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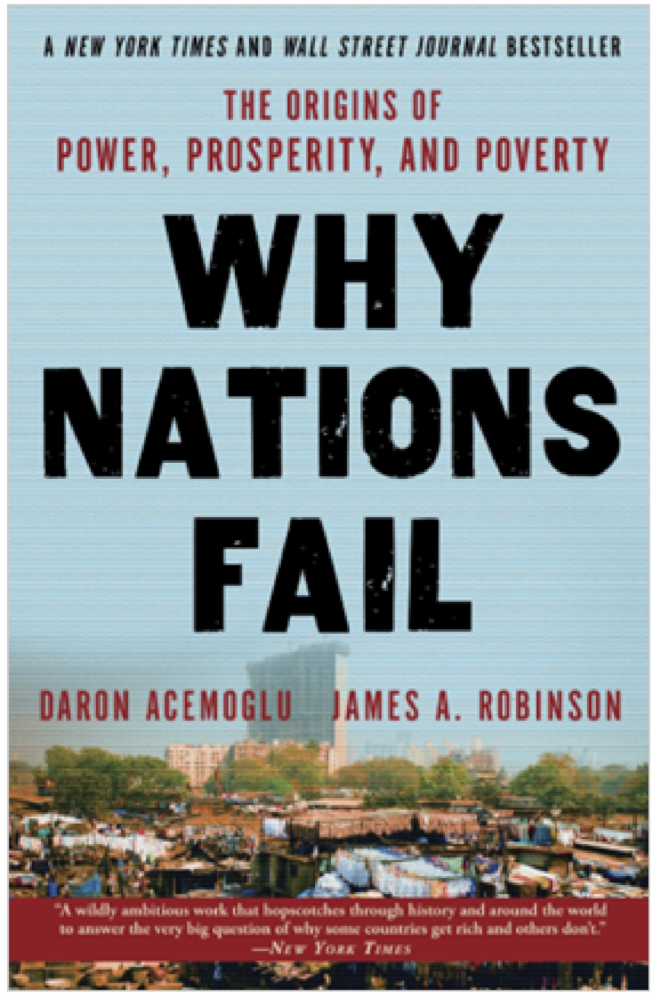
State institutions and economic prosperity

Why Nations Fail: The Origins of Power, Prosperity, and Poverty. By Daron Acemoglu and James A. Robinson. New York: Crown Publishing Group, 2012, 529 pp., $17.10 paperback.



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Globalization has put the issue of global inequality front and center in international policy debates. Why do some countries grow rich while others seem to be perpetually poor? Why do some countries experience economic growth by adopting new technologies while others lag in innovation-driven growth? Why do citizens of rich countries overconsume while citizens of poor countries struggle to meet daily subsistence needs? These are the questions that economists Daron Acemoglu (Massachusetts Institute of Technology) and James A. Robinson (University of Chicago) seek to answer over the course of 529 pages.

In the beginning of the book, the authors argue that a country's institutions determine whether it is rich, whether it adopts new technologies and grows, and whether its citizens struggle to meet basic needs. Acemoglu and Robinson claim that a country can have either inclusive or extractive political and economic institutions. Countries with inclusive institutions spread power over a broad swath of society, allowing various groups to be represented and to participate in political decisionmaking, thereby shaping the economic institutions of their countries. Inclusive economic institutions are characterized by a rule of law that enforces contracts and protects private property rights. This protection incentivizes productivity. Inclusive institutions also promote competition and let individuals choose their occupations, thereby making the most efficient use of talent and skill. To achieve inclusive institutions, a country must have stability, a strong central government, and pluralistic institutions, in which all are represented.

On the contrary, the goal of achieving institutional inclusivity is undermined by extractive institutions. These institutions are characterized by a small elite (not pluralistic) having all the power and making decisions that benefit and enrich it without concern for the greater population. The government can be led by one absolute ruler, a royal family, or a political party, such as the Communist Party. The economic system is exploited by those in power and exists solely to enrich them. Property rights and rule of law are tenuous or nonexistent, and the government either expropriates land and resources or levies high taxes on all production. Either way, the government does not incentivize production or economic growth, and this traps a country far behind those with more inclusive institutions. Some countries with extractive institutions, such as communist China, have a strong central government, but others, including many sub-Saharan African countries, have constant domestic instability that makes them incapable of building a strong centralized state, further quashing the possibility of economic growth.

Acemoglu and Robinson argue that their theory of institutionally driven economic development is necessary because existing theories—such as those relating world inequality to geography or culture—are not adequate to explain the current state of global inequality. The authors reject theories that try to explain world inequality through a geographic or cultural lens by comparing the cities of Nogales, Arizona, and Nogales, Mexico. These cities share a border but are subject to two different sets of institutions. The U.S. city of Nogales is prosperous and advanced, while the Mexican city of Nogales is poor and underdeveloped. The authors also examine the case of North Korea and South Korea, looking at the great progress the South has made under inclusive institutions, and the terrible state in which North Korean citizens find themselves as a result of the highly extractive institutions.

Acemoglu and Robinson go back to colonization and trace the development of a country's institutions to the present day. It is interesting to compare the nascent institutional development that took place in Latin America under Spanish colonization with that which occurred in the United States under British rule. The Spanish invaded a country, kidnapped its leader, expropriated its resources, and forced its indigenous people to work for them. This formed the basis for the institutions that many Latin American countries have today. The authors argue that this legacy of exploitation and extraction has turned into a negative feedback loop, or what they call a *vicious circle*, keeping these countries poor today. The English, on the other hand, were unable to exploit the local indigenous population and the colonists who first lived in the original British colonies of America. They had to incentivize the colonists to work and be productive. This was the beginning of a *virtuous circle*, whereby a positive feedback loop created the inclusive, pluralistic political and economic institutions that still define the United States. (An important caveat to this claim lies ahead.)

In the middle part of the book, Acemoglu and Robinson detail their theory of inclusive and extractive institutions. They define key concepts and illustrate them with historical examples from different periods and different countries (both rich countries with inclusive institutions and poor countries with extractive institutions). The concepts of *institutional drift* and *critical junctures* become very important in this section. The former, as defined in the book, is the idea that every country experiences conflicts over money and politics. The way these conflicts are resolved can cause small institutional differences among countries. Then, at a watershed moment, referred to here as a critical juncture, these small differences can cause countries to choose different paths of development and establish sharply different institutions. Acemoglu and Robinson extensively discuss key critical junctures, such as the Black Death (the bubonic plague), the opening up of Atlantic trade, and the Industrial Revolution. For example, England during the Tudor period became more centralized and freer. Both the aristocracy and the Catholic Church were stripped of their power, and the English Parliament became decoupled from the monarchy. Therefore, when the English challenged Spain's dominance of the Atlantic in 1588, defeating the Spanish Armada, businesspeople and

merchants were able to take advantage of Atlantic trade and become rich. These same people were now in a position to demand participation in government and the decisionmaking process. This led to the Glorious Revolution in 1688, which would eventually cement the pluralistic, inclusive institutions that England has today. The authors also contend that the Industrial Revolution began in England because the country was first to develop inclusive institutions.

Another interesting topic explored by the authors centers on the growth-suppressing effects of extractive institutions. Acemoglu and Robinson maintain that there needs to be some level of economic growth for wealth to be created and extracted. Many different extractive political and economic regimes are explored, including the Ottoman Empire, the Soviet Union, and present-day China. The authors explain that empires and countries such as these, while having extractive institutions, are strong and centralized. This centralization can lead to economic growth, as it did in the Soviet Union when labor and capital were moved from agriculture to industry. However, such growth is not sustainable. Ultimately, centralization, along with extractive institutions, prevents the process of *creative destruction* that political economist Joseph Schumpeter saw as a driver of innovation and growth. This is because those in charge see creative destruction as a threat—one that spreads political and economic resources to groups other than the ruling government and lessens the resources available for extraction. An example given in the book is the Ottoman Empire's ban of the printing press. The empire feared the spread of ideas that might cause political instability. Another example is Austria-Hungary and Russia's opposition to railroads in the 19th century, as the governments of both countries did not want political instability that might come from a more mobile populace. The problem illuminated by these cases is that, without creative destruction, the economic growth of countries with extractive institutions eventually stalls and then declines.

The authors' discussion of China is especially interesting. China is debt ridden and has seen its growth slow down in recent years. However, the authors believe, as I do, that the country is not done with its impressive economic expansion. They state that, at some point in the future, China's extractive political institutions will interfere with and halt its economic growth. They claim that, although China has made toward more inclusive economic institutions, its growth will not continue in the long run without other major institutional changes. However, I wish the authors had speculated and forecasted a bit more about how long the Chinese economy will continue to grow and how strong it will become.

Another aspect of the book that I thought could have been developed in greater detail has to do with the claim that U.S. institutions are inclusive and pluralistic. A caveat is due with respect to slavery, Jim Crow, and the exclusion of Black America. The inclusive institutions were initially only for Whites. The authors discuss how a resilient Black population fought for its civil rights and the ensuing efforts to better integrate Blacks into politics and the economy. However, this discussion ends with the Civil Rights Movement. The book makes it seem as if, after the fight for civil rights, all institutions were more inclusive. I would have liked to see the authors discuss ways to address the discrimination and exclusion that still persist in some U.S. institutions.

The last part of the book drives the theory home, integrating all of the pieces and concepts laid out in previous chapters. Once again, the theory is used against a historical backdrop in order to describe how countries arrived at their current state of economic and political development. Acemoglu and Robinson claim that most of the cross-country differences that we see today are differences in the ability of states to take advantage of the Industrial Revolution. Those with inclusive institutions incentivized their people to innovate and produce, becoming rich in the process, whereas those fearing creative destruction and suppressing innovation became poor and are still

suffering today. The authors contend that their theory is especially useful for identifying weaknesses in policy solutions to economic development and poverty problems. They advocate for policy analysis through the framework of a country's institutions.

I enjoyed this book very much. It is well written and easy to follow, because it sticks with one theory throughout. This theory is backed up by easy-to-understand examples. The reader will walk away with an appreciation of the complex web of historical experiences that have taken place to create the institutions that define a country today. The book is a great read, and it's on the cheaper side.