on almost every measurable margin, societies that are less economically free” (p. 131).

George Ayittey addresses “The African Development Conundrum” stating that economic conditions in Africa have deteriorated since colonialism and “most Africans today are worse off than they were at independence in the 1960s” (p. 138). The reason for the African economic decline, according to Ayittey, is obvious—“they rejected capitalism as a Western colonial institution in one monumental syllogistic error. Colonialism was evil, and because the colonialists were capitalists, it too, was evil. Socialism, the antithesis of capitalism was adopted” (p. 146). Western aid was used to support grandiose socialist projects with no or very little economic justification. “Over time, the defective economic and political systems metastasized into a monstrosity—a “vampire state”... hijacked by a phalanx of unrepentant gangsters and thugs who employ the machinery of the state to enrich themselves, their cronies, their tribesmen” (p. 152). The West could help Africans bolster local entrepreneurs and attract investment by ending aid to vampires and kleptocrats and encouraging reforms that strengthen property rights, the rule of law, and economic freedom.

With a general economic decline of Africa and complete destruction of formerly prosperous Zimbabwe and Kenya by their corrupt socialist rulers, economic

achievements of Botswana show a successful example of economic and political stability, writes Scott A. Beaulier. “Without much foreign aid, and in the absence of a large state, Botswana went from being the third poorest nation in the world in 1965 to an upper- middle-income nation today [2008]” (p. 397). In recent years Botswana has been squandering its freedom and prosperity by greatly increasing the size of its government and public expenditures have been financed largely by revenue from diamond mining. If that revenue source dries up, as some predict, higher taxes and slower economic growth may soon follow.

Coincidentally, I have just returned from Botswana which is still the nicest, safest, and most pleasant country in Africa. My own experience there absolutely validates the famous dictum of Murray N. Rothbard “more socialism—more problems.” There is less socialism in Botswana than in its neighboring countries of Zimbabwe, Zambia, and Namibia, which have been thoroughly devastated by socialism making Botswana look like a superpower in comparison. The economic success in Botswana disproves the theory that African economic failures are based on race: economic catastrophes were engineered by rulers of Zimbabwe, Kenya, Ethiopia, and Tanzania not because they were black, but because they were socialist. White socialists were as destructive and murderous as their black counterparts.

The sad case of Latin America is examined by Alvaro Vargas Llosa. He maintains that, despite conventional wisdom, no true “free market” reform has taken place in Latin America over the last decades. The latest and most far-reaching initiative to foster an open society in the region has run up against the wall of corporatism, state mercantilism, privilege, wealth transfer, and political law. These political and economic systems have been present in Latin America since pre-Columbian times and their endurance has been remarkable. Collectivism and social envy are at the cornerstone of Latin American society. Despite some attempts at reform and initial successes in reducing inflation, attracting foreign investment, and spurring the economy by lowering some barriers to trade in the late twentieth century, a great opportunity was missed. What really took place in those years was crony capitalism, not the decentralization of power through desocialization of the economy, or the spread of property rights, or the elimination of barriers to entry in all markets, instead it was a continuation of political and economic privilege (p. 191).

In Sweden, a bloated regulatory-welfare state “is a dead end for sustaining long-term economic growth” (p. xiv). High taxes, compulsory savings, and very burdensome labor-market regulations have depressed entrepreneurship, created high unemployment, and hampered economic growth. In 1970, Sweden was the fourth richest country in the OCED (Organization of Economic Cooperation and Development); three decades later it had fallen to fourteenth. No other country of the world has fallen so far or quickly (p. 270). Sweden needs to implement radical pro-market reforms, such as opening access to markets, cutting taxes, and relaxing labor-market restrictions to prevent its further economic decline. “To begin growing more rapidly and to return to being among the richest countries in the world, argues Dan Johansson, Sweden will have to make far-reaching pro-market reforms, especially with regard to small business and entrepreneurship” (p. 272).

Making Poor Nations Rich is a very timely contribution. “The overall message of this book is simple, yet is vitally important for the millions who reside in

underdeveloped regions of the world,” writes the editor of the book Benjamin Powell,

Economic freedom and private-property rights are essential for promoting the productive entrepreneurship that leads to economic growth. In countries where this institutional environment is lacking, sustained economic development remains elusive. When countries make pro-market reforms that enhance their institutional environment, growth improves—sometimes dramatically.” (pp. 21–22)

Austrian economic theory could a priori predict dismal failure of central planning and reject any justification of various restrictions on the grounds of economic freedom and property rights shackling entrepreneurship, or econometric models presenting economic growth as a simple function of labor, capital, and technology. Austrian economists also could predict the dismal failure of countries which embraced these policies. Austrian economists start with the ultimate causes of economic success and failure. We could not know a priori what the specific costs of poor choices would be, but empirically, a posteriori examples of successful and failed nations should serve as a warning of the dangers of seemingly simple and quick solutions to our own problems suggested by the mainstream academe and politicians.