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COMMENTARY

Phelps's Prize

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The Nobel Prize lectures given last month by the economics and the peace laureates strikingly emphasized entrepreneurship. But the *kinds* of entrepreneurship espoused by the laureates are profoundly different. The economist Edmund Phelps's lecture highlights the contribution of entrepreneurial individuals, firms and financiers in transforming stagnant societies dominated by small-business owners into dynamic economies with large and highly productive commercial enterprise.

Mr. Phelps's celebration of modern capitalistic entrepreneurship is, to say the least, unusual. Of the 35 winners of the Nobel in economics, 28 did not utter the word "entrepreneur" or "entrepreneurship" in their lectures. Mr. Phelps's lecture has 17 mentions -- more than the total over the previous 19 years.

Moreover when the typical economic theorist uses the word entrepreneur, it is often a short-hand for a Big Blue-like computer that unfailingly makes the right choices. In contrast, Mr. Phelps's entrepreneurs, like those of Friedrich Hayek and Frank Knight, undertake innovations in a dynamic and highly uncertain world. They play a "human role over a vast range of activities, involving management, judgment, insight, intuition and creativity." This entrepreneurial activity, says Mr. Phelps, has not only produced great material prosperity in the economies where it has flourished, but also represents the essence of a "good life," full of "stimulation, challenge, engagement, discovery and personal development." None of this is possible in a stagnant society where individuals are assigned fixed tasks.

The Nobel Peace Prize winner Mohammad Yunus also lauds entrepreneurship. His lecture mentions entrepreneurs or entrepreneurship an unprecedented six times. Mr. Yunus observes that the Grameen Bank, which he started in 1974, has made seven million microloans in Bangladesh, for housing, education -- and micro-enterprise. The bank has turned 85,000 borrowers from "begging to business." Looking ahead, Mr. Yunus envisions a new "social stock market" for investors who will support the mass-proliferation of microloans, and to "defining entrepreneur in a broader way [so that] we can change the character of capitalism radically."

Mr. Yunus's *ameliorative* entrepreneurship however is very different from the *transformative* entrepreneurship that Mr. Phelps argues has been central to modern capitalism. Indeed, most of the ventures funded by microloans in Bangladesh are activities that were marginalized by modern entrepreneurs: They don't involve any

economies of scale or scope or the use of new technologies capable of producing significant advances in overall productivity and incomes.

Economic development does wonders for peace, but what does microfinanced entrepreneurship really do for economic development? Can turning more beggars into basket weavers make Bangladesh less of a, well, basket case? A few small port cities or petro-states aside, there is no historical precedent for sustained improvements in living standards without broad-based modernization and widespread improvements in productivity brought about by the dynamic entrepreneurship that Mr. Phelps celebrates.

In principle, microfinance does not preclude modern entrepreneurship. But in practice, we wonder if the romantic charm of the former might distract governments in impoverished countries from undertaking reforms needed to foster the latter. The poverty of countries like Bangladesh derives from their comprehensive backwardness -- bad roads, illiteracy, inadequate health care, unsound banks, porous tax collection systems, disorganized land records, corrupt policemen and so on. Simple policy changes (such as lowering import tariffs) are a good start; still, the problems won't disappear with a stroke of a pen. They require a change in deeply embedded attitudes. But governments in fragile states have only so much political capital and capacity. So it is crucial to proceed in a disciplined sequence: Identify the worst impediments, overcome them and move on to the next lot.

Micro-enterprise may well help those left behind in economies that are already advanced help themselves: The inner cities in the U.S. may derive great benefit from Mr. Yunus's innovations. But chasing will o' the wisps instead of tackling the first-order causes of backwardness is probably not a winning strategy for countries like Bangladesh. That country has, in fact, made some economic progress in recent years, most notably through the growth of an export-oriented garment industry. Although the few thousand firms in the industry are smaller and less efficient than their Chinese counterparts, they are larger and more productive than individual craftsmen, microfinanced or not.

The not-quite-miraculous growth in Bangladesh has followed rather modest reforms. What might have been achieved with more vigorous modernization? Consider the case of Vietnam, now one of the fastest growing economies in Asia. In 1987 the country started a transition to an open economy. Ongoing reforms that fostered a new class of modern entrepreneurs, not microlending to marginal businesses, helped cut poverty in Vietnam by half in the 1990s. Surely the country's unsung and possibly uncharismatic policy makers also deserve a Prize?

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