Politics, Institutions and Development Economics

Julie Schaffner
Professor of Economics, The Fletcher School, Tufts University

In *Why Nations Fail,* Daron Acemoglu and James Robinson present their answer to the question: Why are some countries so much richer than others? Many countries are poor, they say, not because the countries face geographic or cultural disadvantages, but because their leaders have chosen bad policies, and bad economic institutions more generally. More important, their leaders have chosen bad economic institutions, not because they didn't know better, but because the bad institutions allowed them to enrich themselves and the rest of the elite by extracting labor and wealth from powerless people. Rich countries have prospered only because, at critical turning points in the past, coalitions of non-elite groups came together to overpower the elites and create inclusive *political* institutions, which prevent any single group from becoming an elite with extractive power. The practical implication most emphasized by the authors is that development economists should stop wasting their time trying to design better economic policies and institutions. The only way to improve poor countries' living conditions is through political change. Once the politics are right, the authors seem to say, the economic institutions will take care of themselves.

To unpack and support their thesis, the authors narrate historical episodes dating from the Neolithic Revolution to the present, and touching on every continent but Antarctica. The repetition of themes across this broad range of cases helps sensitize readers to the important influence of power and politics on human well-being. Unfortunately, the volume's breadth comes at the expense of detail, depth and rigor, rendering its argument unsatisfying and its main conclusion misleading.

1. Acemoglu and Robinson's theory of institutions, power and prosperity

To the question of why countries' average incomes differ so greatly today, Acemoglu and Robinson (henceforth AR) propose an answer with three layers. At the most superficial level, which AR take largely for granted, average income levels differ across countries today because differences in the rates of physical and human capital accumulation, technical change and improvement in allocative efficiency have caused them to grow at different average rates over many years (starting from similar levels hundreds of years ago).

At a deeper level, average incomes differ because differences in countries' economic institutions have created differences in their citizens' *incentives* toward the investment and innovation required for economic growth. Along with other economists, they quote North (1990) in defining institutions simply as "the humanly devised constraints that shape human interaction." The economic institutions relevant to growth include the formal policies and rules, and informal norms, that help determine the security of property rights, the credibility of contractual promises, the profitability of invention, the availability of business investment financing, and the feasibility of investments in infrastructure and education. The connection between economic institutions and growth, too, AR mostly take for granted when laying out their historical narratives. They offer one very general—but also rather extreme and contrived—empirical argument for the importance of economic institutions in Chapter 2. The historical and econometric argument they provide in Acemoglu, *et al*. (2001) is more compelling.

At the deepest levels addressed in this book, cross-country differences in current average incomes are the result of differences in "political institutions," which have long and complex historical roots. The authors devote most of the book to describing the path-dependent and contingent process of institutional differentiation that they believe underlies the array of political institutions we see today. Along the way, they develop a simple theory of institutional determination and change, which is suggested to them by repeated patterns they see in the historical record.

The starting point for their theory is that economic institutions are chosen through a political process. More specifically, they are chosen through a process best understood as one of conflict between two groups—the elite and the rest of society—in which the group with most power chooses the society's economic institutions. The significance of this conflict follows from AR's important observation that the economic institutions that are good for growth tend to be at least somewhat "inclusive," in the sense that they provide incentives for investment and innovation to a reasonably broad array of socio-economic groups, while the economic institutions that are bad for growth tend to be "extractive," in the sense that they allow a powerful elite to enrich themselves by extracting cheap labor and expropriating other wealth from less powerful groups.

In AR's view, countries enjoy good, inclusive economic institutions only when the right kind of political power is distributed in a sufficiently pluralistic fashion. The right kind of power is centralized, so that leaders can establish property rights, internal peace, and other economic and social infrastructure on a national scale. This power must be distributed in a pluralistic fashion, meaning that it is distributed across a diverse array of socio-economic groups. Where power is allocated in a centralized and pluralistic way, a country is said to have "inclusive political institutions," which give rise to inclusive economic institutions. Where power is centralized and allocated to an autocrat (or is decentralized across a chaotic set of smaller competing groups), a country has "extractive political institutions," which give rise to extractive economic institutions.

This begs the question: what determines the relative power of the elite and the rest of society, and the nature of political institutions? AR sensibly suggest that a group's political power is a function of its economic power and its closely-related capacity for violent force, as well as its capacity for collective action. These relationships suggest some tendency for the extractive or inclusive nature of a country's institutions to persist. Extractive political institutions allow the elite to gain economic power from extractive economic institutions, and to prevent the spread of education and innovation that might threaten their power. Sometimes a country's institutions remain extractive, despite dramatic change (such as the change associated with gaining independence from a colonial power), as a new elite group succumbs to temptation and simply takes over the extractive power of the old elite. AR argue that inclusive political institutions, too, have a tendency to persist, and even tend to evolve in ways that allow broader and broader political participation, because the inclusive economic institutions they support spread wealth and education broadly, allow a freer media, and empower groups opposed to the use of oppressive force by any leader. This argument seems incomplete, however, because it explains only why the non-elite groups would retain total power greater than that of the elite, but not why cooperation among the non-elite groups would remain resilient.

Despite the tendency to persist, political institutions can change. AR give the name "critical junctures" to important episodes of economic or social change that drive changes in groups' economic power, capacity for violence or coherence of organization, and thus in their political power. Political institutions seem to be sticky, for unspecified reasons beyond the persistence of political power. Thus the changes in power arising during critical junctures sometimes remain latent until conflicts reach critical peaks. In these decisive moments, power also depends on the "contingencies" that affect success in military battles or in contests for the public's affection, which groups must win to put their preferred political and economic institutions into place. Significantly, a shared critical juncture sometimes alters power differently in places starting with different political and economic institutions—even when the initial differences are small—rendering the evolution of power and institutions path-dependent.

AR apply this simple theory of institutional change to describe how institutions, which long were extractive everywhere, have become differentiated in a way that explains today's global variation in economic prosperity. They narrate critical episodes of differentiation (with effects lasting to the present) as far back as the fall of the Roman Empire. Other critical junctures that figure into their story include the Black Death, the rise of Atlantic trade, colonization, de-colonization and the death of Mao.

Their narrative of England's Glorious Revolution of 1688—the seeming center of history in AR's telling—exhibits most of their theory's elements. One hundred years prior to the Glorious Revolution, political institutions in England, France and Spain were similar and extractive, with one small difference: Because the British crown was less financially independent than the French and Spanish crowns, Elizabeth I was forced to relinquish her right to create new royal monopolies. As a result, while the rapid expansion of Atlantic trade after 1600 (a critical juncture) enriched the autocrats in France and Spain, it enriched and empowered anti-autocratic groups in England (bringing path-dependent change). The resulting tilt in political power in England made possible the Glorious Revolution; and whatever contingencies allowed the rebels to win yielded a new constitution, which greatly limited the monarch's policymaking scope. The introduction of more inclusive economic institutions soon followed, as Parliament used its new power to curb monopolies further, redistribute tax burdens, reorganize property rights, encourage an expansion of banking and finance, and otherwise support manufacturing. According to AR, the Industrial Revolution would not have happened in England without these changes. Interestingly, the "inclusive" institutions put into place by the Glorious Revolution endowed less than 2 percent of the population with the right to vote.

2. Proof by plausibility

The way the authors seek to demonstrate the validity of their theory is to narrate an impressively broad array of historical episodes in ways that make plausible (though elastic) use of the theory's vocabulary (e.g. elites, extractive institutions, and critical junctures). Even though I find AR's interpretations of history plausible, I find this methodological approach off-putting. In choosing this approach, the authors chose not to pursue more rigorous approaches, such as identifying falsifiable implications of their theory (as applied to the specific episodes they study) and subjecting them to empirical testing, or identifying alternative explanations for critical historical outcomes and ruling them out. Such approaches might have required the authors to sharpen their definitions and hypotheses. They would also have left me less concerned that the brief synopses of historical episodes presented in the book might be leaving out important information that did not fit neatly with the proposed theory.

For example, the authors describe how, after the Black Death, feudalism disappeared in Western Europe while becoming more oppressive in Eastern Europe. They assert that these very different paths of change both represented responses to the same labor supply reduction wrought by the plague, but differed as the result of small initial differences in institutions, such as the somewhat better organization of land owners in the east (on which no details are provided). That is a pretty big claim! Was nothing else happening in this period? Would other historians tell the story the same way? Why should we conclude that this explanation is the right one?

3. Politics, political institutions and political change

If poor countries are poor because their political institutions are extractive, then AR's research yields practical implications about how to raise living standards in poor countries only if it yields practical implications about how to improve political institutions. In their search for practical suggestions, they take a first step in an intriguing direction, but I would have liked them to dig deeper. The intriguing first step is to posit that inclusive political institutions must be established by a *coalition* of diverse non-elite groups, each willing to accept and enforce institutional checks against any one group's extractive power. This suggests an important asymmetry between extractive and inclusive political institutions, with extractive institutions supported only by the appropriate preponderance of economic and military power, while inclusive institutions also require adequate incentives for cooperation within a coalition. I would have liked to see more detail in the historical narratives regarding the nature of successful coalitions, the implicit or explicit negotiations required to seal their alliances and the details of their institutional compromises. I would also have appreciated more systematic study of the critical junctures and contingencies capable of catalyzing the required cooperation.

I suspect that to make further progress toward practical implications, AR will have to articulate more carefully their definition of political *institutions*, as distinguished from the mere balance of political power, and to dig deeper into political institutions' underpinnings and impacts. The authors whose work on institutions I find most insightful, including Greif (2006), Ostrom (1990) and Platteau (2000), make clear that institutional rules play meaningful roles in determining socio-economic outcomes only if they constrain particular people to behave in particular ways that they would not behave in the absence of the rules. To fully understand a set of institutional rules, therefore, one must identify in detail whose behavior and which behaviors are constrained by the institutional rules, and—most important—why people obey the rules. AR explicitly define political institutions as rules that determine "who has power in society and to what ends that power can be used" (p. 80), sometimes (but not always) identifying them closely with formal constitutional rules; but they do not offer any specifics regarding the rules they consider important or how the rules are enforced. The question of why people obey political institutions, and continue to obey them even when political power shifts, is especially intriguing. While people might obey extractive economic institutions because other people with power coerce them to obey, no such simple story can explain enforcement of inclusive political institutions, which by definition constrain the very exercise of power.

Case studies of community-level cooperation-supporting institutions (such as local institutions that protect common pool resources), together with experimental research in behavioral economics, suggest a rich list of mutually reinforcing reasons why people seem to obey healthy institutional rules: the hope of future cooperative interaction (as in infinitely repeated games), preferences toward conformity to norms, and threats of immediate punishments by other community members that are made credible by the punishers' preferences toward reciprocity. People with preferences toward "reciprocity" derive utility from punishing those who act unfairly or rewarding those who act fairly (Fehr and Gachter, 2000). All this suggests that to understand the emergence or persistence of coalition-supporting political institutions we may need to study the formation of social norms, notions of fairness, and beliefs about what is right and wrong. Notions of right and wrong, such as beliefs about when it is right to defer to socio-economic superiors and when it is instead virtue to challenge them, may be especially important. If so, then the creation and dissemination of influential (non-technological) *ideas*—variables that do not enter into AR's description of history—may figure crucially among the critical junctures and contingencies that help catalyze the creation of inclusive political institutions.

4. Are development economists wasting their time?

A repeated theme in *Why Nations Fail* is that political change is a necessary and sufficient condition for raising incomes in poor countries; so development economists are wasting their time trying to devise better policies and better ways to build healthy economic institutions. The real world is more complicated than the stylized world of AR's simple theory, however, in several ways that I suspect invalidate this extreme conclusion.

First, in AR's world, if a country is poor, it must have suffered under extractive political institutions in the past and must *still* languish under extractive institutions in the present. In the real world over the last two decades, however, many poor countries have experienced significant political openings, which AR do not discuss. On the advance of democracy in Africa, for example, see Radelet (2010). The recently reformed political institutions are not perfectly inclusive, but neither are they perfectly extractive. Thus I suspect there is room to improve economic institutions in a larger number of poor countries than AR acknowledge.

Second, in AR's world, the elite exercise unanimous and complete control over economic institutions. Today's real world institutions are more complex and variegated. Governments are composed of multiple ministry lines, operating at multiple geographic levels, interacting with many non-governmental organizations. I suspect that, just as pockets of corruption flourish in hierarchies overseen by well-intentioned leaders, so pockets of competence and compassion flourish in hierarchies overseen by greedy leaders. Here I am influenced by years of working with bright master's students, who are dedicated to making the world a better place even if that requires sacrifice. Some now work in countries AR would consider extractive. They are constrained by the extractive institutions around them, and must take those constraints into account in their work, but the institutions do not entirely prevent them from introducing improving change.

Third, in AR's world, the details of economic institutions either do not matter, or quickly take care of themselves once political institutions become inclusive. After years of studying the detailed designs and impacts of development policies and their governance structures, I conclude that the details matter a great deal and do not take care of themselves, even when policymakers are well-intentioned and competent. Getting design right takes careful, context-specific economic analysis, together with on-going evaluation and re-design. This is true even for seemingly straightforward policies like cash transfer programs. The challenges are much greater when attempting to create effective institutions for dispensing justice, protecting land rights or constructing and maintaining infrastructure. On-going research is also required as efforts are made to replace modestly-inclusive economic institutions by institutions that deliver more benefits to the poor.

Finally, in AR's world, economists who brainstorm about the design of economic institutions have no role to play in creating the critical junctures or contingencies that help catalyze political change. In reality, by generating new ideas about how economic institutions might be organized, and by spreading information about the disaggregated impacts of diverse policies, they may sometimes play such roles. For example, by proposing the concept for Mexico's Progresa program (now called Oportunidades) – which conditions a household's receipt of cash transfers on its sending children to school – and by ensuring rigorous evaluation of the program's impact, economist Santiago Levy helped render poverty reduction remarkably popular politically, in Mexico and elsewhere. It seems likely that the increases in poor households' incomes and school enrollment rates that resulted from the program will eventually increase the inclusivity of political institutions.

5. The value for Christians of *Why Nations Fail*

Why Nations Fail is about how the world works. It does not set out theology or doctrine, nor does it offer moral arguments for any particular course of action. Thus my Christian beliefs and values do not much enter my evaluation of the book's arguments and conclusions. If I have any comment worth directing specifically to Christian readers, it is simply that AR paints a picture of how the world works that is both consistent with Christian worldviews and potentially challenging to Christian lifestyles. It is a world in which human beings are capable of perpetrating great evil against other human beings, when their greed and pride remain unchecked and especially when their economic and social circumstances endow them with power. It is also a world in which global poverty is not "merely" a matter of widespread deprivation, but also one of searing injustice. At the same time, AR describe a world in which improving change is possible, especially when people are willing to cooperate with others who are different, and especially when they are willing to accept checks on their power. I hope AR's description of the world challenges us to grieve with God over sin and the centuries of suffering it has engendered; to examine how selfishness, pride and power affect the way we treat other people; and to redouble our efforts to advance God's kingdom by pursuing justice.

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