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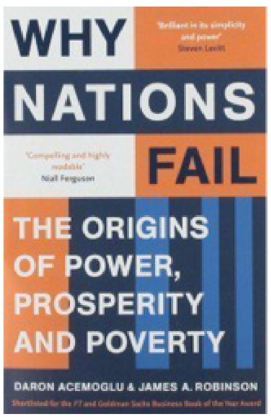

Why Do Nations Fail : The Origins of Power, Prosperity, and Poverty. Daron Acemoglu & James A. Robinson

Summary By: Ali Dost

About the authors

- Daron Acemoglu
- Turkish Born American Economist
- Professor of Economics at MIT

- James A. Robinson
- An Economist
- Political Scientist
- Professor at Harvard University

Overall Summary

- Developed countries are wealthy because of ‘inclusive economic institutions’ – Basically a combination of the state and the free market in which:
- The state creates incentives for people to invest and innovate through guaranteeing private property rights and enforcing contract law.
- The state enables investment and growth through providing education and infrastructure.
- The state is controlled by its citizens, rather than monopolized by a small elite. Crucially, there needs to be a democratic principle at work in which people in politics establish institutions and laws which work for the majority of people, rather than just working to benefit the rich.
- The state also needs to maintain a monopoly on violence.

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- In contrast to those countries which develop 'inclusive economic institutions' which encourage development, the authors suggest the opposite 'extractive economic institutions' (think about a corrupt dictator and his clique stashing money into a Swiss bank account) can generate growth in the short-term, but in the long term result in poverty.
- They also suggest that there has been 'a vicious circle' at work in many underdeveloped countries over the last three to four centuries: Extractive institutions were first established by a colonial power (typically built on already existing internal extractive institutions), which, on independence, became even more extractive under postcolonial rulers, which in turn lead to civil war as competing factions fought for control over the extractive institutions – which then led to a decent into chaos and failed states. The authors see little hope for such countries.
- In contrast, developing countries such as the US and the UK have benefited from three to four centuries of a virtuous circle in which institutions have become gradually more inclusive, which has created increasing incentives for entrepreneurs and economic growth.

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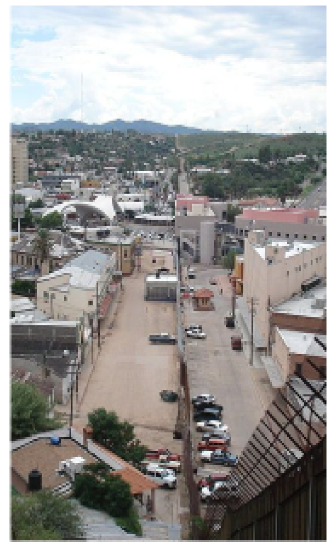
- The authors come to this conclusion through a number of comparative studies of countries which are in close geographical proximity to each other such as:
- Mexico/ America
- South/ North Korea
- Botswana/ Zimbabwe
- They argue that the crucial difference between these pairs of countries is the institutional infrastructures which have been established through the last few decades/ centuries, and it is this that explains their relative development/ underdevelopment.

Chapter 1: So close and yet so different



A comparison of the two sides of Nogales, half of which lies in Arizona, in the US, the other half in Mexico.

In the Arizonan half the average income is $30 000 U.S dollars, the majority of adults are high school graduates, the roads are paved, there is law and order, most live until over 65. In the Southern half, the average income is three times less and everything else is similarly worse.

The authors point out that the difference cannot be because of environment or culture, it must be because of politics and economic opportunities.

They also argue that in order to understand the difference, you need to go right back to early Colonialism in the 16th and 17th centuries.

Mexico was the first to be colonized, under a system of slavery and extraction. In the 15th century, the Spanish basically used already existing systems of slavery to their own benefit and extracted mountains of gold and silver, leaving a legacy of elite-governance and a dearth of political rights for the majority.

In North America, settled by mainly the English 100 years later, the absence of slavery amongst indigenous populations and much lower population densities meant that slave systems simply would not work, although this didn't stop them trying for the first twenty years or so. Eventually, however, the original settler company (The Virginia company) back in England realized the only way colonialism was going to work was to provide incentives for the settlers – So they offered them land in return for work. It was this that set the basis for the democratic constitution and congress of the US, which then went on to create problems for the English government.

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- The rest of chapter goes on to argue that the next 300 years of history are crucial to understanding why the US is now so wealthy, and why most of Latin America is so poor.
- America has had 300 years of political stability, where poltical institutions control economic institutions, at least to an extent (the authors cite the breaking up of the Microsoft Monopoly as an example) broadly making them work for everyone. Other factors such as the patent system, credit systems, and education provide opportunities for anyone to make it rich and enjoy the benefits of the wealth.
- By contrast in Latin America (Mexico), up until the 1990s most countries saw political turmoil and a series of dictatorships where a series of small elites ruled for their own benefit. This instability has lead to the rise of monopoly power, and it acts as a disincentive for anyone to try and do well and become rich (the next dictator might just take all your money away), also lack of finance and education prevents competition anyway.
- Crucially, historical good fortune appears to be central to explaining why a country is rich now, so figuring out how a current poor country can develop is not that straight forward if a culture of monopoly, corruption and lack of political rights are the norm…..

Chapter 2: Theories That Don't Work

- The geography hypothesis:

People in tropical areas tend to be lazy e.g. Nogales U.S and Nogales Mexico as stated above East and West Germany before the fall of the Wall.

- The culture hypothesis:

Religion, beliefs, values and ethics determine the fate of the nation counter example, South and North Korea both have same cultural identities yet they are different (Explained in the next chapter in detail)

- The ignorance hypothesis:

Rulers do not know how to make poor countries rich. This is challenged by the Authors. The authors believe that countries have different institutions such as wealthy and prosperous countries have inclusive institutions while poor countries have extractive institutions. The ignorance hypothesis is simply a blame the poor approach because leaders of 3rd world countries keep people poor on purpose in order to retain power.

- All three hypothesis are flawed are debunked by the authors in this chapter.

Chapter 3 – The making of prosperity and poverty

This chapter contrasts North and South Korea, divided along the 38th parallel after world war two. In the late 1940s these had similar levels of development, today, however, their economies have diverged.

South Korea has living standards 10 times higher than North Korea, the former being similar to Portugal, the later similar to sub-Saharan African countries. People in North Korea also live ten years less than those in South Korea.

The differences cannot be explained by anything other than institutions. In the South, private property and markets were encouraged (albeit by dictators initially) and thus investment and economic growth were encouraged. At the same time, the government invested in education and new industries took advantage of a better educated population.

In North Korea, private property and markets were banned, and a centrally planned economy instigated. This simply led to stagnation.

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- **Extractive and Inclusive economic institutions:**
- Extractive Institutions are Narrow, absolutist and unconstrained while Inclusive institutions are centralized and pluralistic.
- Inclusive political institutions give birth to inclusive economic institutions while Extractive political institutions give birth to extractive economic institutions.
- Countries differ in their economic success because of their different institutions – the rules influencing how the economy works and the incentives that motivate people. Crucial is private property rights – which needs to be backed by the state…. In South Korea, people know that they will be rewarded for their efforts, in North Korea, there is no incentive to innovate and invest because the state will expropriate the benefits of any such initiatives.
- In order to develop a society needs to have 'inclusive economic institutions' – A state that guarantees prosperity for the masses – Such a state provides a degree of infrastructure that is necessary for economic growth – for example enforcing private property rights, contract rights for all, not just a minority, and providing education and physical infrastructure such as roads. Private enterprise uses and needs such institutions.
- What doesn't work for development is extractive institutions – where the state is used to extract wealth from one subset of the population to another…. Such as slave and colonial systems (and the Tories in the UK today?)
- **Engines of Prosperity:**
- Education for the masses is crucial for innovation in an advanced technological world – This is what all developed nations have, and what many undeveloped nations lack. Education needs to be well financed and parents need to have the incentive to send their kids to school.

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- **Why not always choose prosperity?**
- The simple fact is that where technological change is the engine of economic growth, this means social change, and with change there are winners and losers… Thus existing elites may resist changes that make institutions more inclusive even if this means greater prosperity for all, because it will mean less prosperity for them. (Think industrial revolutions in Europe).
- **Case study of Congo:**
- The Congo has not developed since independence because it has not been in the interests of the ruling elite to build a centralized state which includes all voices, or in their interests to use the state to provide public services which will benefit the masses – instead the institutions remain extractive.
- As an independent polity, Congo experienced almost unbroken economic decline and poverty under the rule of **Jospeh Mobutu** between **1965 and 1997**. Mobutu created a set of highly extractive economic institutions. The citizens were impoverished but Mobutu and the elite around him (known as the Grosses Legumes or The Big Vegetables) became fabulously wealthy. Mobutu built himself a palace at his birthplace, **Gbadolite**, with an airport large enough to land a supersonic Concord jet, a plane he frequently rented from Air France for travel to Europe. In Europe he bought castles and owned large tracts of the Belgian capital Brussels.
- The simple truth is that if Mobutu had introduced more inclusive economic institutions he would not have been as rich.

Chapter 4: Small Differences and Critical Junctures: The weight of History

- History and critical junctures shape the path of political and economic trajectory for example:
  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.
- Why some nations make the transition to inclusive economic and political institutions? As some nations gain intellectual freedom and change is directly proportional to the advancement in technology. For example Magna Carta 1215 and the industrial revolution.

		Economic	Institutions
		Inclusive	Extractive
Political	Inclusive	↻	⟵↓
Institutions	Extractive	↑⟶	↻

Chapter 5: Growth under Extractive Institutions

- In this chapter the Authors prove that growth can occur under extractive institutions. For example, The economic growth of the soviet union from 1920 to 1970.
- The authors assert that sustainable growth needs technological changes and extractive institutions limit technological changes thus making the overall process unsustainable. E.g Collapse of Soviet Union.
- The Authors assert that China's political system is not inclusive and if China does not have political transformation it will ultimately collapse.

Chapter 6: Drifting Apart

- In this chapter the authors explain the historical development of political and economic institutions over the world.
- The authors point out that inclusive institutions can be reversed for example in Venice. This shows there is no cumulative process of institutional improvement.
- Thus, inclusive institutions can be reversed or overthrown as in Rome and Venice when this happened growth became stunted in both

Chapter:7 The Turning Point

- **Case study of England from 1200-1700**
- This chapter analyzes the transform of England's extractive institutions to inclusive institutions.
- Throughout history the elite has a fear of creative destruction which is a hindrance in development
- New technology renders old practices obsolete, Thus the elite shows resistance to creative destruction
- Industrial revolution in England prior to the 17th century extractive institutions were the norm in England. England saw the phases of **creative destruction**.

1. **Magna Carta 1215:** Where the people of England showed they could limit the power of the king where Barons represented them.
2. **War of Roses 1455-1485:** the English civil wars between the houses resulted in a strong govern of the house of Tudors. The Tudors increased political centralization and broke away from the catholic church.
3. **Glorious Revolution 1688:** After the Tudors the House Stuart came to rule England which reversed the inclusive institutions of House Tudors. This caused a revolution which transformed the political institutions to be plural and foundations of inclusive economic institutors were laid this paved the way for the industrial revolution

Chapter 8: Barriers to development

- In this chapter authors outline the barriers to development they are:
- Ottomans opposed printing press.
  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 1st printing press is allowed in the Ottoman lands. Then Sultan Ahmed III issued a decree granting ·Ibrahim Muteferrika permission to set up a press, but under close supervision and censorship. Muteferrika printed few books in the end, only seventeen between 1729, when the press began to operate, and 1743 when he stopped.
- Absolutist regimes blocked the spread of industry.
- Consequence; they lagged behind.

Chapter 9: Reversing Development

- In this chapter the authors analyze colonialism and how it reverse development.

- European colonialism impoverished large parts of the world. E.g. The Scramble for Africa, **The Scramble for Africa**, also called the Partition of Africa or the Conquest of Africa, was the invasion, occupation, division, and colonization of African territory by European powers during a short period known to historians as the New Imperialism (between 1881 and 1914). Furthermore, A case study of Sub-continent shows that before the British the subcontinent was producing **28%** of the worlds GDP while after the British left it was only producing **3%** of worlds GDP.
- Colonies did not benefit from industrialization, rather strengthened already present extractive institutions. The colonists left these institutions still operating in the colonies and they were adapted by the Ex-colonial states and thus the extractive institutions put these states in a reverse gear. E.g. the civil war in **Sierra Leone** ,the authors put this down to decades of extractive institutions by the tyrannical APC government

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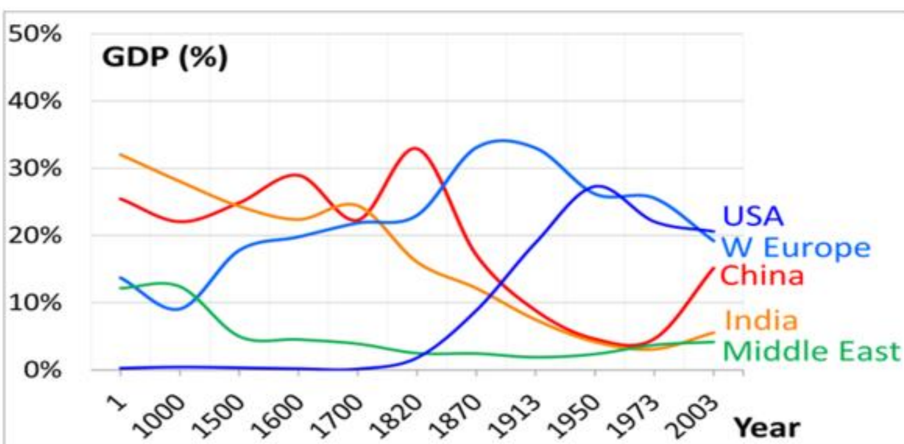


Chapter 11: The Virtuous Cycle

In this chapter the authors outline the effects of inclusive institutes within a state.

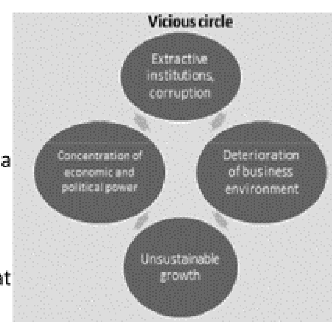
Democracy thrives due to inclusive institutions and dictatorship is not welcomed in inclusive political institutions inclusive political institutions support and are supported by inclusive economic institutions .e.g. The development of parliament during the rule of Tudors in England laid the foundations of an inclusive political institution which ultimately led to the industrial revolution which was attributed to inclusive economic institutions.

Inclusive political institutes:
1.Remove extractive economic relations.
2.Slavery and serfdom.
3. Does not let one party or individual create a monopoly.
4. Create a dynamic economy.
5. Allow a free media to flourish which creates checks and balances.

This generates a positive feedback loop where the people own the state's or governments institutions e.g. People who trust their government do not evade tax.

Chapter 12: The Vicious Cycle

- Extractive political institutions lead to extractive economic institutions which tend to enrich a few at the expense of many.
- Create the platform for extractive political institutions to persist where no checks are provided against abuses of power.
- This leads creation of unconstrained power and great income in the hands of a few and inequality increases the potential stakes of the political game leading towards anarchy.
- The British Colonial Authorities built extractive institutions which many post independence African politicians were only too happy to continue in order to enrich themselves. This happened in countries such as Sierra Leone, Ghana, Kenya and Zambia. The postcolonial rulers used their wealth to build personalized security forces which were answerable to them and also to rig elections – money thus became essential to maintain power, with only those who have money able to maintain power. This creates incentives among the opposition to depose the existing leaders in order to gain power and wealth themselves, and to protect themselves from being killed off by the said existing leaders. The point here is that power has become an end in itself rather than as a means to developing a country.
- This generates a negative feed back cycle which results in the masses not trusting their insertions and see them as a tool of subjugation.



A case study of colonialism

This is best illustrated through the example of Sierra Leone –

All of the West African nation of Sierra Leone became a British colony in 1896. The British identified important rulers and gave them a new title – paramount chief. In Eastern Sierra Leone, for example, they encountered **Suluku**, a powerful warrior king, who was made Paramount Chief. In 1898 the British tried levying a hut tax of five shillings, which resulted in a civil war known as the hut tax rebellion. It started in the north, but was strongest and lasted longest in the South. In 1904, the British stopped construction of a railway line from Freetown to the North East and instead diverted it south, to Bo, in Mendeland, to give them quick access to put down this rebellion. When Sierra Leone became independent in 1961 the British handed power to the SLPP, which attracted support from the South, and in 1967 this party lost the election to the opposition party, the APC which drew support from the North. Though the railway line was initially established to rule SL, by 1967, its role was economic – it allowed transportation of the country's exports – coffee, cocoa, and diamonds, which came mostly from Mendeland in the south. The then leader of the APC, **Siaka Stevens**, who drew his political support from the north, ripped up the railway line and sold off the track and rolling stock in order to weaken the opposition in the south and consolidate his political power. This decimated the SL economy, but when it came to a choice between consolidating power and economic growth, the consolidation of power won out. Today, you can't take the train to Bo anymore. There is continuity between Colonial rule and Steven's government – both extracted wealth from the people.

Chapter 13: Why Nations Fail Today

In the year 2000 Zimbabwe held a national lottery for everyone who had kept more than 5000 Zimbabwean dollars in their bank account (following a period of hyperinflation). The fact that it was Robert Mugabe who won this lottery just goes to show the extent of his control over Zimbabwe's institutions and just how extractive those institutions had become.

The most common reasons nations fail today is because they have extractive institutions – and Zimbabwe illustrates the economic and social consequences of these…. By 2008 its per capita income was half that when it gained its independence, and 2009 the unemployment rate stood at 94%.

The roots of the political and economic institutions lie in the colonial period. Originally apartheid institutions were established for a white elite to extract wealth from the country, but when Zimbabwe gained its independence, these institutions were simply maintained by Mugabe. Eventually (because of lack of inclusivity) his support waned until by the year 2000 he had to find further resources to buy political support – so he expropriated the farms owned by white people and when that wasn't enough he printed money, which led to massive hyperinflation.

Nations fail today because their extractive institutions do not create the incentives to save, invest and innovate. In many cases politicians stifle economic activity because this threatens their power base (the economic elite) – as in Argentina, Colombia and Egypt. In the cases of Zimbabwe and Sierra Leone this led to total state failure and economic stagnation. The countries in which this has happened include: Angola, Cameroon, Chad, DRC, Haiti, Liberia, Sudan, Zimbabwe etc.

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What all of the countries looked at in the book have in common is that they have an elite who have designed economic institutions in order to enrich themselves and perpetuate their power at the expense of the vast majority of people in society.

Despite differences the bigger picture is that in each of these countries extractive political institutions that have created extractive economic institutions which transfer wealth and power toward the elite.

The solution is to transform the extractive institutions into inclusive ones...

Chapter 14: Breaking the Mold

- The most interesting section of this concerns the predictive power of the theory – which is limited given the role of agency and contingency in said theory. However, the authors do predict that.
- America and Europe are likely to get even richer than countries in most of the rest of the world, because these are the most inclusive institutions (I'd beg to differ given Tory Policy). Nations that have undergone no significant state centralization such as Afghanistan, Somalia and Haiti are unlikely to witness any development. Some Latin American countries are set two grow – most notably Brazil, Chile Mexico as are some African countries – Tanzania and Ethiopia for example. Growth will not be sustained in China.
- **The irresistible charm of authoritarian growth:**
  This section reminds us that modernization theory is flawed – economic growth (more Mcdonalds as Thomas Friedman might put it) does not necessarily lead to to more inclusive political institutions.Plenty of repressive regimes have pursued and achieve very rapid economic growth in the last 60 years – Germany, for example, Russia, and China.This chapter also deals with what probably won't work in terms of development... Firstly, any attempt at engineering policy changes such as those attempted by neoliberalisation throughout the 1980s and 90s – Because if a country is politically corrupt, they just subvert the policy changes – Privatisation happens, but the people winning the contracts are the brothers of the ministers for example, or the country says it implements a policy but they just carries on as normal

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- **You can't engineer prosperity:**
  Because the actors within developing countries are constrained by their institutions, and if these are extractive then any programme's designed to engineer change will ultimately result in further extraction. This is true of two approaches to foreign aid preferred by the West – both the neoliberal 'restructure your economy' type approach and the micro-economic approach which focuses on specific institutions.
- **The failure of foreign aid:**
  As above, any aid money going into a country with extractive institutions will ultimately end up being extracted. The authors do argue, however, that even if only 20% of aid money reaches its ultimate destination then it's worth it!
- **What works….?:**
  The chapter and book round off by going back to the English and US revolutions which resulted in institutions becoming more inclusive – what is required for development is a plurality of voices demanding to be heard by government and actually being heard. This cannot be imposed from above, but seems to have to become from below. In this sense, any attempt to engineer growth and provide aid seem pointless – the only things that make any sense are programmes oriented towards empowerment and making sure media is free because the later fosters the former.

Thesis of the Authors (The whole book in a nutshell)

- Economic prosperity depends upon institutions
  Political institutions
  Economic institutions
- Further divided into two categories
  Inclusive political and economic institutions
  Extractive political and economic institutions
- Virtuous circle strengthens inclusive institutions
- Vicious circle strengthens extractive instututions

Shortcomings or Limitations of the Authors Approach

- Fails to tell how nations can prevent the build-up of institutions that cause poverty.
- Does not ponder upon the reasons of emergence of inclusive and extractive institutions.
- Ignores the role geography, culture and ignorance have to play in a Nation's failure or success.
- Growth cannot also sustain even under inclusive institutions.

  global financial meltdown of 2008
- Goes too far back in time in citing examples, reducing its relevance in current world situations
- Use of too many historical examples makes the thesis a bit relevant.

Relevance to Pakistan

- Do extractive political institutions exist in Pakistan?
- Is there a monopoly of civil and military elite on politics?
- Do feudal lords use political institutions for their own benefit?
- Can a common man in Pakistan fight an election, or do the elections strengthen position of narrow elite?
- Has foreign aid induced development benefits for the rich?
- Was the huge inflow during military dictatorship helpful? If so why still Pakistan's Police service has "Thana Culture"?
- Is Pakistan dependent on other countries?
- Is the Pakistani education system producing thinkers, innovators or intellectuals?
- These are those tough questions that all Pakistanis need to ask themselves.