Why Nations Fail review part I

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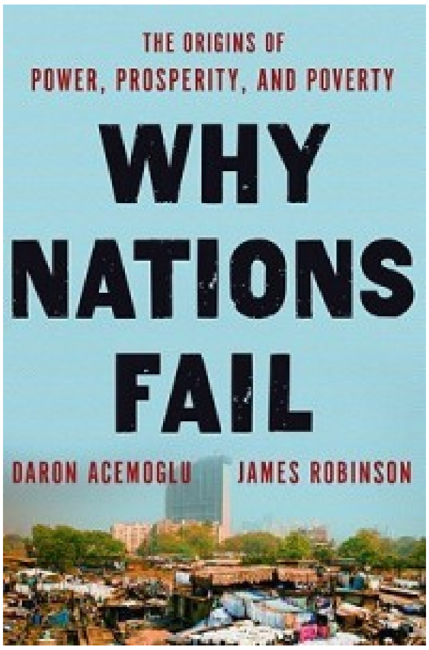

The big two questions I keep on being hit with as an Australian living and working as a public policy consultant in Timor-Leste and the Pacific are why and what to do. Why in economic terms are these countries poor and Australia rich; and what can be done about closing the gap?

I jumped at the chance to read Daron Acemoglu and James Robinson's *Why Nations Fail: The Origins Of Power, Prosperity And Poverty* (2012) to see what their answers were. The book is a great read in the tradition of Jared Diamond's *Guns, Germs and Steel* (1997) and *Collapse: How Societies Choose To Fail Or Survive* (2005), as well as David Landes' *The Wealth and Poverty of Nations: Why Some Are So Rich & Some are So Poor* (1998).

This review is in two parts. Initially I give some background about the authors and outline their main arguments. The second part of the review teases out the lessons from Acemoglu and Robinson's analysis for Timor-Leste and the Pacific.

Why Nations Fail is an important book because it does what few academics are willing to do: offer an analysis on a grand scale, covering a huge expanse of history. Moreover, their analysis is underpinned by authors' peer-reviewed articles in prestigious journals written over a period of fifteen years.

Despite their backgrounds as quantitative researchers, the book is largely free of jargon. Nor are there any esoteric data analyses or even a data table in the text. Chapter subheadings show the breadth of the historical examples used to illustrate their analysis: 'why the politically powerful in many nations opposed the industrial revolution', 'how European colonialism improvised large parts of the world', and 'how some parts of the world took different paths to prosperity from that of Britain'.

Acemoglu is an economist at MIT and Robinson is in the Department of Government at Harvard, but they both have backgrounds which are not conventional. Robinson grew up in Barbados and Trinidad, the son of an engineer who worked for the British colonial governments of Nigeria and Ghana and then as a consultant in Africa. He studied economics at the LSE, Warwick and Yale Universities. Robinson has held positions in

Economics at the University of Melbourne, University of Southern California and in Economics and Political Science at the UC Berkeley. Acemoglu grew up in Turkey, the son of a law professor. He completed his studies in Economics in the UK at the University of York and the LSE.

The argument

Their first contention is that inequality between countries is due to the differences in political and economic institutions rather than to differences in geography, culture, or access to knowledge and skills. By institutions, they mean the rules affecting how the economy works and the incentives that motivate people.

Next, they argue that institutions act in an inclusive or exclusive way to encourage or discourage people taking part in economic and political activities. To be inclusive, economic institutions need to have rules which secure private property, have an unbiased system of justice and provide public services to enable citizens to participate in the economy. Inclusive economic institutions pave the way for the workforce to access education and skills, competencies, and know-how which underpin technological innovation.

Poverty of opportunity is caused by exclusive institutions that fail to provide equitable access to public services such as education:

> The low education level of poor countries is caused by economic institutions that fail to create incentives for parents to educate their children and by political institutions that fail to induce the government to build, finance, and support schools and the wishes of parents and children (p 78).

Exclusive or extractive economic institutions are controlled by political elites who ensure that the benefits of any economic growth that does occur are captured by them.

The third prong is to argue that economic growth achieved under extractive institutions cannot be sustained for two reasons. Political elites in charge of extractive institutions resist the creative destruction required for innovation to emerge because they fear they cannot control its effects. In time, this tight political control to limit the spread of benefits leads to instability. China is offered as the key contemporary illustration of this contention.

Finally, how can countries break out of the vicious cycle of extractive economic and political institutions reinforcing each other? Acemoglu and Robinson argue that countries can do so, but they do not offer any simple recipes for doing so and are highly critical of those who do. They also argue that any change to institutions also depends on ‘critical junctures’. These are major events that upset the existing political and economic balance in the society.

Criticism

Jared Diamond, in his over 4,000 word review entitled ‘what makes countries rich or poor’, has offered some strong criticisms of their single-minded analysis. He argues that their dismissal of geographical factors in general and the impact of agriculture systems in particular is too peremptory. The legacy of how societies developed and where they are located shapes their chances of surviving and prospering.

The World Bank’s draft Note on Pacific Futures argues that the small size of the economies of most Pacific island countries and long distances to major markets have a determining impact on their prospects for economic development. Small size in itself is not necessarily a hindrance to development, as the examples of Singapore, Finland and Ireland show. Distance from major markets and the main transport nodes are much more difficult obstacles to overcome.

Cultural factors are also a constraint on development. Diamond uses the example of Papua New Guinea to point out that societies with a lack of history of centralised government find it hard to develop these institutions.

> One can't just suddenly introduce government institutions and expect people to adopt them and to unlearn their long history of tribal organisation. That cruel reality underlies the tragedy of modern nations, such as Papua New Guinea, whose societies were until recently tribal. Oil and mining companies there pay royalties intended for local landowners through village leaders, but the leaders often keep the royalties for themselves. That's because they have internalised their society's practice by which clan leaders pursue their personal interests and their own clan's interests, rather than representing everyone's interests.

The culture and institutions of societies with few resources are often shaped by a sharing ethos based on the need to distribute scarce goods to survive. These rules requiring people to share what assets they have act as an informal security net to avoid extreme poverty. Some people in these societies appear to benefit more than others from their place in the kinship network. However, it may be going too far to claim a priori that these leaders are always acting is a narrow self-interested way.

Nevertheless, supportive institutions are important as the recent analysis of Some Small Countries Do It Better (World Bank 2012) makes clear in the chapter on governance and growth. So what are the implications of Acemoglu and Robinson's analysis for the Pacific and Timor-Leste? Part II of this review addresses this question.

This blog is a part of a series on 'Why Nations Fail.' For other blogs in the series, see here.

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