

Why Nations Fail

Based on

Why Nations Fail: The Origins of Power, Prosperity and Poverty

by Daron Acemoglu and James A. Robinson

Daron Acemoglu

MIT

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The Lay of the Land

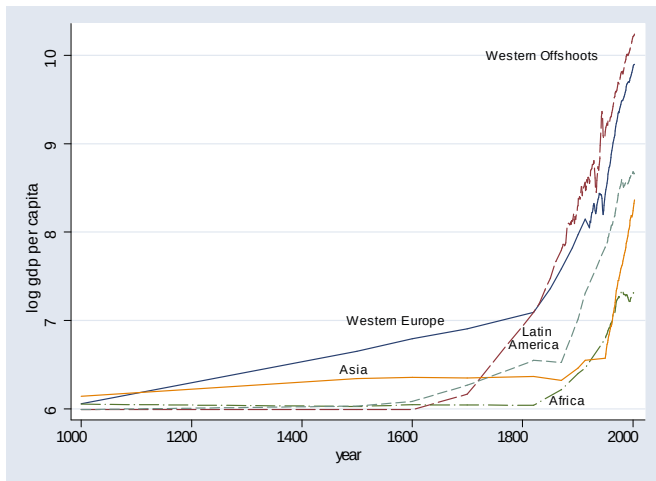


Figure: The evolution of average GDP per capita in Western Offshoots, Western Europe, Latin America, Asia and Africa, 1000-2000.

The Beginning—Latin America

- Juan Díaz de Solís colonizes Río de la Plata in 1516, 'River of Silver' and Pedro de Mendoza founds Buenos Aires in 1534.
- But Solís and de Mendoza unable to enslave and put to work the hunter gatherer Indians of the area, Charrúas and the Querandí. Starving Spaniards soon left the area.
- In 1537, Juan de Ayolas found the sedentary and more densely settled Guaraní up the Paraná river, in Paraguay. The Spaniards could successfully take over the Guaraní hierarchy, enslave them and put them to work to produce food for them.
- A very similar pattern to the colonization of the Aztecs and the Incas.

The Beginning—United States

- Colonization attempts of Virginia Company in Jamestown in early 17th century, attempting to re-create an authoritarian, “extractive” regime:

“No man or woman shall run away from the colony to the Indians, upon pain of death.

Anyone who robs a garden, public or private, or a vineyard, or who steals ears of corn shall be punished with death.

No member of the colony will sell or give any commodity of this country to a captain, mariner, master or sailor to transport out of the colony, for his own private uses, upon pain of death.”
[from the laws passed by Sir Thomas Gates and Sir Thomas Dale].

- But the Company was unsuccessful—it could not force the English settlers into gang labor and low wages.

The Beginning—United States (continued)

- The Company switched to the 'headright system' giving all settlers 50 acres of land and then shortly thereafter also political rights, in the form of it General Assembly.
- Similar events unfolded in Chesapeake Bay, Maryland and Carolina.
- The chain of events that ultimately leading to the Declaration of Independence and the U.S. Constitution.

Making Sense of the Divergence

- While both culture (religion, attitudes, values) and geography (climate, topography, disease environments etc.) are important for the ability of humans to form well functioning societies, they are not the “main” source of this divergence.
 - Much of Latin America likely richer than North America as late as mid-18th century.
 - Divergence due to the ability of the United States, just like Britain, to take advantage of new economic opportunities.
- The “ignorance hypothesis” also unable to explain the logic of social arrangements leading to relative poverty—Cortes, Pizarro and Ayolas did not set up forced labor and repressive regimes because they were “ignorant” about their implications.
- Instead, central role of “institutions” broadly defined.
- **Key questions:** historical roots of institutional differences and the logic of institutions that do not unleash growth.

Towards a Theory of Institutions

- **Extractive economic institutions:** Lack of law and order. Insecure property rights; entry barriers and regulations preventing functioning of markets and creating a nonlevel playing field.
- **Extractive political institutions**—in the limit “absolutism”: Political institutions concentrating power in the hands of a few, without constraints, checks and balances or “rule of law”.
- **Inclusive economic institutions:** Secure property rights, law and order, markets and state support (public services and regulation) for markets; open to relatively free entry of new businesses; uphold contracts; access to education and opportunity for the great majority of citizens.
- **Inclusive political institutions:** Political institutions allowing broad participation—*pluralism*—and placing constraints and checks on politicians; rule of law (closely related to pluralism).
 - But also some degree of *political centralization* for the states to be able to effectively enforce law and order.

Synergies

		Economic	Institutions
		Inclusive	Extractive
Political Institutions	Inclusive	↻	← ↓
	Extractive	↑ →	↻

Growth under Inclusive Institutions

- Inclusive economic and political institutions (or inclusive institutions for short) create powerful forces towards economic growth by:
 - encouraging investment (because of well-enforced property rights)
 - harnessing the power of markets (better allocation of resources, entry of more efficient firms, ability to finance for starting businesses etc.)
 - generating broad-based participation (education, again free entry, and broad-based property rights).
- Key aspect of growth under inclusive institutions: investment in new technology and **creative destruction**.
- *Central question*: why are extractive institutions so prevalent throughout history and even today?

An Example: Labor Coercion

- “In the context of universal history, free labor, wage labor, is the peculiar institution” —M.I. Finley
- Forced labor (**slavery, serfdom**) basis of ancient Greece, Egypt and Rome; several Islamic and Asian empires; most pre-Colombian civilizations; plantation economies in Latin America and the U.S. South; European agriculture until the 19th century (feudalism).
- The ILO estimates that there are still between 8 and 12 million forced laborers worldwide, not counting forced sex workers.
- *Acemoglu and Wolitzky (2010)* “The Economics of Labor Coercion”: Principal-agent model of coercion, where coercion $\equiv$ costly reduction in agent’s outside option.
 - The option to coerce will always lead to inefficiency because of the redistributive role of coercion.
 - This inefficient economic institution may be widespread because it benefits employers at the expense of workers.

Labor Coercion (continued)

- **Central question:** Does labor scarcity lead to more or less coercion?
 - “I would... expect to find a positive statistical correlation between free land and serfdom (or slavery)” —E. Domar
 - Neo-Malthusian economic history: falling population in the 14th century leading to the collapse of feudalism: H.J. Habakkuk, M.M. Postan, North and Thomas.
 - Brenner critique: falling population did not lead to the collapse of feudalism everywhere; second serfdom in Eastern Europe.
- **Answer:**
 - ① better outside options for workers reduce coercion → “outside option effect” from lower population
 - ② “price effect” increasing coercion when prices are higher, e.g., because of lower population
 - ③ the impact of lower population on coercion different depending on how developed cities are and how large the price effect is.

The Logic of Extractive Institutions

- Main thesis is that growth is much more likely under inclusive institutions than extractive institutions.
- Growth, and inclusive institutions that will support it, will create both winners and losers. Thus there is a logic supporting extractive institutions and stagnation:
 - **economic losers:** those who will lose their incomes, for example their monopolies, because of changes in institutions or introduction of new technologies
 - **political losers:** those who will lose their politically privileged position, their unconstrained monopoly of power, because of growth and its supporting institutions—**fear of creative destruction.**
 - both are important in practice, but particularly political losers are a major barrier against the emergence of inclusive institutions and economic growth.

Political Losers

- *Acemoglu and Robinson (2006)* “Economic Backwardness in Political Perspective”: a switch towards a more inclusive economic institutions may reduce the ability of the ruler to maintain power.
- *Acemoglu, Egorov and Sonin (2010)* “Dynamics and Stability of Constitutions, Coalitions and Clubs”:
 - Three states: absolutism, constitutional monarchy, full democracy
 - Two groups: the elite and middle class. The elite have political power under absolutism, and the middle class have decisive power both under constitutional monarchy and full democracy
 - Payoffs:

Elite: democracy	<	absolutism	<	constitutional monarchy
Middle class: absolutism	<	constitutional monarchy	<	democracy
 - Myopic elite: absolutism→constitutional monarchy→democracy
 - Forward-looking elite: stay in absolutism.

Growth under Extractive Political Institutions

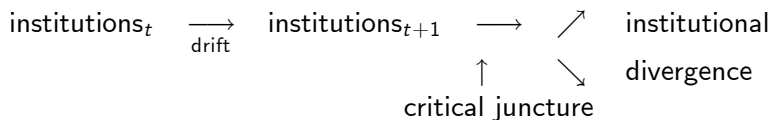
- Though growth is much more likely under inclusive institutions, it is still possible under extractive institutions.
- Why? → Generate output and resources to extract.
- Two types of growth under extractive political institutions:
 - ① extractive economic institutions allocating resources to high productivity activities controlled by the elites (e.g., Barbados, Soviet Union)
 - ② when relatively secure in their position, the elites may wish to allow the emergence of relatively inclusive economic institutions under their control (e.g., South Korea under General Park, China today).
- But big difference from growth under inclusive institutions: no creative destruction and dynamics very different. Consequently, even though growth is possible under extractive institutions, this will not be **sustained growth**.

Limits of Oligarchic Growth

- Democracy $\neq$ Inclusive political institutions, but many commonalities.
- *Acemoglu (2008)* “Oligarchic vs. Democratic Societies”:
 - Oligarchy may be better than democracy in the medium run because it creates favorable environments and low taxes for entrepreneurs
 - But in the long run, oligarchy unlikely to lead to good economic performance.
 - It tends to create entry barriers protecting current incumbents.
 - This is costly both because an oligarchic society will be unable to exploit dynamic comparative advantage and will be less able to adapt to changes in environment.

Towards a Theory of Institutional Change

- **Conflict** pervasive in society.
- Leading to **differential institutional drift** → small but notable differences in institutions across nations
- **Small differences that matter.**



- But outcomes during these critical junctures not historically determined, partly **contingent** ($\approx$ stochastic).
- Naturally, the changes that happen as a result of this interaction then become the background—small or not so small—institutional differences upon which new critical junctures act.

Transition to Inclusive Institutions

- Extractive institutions have been the norm in world history.
- Where do inclusive institutions come from?
 - Earlier moves towards inclusive institutions resulting from conflict and institutional drift— Roman Republic, Venice, but ultimately reversed.
- Crucial turning point: the **Glorious Revolution** in England in 1688.
 - The Glorious Revolution brought much more inclusive, pluralistic political institutions which then led to a transition towards much more inclusive economic institutions.
- This created the conditions which led to the **Industrial Revolution**.
- Growth in the 19th century and dissemination of industry were conditioned by interactions between initial institutional differences and the critical junctures created by political events and the Industrial Revolution itself.

The Emergence of Inclusive Institutions in Europe

- Driven by the interaction of initial institutions and critical junctures:
 - **Initial institutional drift:** Britain was the beneficiary of a long history of gradual institutional change from the Magna Carta of 1215 onwards, through the creation of a monopoly of violence by Henry VII after 1485, nascent state under Henry VIII, Civil War of the 1640s.
 - **Critical juncture:** Development of the Atlantic economy after 1492 led to the emergence of a broad and powerful coalition in society in favor of reforming political institutions and removing absolutism (*Acemoglu, Johnson and Robinson (2005) "The Rise of Europe: Atlantic Trade, Institutional Change and Economic Growth"*).
 - Owing to the context created by the initial institutional drift, this coalition triumphed in 1688.
 - **Small difference:** Initial institutions in Spain somewhat different, especially in allowing the crown to monopolize colonization and Atlantic trade → critical junctures leading to greater wealth and political power of the monarchy.

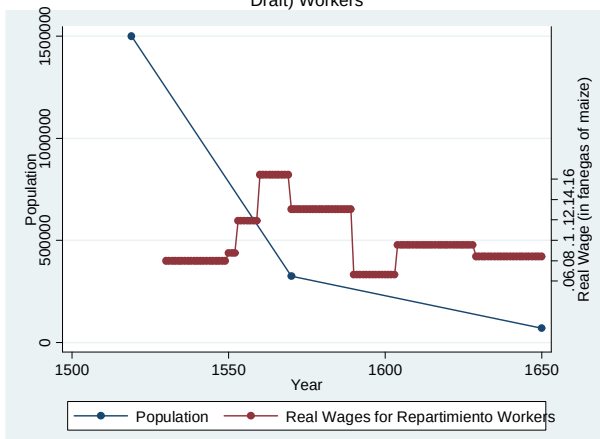
Institutional Divergence at Critical Junctures: Black Death and Feudalism

- The divergence of Western and Eastern Europe after the Black Death—in the West the power of landlords declines and feudalism withers away, in the East the power of landlords intensifies leading to the Second Serfdom in the 16th century.
- This institutional divergence driven by a large demographic shock interacting with initial institutional differences (organization of peasant communities, distribution of landholdings).
- Key mechanism: increases in wages following population decline (e.g., Phelps Brown and Hopkins, 1956).

Meanwhile in Mexico: Implications of Coercion

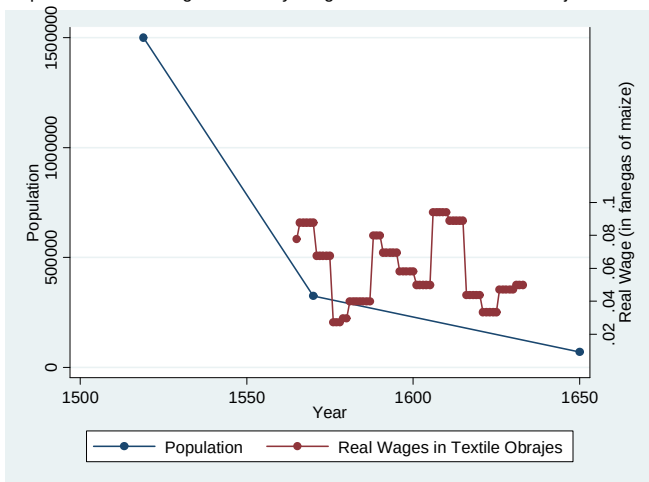
- The effects of lower population very different when there is coercion. Another instance of institutional divergence.

Population and Average Real Daily Wages for Unskilled Repartimiento (Labor Draft) Workers



Meanwhile in Mexico (continued)

Population and Average Real Daily Wages for Unskilled Textile Obraje Workers



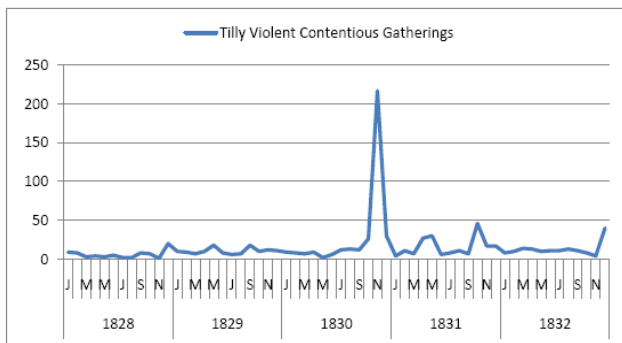
Source: Own Calculations based on Borah and Cook (1958), Gibson (1964) and Viqueira and Urquiola (1990)

Dynamics of Institutions: Persistence and Change

- **Key ideas:** *Acemoglu and Robinson (2001)* “Why Did the West Extend the Franchise?” and *(2006)* Economic Origins of Dictatorship and Democracy:
 - Conflict over political institutions
 - Political institutions allocate *de jure* political power
 - democracy does so more equally
 - But this does not necessarily coincide with *de facto* political power
 - Example: the citizens and activists may solve their *collective action problem* even when *de jure* power is in the hands of a military regime.
 - *Threat of social unrest* → “no revolution constraint”
 - Crucially, solving the collective action problem and *de facto* empowerment are in general temporary.
 - Commitment value of political institutions → transforming temporary *de facto* into more durable *de jure* power

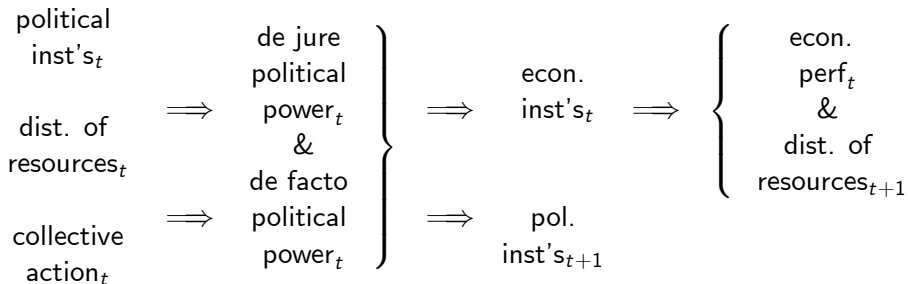
De Facto Power

- In almost all cases of democratization, de facto power of the disenfranchised important.
- In the British case, leading up to the First Reform Act:



Institutional Persistence

- Why do extractive institutions persist? **Vicious circles**



- But also possibility for change.

Logic of Institutional Change: Transition to Democracy

- Elites control non-democracy, but citizens can sporadically solve their collective action problem, exercise de facto power and threaten a revolution or social unrest
- Elites can respond with:
 - 1 repression;
 - 2 concessions with unchanged political institutions;
 - 3 change in political institutions, e.g., democracy.

Logic of Institutional Change: Transition to Democracy (continued)

- Concessions generally “cheapest” option, but not credible because:
 - De facto power of citizens often transitory. E.g., citizens can solve their collective action problem with probability q .
 - If $q \simeq 1$, then de facto power of citizens is almost permanent and can balance the power of the elite. Then concessions become credible.
 - If q is small, then concessions are not credible.
- Democracy arises when repression is too costly and concessions are non-credible.
- Democracy gives a commitment to future pro-citizen policies → turning temporary de facto power into more durable de jure power.

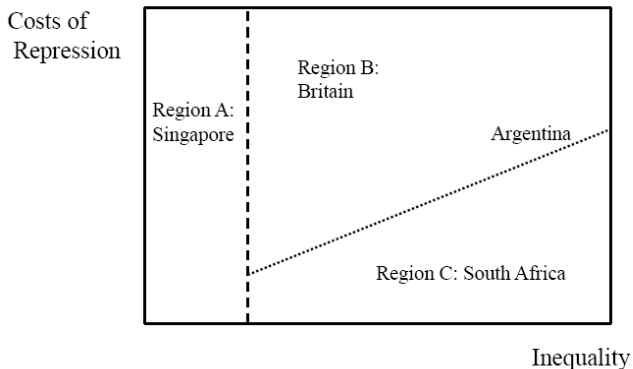
Key Parameters

- Inequality: benefits of democratization for citizens and costs of democratization for the elite
- Civil society: degree of empowerment of citizens
- Cost of repression: how costly the repression alternative will be.

Patterns of Political Development

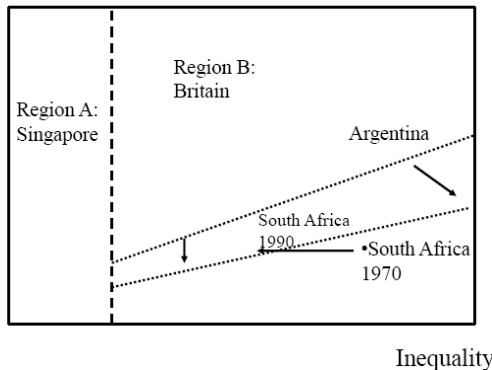
- Britain in the 19th century; democratization and democratic consolidation
- Argentina in the 20th century; democracy-coup cycles
- Singapore; persistent nondemocracy with limited repression
- South Africa until the end of Apartheid; persistent nondemocracy with repression
- What accounts for this diversity?

Revisiting the Patterns

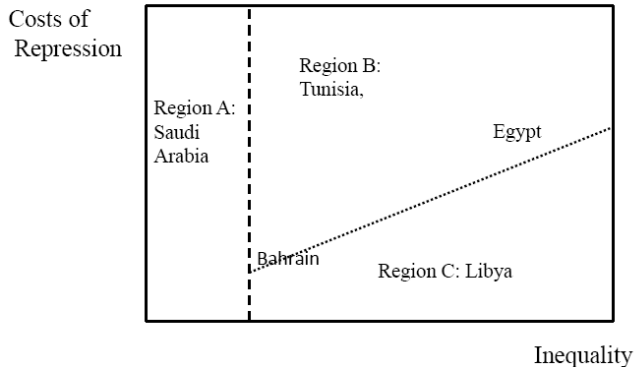


Democratization in South Africa

Costs of
Repression



Democracy in the Middle East



Revisiting Early Latin American Experience

- Early Latin American institutions example of *extractive economic and political institutions*.
- In line with the logic of these extractive institutions, early on productivity in Latin America and the Caribbean is high, though unequal it is committed.
- The break comes with another critical juncture: **Industrial Revolution**.
- Different responses in the North and the South.
 - Why? New opportunities, particularly conducive to fear of creative destruction.
 - In the United States and Britain, industrialization spearheaded by new individuals and groups—not the existing elites. This type of creative destruction difficult or impossible under extractive political institutions.

Divergence in Europe

- The Latin American response to the Industrial Revolution not so different from those of other extractive political institutions, such as Austria-Hungary, Russia, China or the Ottoman Empire.
- Industrialization and railways blocked in Austria-Hungary and Russia, because emperors and elites afraid of political change.
- Francis I and Metternich's approach:

"We do not desire at all that the great masses shall become well off and independent ... How could we otherwise rule over them?"

- Nicholas I and Kankrin's approach in Russia:

"Railways do not always result from natural necessity, but are more an object of artificial need or luxury. They encourage unnecessary travel from place to place, which is entirely typical of our time."

Why Didn't the Ottoman Empire Catch-Up?

- In 1445 in the German city of Mainz, Johannes Gutenberg invented the printing press based on movable type. Spread rapidly throughout Western Europe.
- In 1485, the Ottoman Sultan Bayezid II issued an edict to the effect that Muslims were expressly forbidden from printing in Arabic.
- Sultan Selim I in 1515 strengthened this edict.
- Only in 1727, the first printing press is allowed in the Ottoman lands. Then Sultan Ahmed III issued a decree granting İbrahim Müteferrika permission to set up a press, but under close supervision and censorship. Müteferrika printed few books in the end, only seventeen between 1729, when the press began to operate, and 1743 when he stopped.

Divergence in Asia

- Critical juncture from European and American intervention in Asia both for China and Japan.
- Another case of small differences leading to significant divergence at a critical juncture.
- Absolutism continued in China in the face of British threat during the opium wars.
- A political revolution leading to the end of absolutism in Japan in the face of American threat.
- Small difference: Tokugawa rulers had much less control over entire society than Chinese emperor and imperial elite.

Institutions, Critical Junctures and Development: the Industrial Revolution

- *Acemoglu, Johnson and Robinson (2002) "Reversal of Fortune":*
 - The pattern illustrated here appears more general.
 - Almost all of differential growth during the 19th and early 20th centuries explained by the interaction of initial (pre-19th century) institutions and opportunities to industrialize.
 - This pattern is true regardless of whether one uses exogenous sources of variation in institutional differences across countries.

Persistence of Power and Elites: the US South

- Why and how do extractive institutions persist?
- In the antebellum period, the South run by plantation owners, and the system of slavery and labor-intensive cotton production.
- Relatively poor (about 70% of the national level of GDP per-capita). Little manufacturing industry, much lower urbanization and density of canals and railroads than the North.
- Civil War: major change in economic and political institutions; the abolition of slavery and the enfranchisement of the freed slaves.
- One might have anticipated a dramatic change in economic institutions.
- But what emerged was a labor-intensive, low wage, low education and repressive economy—just like the antebellum South.

Persistence of the Southern Equilibrium

- Despite losing the Civil War, traditional landed elites could sustain their political control of the South, particularly after Reconstruction ended in 1877 and the Union army was withdrawn.
- Blocking of economic reforms that might have undermined their power, such as the distribution of 50 acres and a mule to each freed slave.
- Were able to use their local political power to disenfranchise blacks and re-exert control over the labor force.
- Use of Black Codes, Vagrancy Laws, Ku Klux Klan and Jim Crow.
- What persists? Specific economic and political institutions changed, but the underlying distribution of political power did not and neither did the interests of the elite. They were able to use different institutions to achieve the same goal. The incentive environment for the mass of the population did persist.

Persistence of the Southern Equilibrium (continued)

The persistence of the landed elite in three “Black Belt” counties of Alabama

Name	County	Real estate holdings ^a		
		1870	1880	1890
Minge, G.	Marengo	\$ 85,000		30,000
Lyon, F.	Marengo	75,000	115,000	35,000
Pauling, William	Marengo	72,000	150,000	29,000
Hatch, Alfred	Hale	70,000	120,000	40,000
Alexander, J.	Marengo	69,000	38,000	10,000 ^b
Whitfield, B.	Marengo	65,000	200,000 ^b	100,000
Ternill, J.	Marengo	62,000	93,000	
Taylor, E.	Marengo	61,000		
Robertson, R.	Marengo	60,000		
Dew, Duncan	Greene	52,000	200,000 ^b	41,000
Walton, Jhon	Marengo	50,000	250,000	25,000
Collins, Charles	Hale	50,000	201,000 ^b	30,000
Hays, Charles	Greene	50,000	113,000	
Brown, Jhon	Sumter	50,000	69,000	13,000
Pickering, Richard	Marengo	50,000	42,000	15,000
Withers, Mary	Hale	50,000	40,000	75,000 ^b
Jones, Madison	Hale	50,000	36,000 ^b	27,000
Nelson, A.	Hale	48,000		10,000 ^b
Taylor, J.	Hale	48,000		
Pickens, Wm.	Hale	45,000	210,000 ^b	51,000
Reese, Henry	Marengo	45,000	52,000	24,000
Walker, R.	Hale	42,000	55,000	
Smaw, W.	Greene	42,000	32,000	
Blanks, E.	Marengo	41,000		
Walker, Morns	Marengo	41,000		
Number of planters		25	18	16
Percent present in 1870			72%	64%

^aRounded off to the nearest thousand; as reported in the U.S. Census of Population, manuscript schedules. To convert to constant gold prices, see p. 14, note 13.

^bWealth of father or husband

Source: Weiner (1978, Table 2, p. 12)

Persistence of Power and Elites: Theory

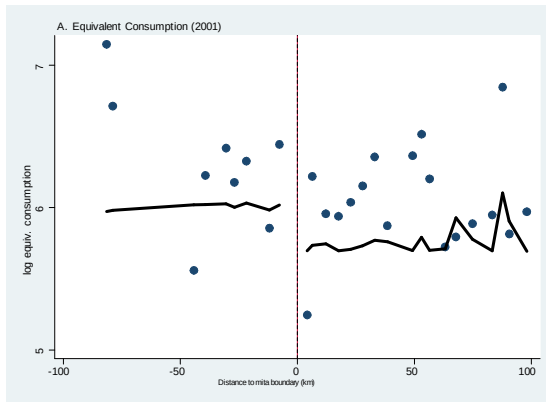
- *Acemoglu and Robinson (2008) "Persistence of Power, Elites and Institutions"*.

"The domination of an organized minority... over the unorganized majority is inevitable. The power of any minority is irresistible as against each single individual in the majority, who stands alone before the totality of the organized minority. At the same time, the minority is organized for the very reason that it is a minority." Mosca

- Once again, related to the distinction between *de jure* and *de facto* power, but now *de facto* power is the agent for persistence rather than change.

Legacy of Colonial Times Today

- Regression discontinuity effects of *Mita* from *Dell (2010)* “Persistent Effects of Peru’s Mining Mita”:



Labor Coercion in Uzbekistan

- On September 6 2006, schools in Uzbekistan were emptied of 2.7 million children. A mother of two explains:

"At the beginning of each school year, approximately at the beginning of September, the classes in school are suspended, and instead of classes children are sent to the cotton harvest. Nobody asks for the consent of parents. They don't have weekend holidays [during the harvesting season]. If a child is for any reason left at home, his teacher or class curator comes over and denounces the parents. They assign a plan to each child, from 20 to 60 kg per day depending on the child's age.

- Why? Uzbekistan under the corrupt regime of Ismail Karimov.
- Cotton farmers are forced to sell at very low prices. Lack of incentives and running down of machinery. Use of forced labor as a substitute for incentives for farmers.

Breaking the Mold

- History is not destiny.
- Effective reforms towards inclusive institutions possible.
- But it often necessitates a minor or major political revolution.
- Two examples:
 - 1 End of Southern equilibrium in the United States
 - 2 Botswana

“Political Revolution” in the South

Figure 3: Incidence of Different Types of Collective Action, 1955-62

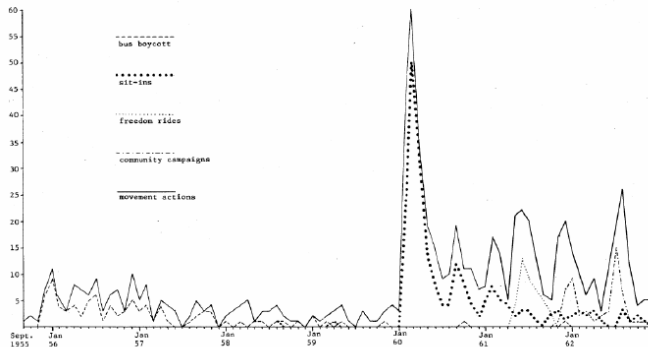


Figure 2. Movement-Initiated Actions, September 1955 through December 1962

Source: *Annual Index of the New York Times, 1955–1962.*

Source: McAdam (1983)

An Unlikely Success Story

- Upon independence in 1966, Botswana was one of the poorest countries in the world; it had a total of 12 kilometers of paved roads, 22 citizens who had graduated from university and 100 from secondary school.
- It was also almost completely surrounded by the white and hostile regimes in South African, Namibia and Rhodesia.
- In the subsequent 45 years, Botswana would become a stable democracy (Africa's only), achieve one of the fastest growth rates in the world and reach the highest income level in sub-Saharan Africa on a par with places such as Estonia, Hungary, or Costa Rica.

An Unlikely Success Story (continued)

- How?
- Proximate answer: inclusive economic institutions (secure property rights, stable macroeconomic policies, investment in education and infrastructure) supported by inclusive political institutions (democracy with checks and balances).
- But the real question is: why did these get adopted in Botswana?
- Good leadership by Seretse Khama and Quett Masire. But also historical factors making such leadership possible and meaningful.

Three African Chiefs

- On September 6 1895, Chiefs Khama of the Ngwato, Bathoen of the Ngwaketse and Sebele of the Kwena arrived in Britain on a mission—to save their and five other Tswana states, making up Bechuanaland (Botswana), from Cecil Rhodes.
- In 1885, Britain had declared Bechuanaland a Protectorate to block further expansions by the Boers and possible expansions by Germans who had annexed Southwest Africa, but had no interest in actively colonizing it.
- When Cecil Rhodes's British South Africa Company started expanding north out of South Africa, the Chiefs decided to ask for greater British control and protection from Rhodes.
- They met colonial secretary Joseph Chamberlain and went on a speaking tour to shore up support. With the background of the disastrous Jameson Raid, Chamberlain agreed.
- Since the British still had no interest in the area, they did not set up the usual indirect rule.

Contingency during a Critical Juncture

- Botswana would avoid both the establishment of white rule as in South Africa or Rhodesia, and British indirect rule transforming indigenous institutions.
- This was particularly fortunate since the indigenous political institutions of the Tswana were more participatory than most—certainly more so than what would emerge under Rhodes or British indirect rule.
- The 'kgotla,' a formal great assembly, was used both for dispute resolution by broad participation and as a check on Chiefs' actions.
- Chieftaincy, in great contrast to the institution of Paramount Chiefs set up by the British in other African nations, was not hereditary, but in practice open to those demonstrating talent, ability and leadership.
- These institutions persisted until independence.
- Clearly these institutions were far from inclusive. But just like Magna Carta and elected Parliaments in England, they created the basis for a possible further development of inclusive institutions.