

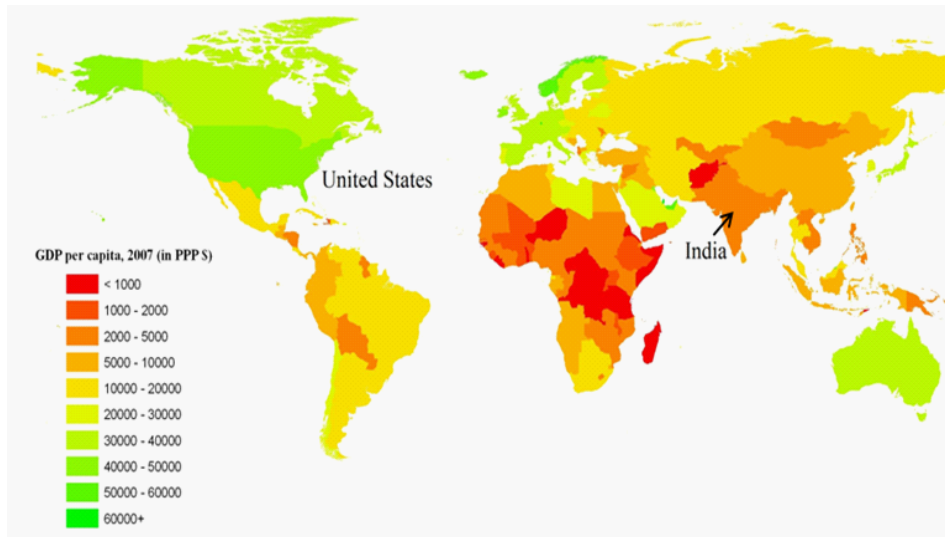
Why Is Latin America Poor? Based on *Why Nations Fail* by Acemoglu and Robinson

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The Disparity



How Did We Get Here?

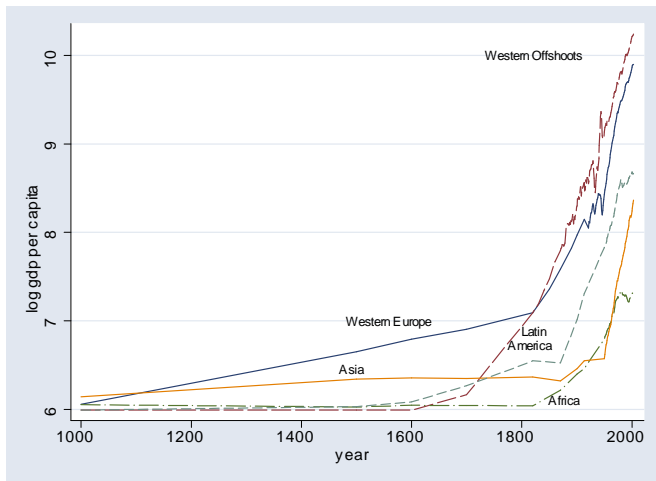


Figure: The evolution of average GDP per capita in Western Offshoots, Western Europe, Latin America, Asia and Africa, 1000-2000.

The Beginning—England

- **Glorious Revolution of 1688**—absolutism of James II defeated.
 - Following on the tails of major—successful or unsuccessful—reforms going back centuries: Magna Carta of 1215; political centralization and kernels of the modern state; the English Civil War.
- Declaration of Rights of February 1689: Parliament to meet regularly and to act as a real constraint on the power of the monarchy.
 - In addition, Parliament itself consisting of different factions, so another layer of balance of power → origins of **pluralism**
- The power to levy taxes and set spending transferred to Parliament.
- Military power de facto stripped from the crown; raising a standing army requires consent of Parliament, which also controls spending for war.
- Act of Settlement of 1701 introducing judicial independence.
- Strengthening of the notion of **rule of law**—central for the persistence of these institutions.

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 British settlers into gang labor and low wages.

The Beginning—United States (continued)

- The Company switch 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.

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 find the sedentary and more densely settled Guaraní up the Paraná river, in Paraguay. The Spaniards can 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.

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 neither 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.
- Instead, our emphasis will be on “institutions” broadly defined, historical roots of institutional differences and the logic of institutions that do not unleash growth.

“Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.” (North)

Making Sense of the Divergence (continued)

- Yet another alternative perspective is that policies matter but policymakers are “ignorant” and don’t know what’s good for growth also lacking.
 - But 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.

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.

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?

The Logic of Extractive Institutions

- Our 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:
 - those who maintain power and will lose out from major changes in institutions or economic growth will resist and block economic progress—**fear of creative destruction**
 - **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.
 - we will argue that both are important in practice, but particularly political losers are a major barrier against the emergence of inclusive institutions and economic growth.

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**.

Is Growth under Extractive Political Institutions Always Possible?

- Difference between extractive political institutions with and without political centralization.
- Comparison of China vs. sub-Saharan Africa today.
- roots of political centralization also historical and subject to similar dynamics and logic as to the roots of pluralism.

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.**
- Major change happens as

small institutional differences + big shocks → big institutional differences
- Big shocks \approx **critical junctures** for society leading to potential divergence.
- 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 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 Britain

- Driven by 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.
 - Owing to the context created by the initial institutional drift, this coalition triumphed in 1688.

The World in 1688: Small Differences That Matter

- There were important institutional differences in the world in 1688 which emerged historically—again institutional drift.
- Compare Europe and Africa: There were some centralized states in parts of Africa in 1688—Kongo, Kuba and Loango in the Congo basin, Asante, Bornu and Oyo in West Africa—but these were institutionally much less complex and less centralized than European states and far less pluralistic.
 - These states were also the exception rather than the rule.

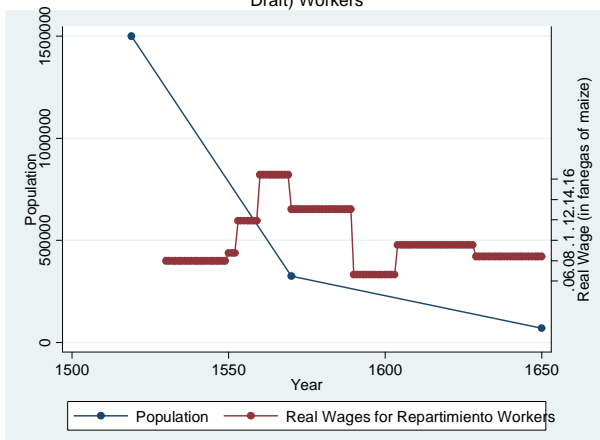
Institutional Divergence at Critical Junctures: Black Death and Feudalism

- 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).

Meanwhile in Mexico

- 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)

Institutional Divergence at Critical Junctures: Atlantic Trade

- The economic divergence of the Netherlands and Britain from the rest of Western Europe in the Early Modern period.
- Institutional divergence as a consequence of the discovery of the Americas caused by how differences in initial institutions (power of absolutism) led to different ways of organizing trade (how open) which in turn drove pressure for further change in political institutions. Britain become less absolutist, Spain more.

Institutional Divergence at Critical Junctures: North vs. South America

- Institutional divergence at independence.
- U.S. Constitution vs. the Mexican Constitution.
 - In one case, insurgence and rebellion against authority, and a constitution protecting a broad cross-section of society.
 - In the other case, insurgence and rebellion against the Cadiz Constitution by the Mexican elite in order to stave off any threats to their dominance.

Revisiting Early Latin American Experience

- Early Latin American institutions example of *extractive economic and political institutions*.
- But by 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 data destruction difficult or impossible under extractive political institutions.
 - The Latin American response to the Industrial Revolution not so different from those of other extract of political institutions, such as Austria-Hungary or Russia.

Why Is Latin America Still Poor?

• Vicious circles

- Extractive political institutions lead to the establishment of extractive economic institutions
- Extractive economic institutions lead to inequality, making the elite more able to control monopoly of political power
- Extractive economic institutions increase the gain in terms of wealth and power from controlling the state, thus encouraging the elites to remain in power or others to fight to come to power
- Extractive political institutions mean that those who come to power can also act in an unconstrained manner.
- *Iron law of oligarchy*: emergence of new oligarchies after “regime changes”.

Feedback Loops in Latin America

- Persistence of elites: Guatemala.
- Instability: Caribbean, Mexico.
- Recreation of new elites: Mexico, Argentina.

In Chile?

Table 47 Number and percentage of Chilean congressmen who directly own a large rural estate: 1854, 1874, 1902, 1918

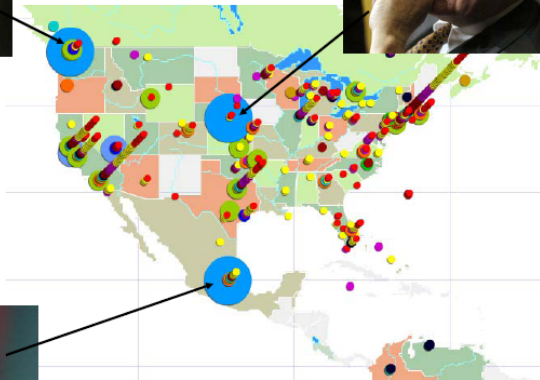
	1854		1874		1902		1918	
	Senator	Deputy	Senator	Deputy	Senator	Deputy	Senator	Deputy
Total members of Congress	29	34	30	96	33	94	37	118
Of these, the number who own large estates	14	20	21	42	24	49	25	47
Percentage of Congressmen who own large estates	48%	37%	70%	44%	73%	52%	67%	40%
Total number of Senators and Deputies in Congress	83		126		127		155	
Number of these who own large estates	34		63		73		72	
Percentage of all congressmen who own large estates	41%		50%		57%		46%	

Source: The names of congressmen are from Luis Valencia Avaria, *Anales de la República* (Santiago, 1950), 2 vols.; 'large estates' are defined as having \$6000 or more annual income in the 1854 *Renta agrícola* and 1874 *Rol de contribuyentes*; over \$200 000 *avalúo* in Espinoza, *Geografía* and the 1908 *Índice de propietarios*. For 1918, I used the Valenzuela O., *Album*.

Why Nations Fail Today

- Extractive institutions: still the main cause of economic problems.
 - In many societies persisting because of the vicious circle
 - In particular, insecure property rights and oligarchies dominating economies are still commonplace
 - Sometimes in the form of domination of traditional elites, sometimes under communist dictatorships, sometimes under corrupt politicians, sometimes under populist regimes without any checks.
- Total failures of states
 - Civil war and total state failure a major factor in economic problems around the world today, particularly in sub-Saharan Africa.
 - Also consequence of a history of extractive institutions.
 - Often, a cycle of moves between extractive institutions under a semi-authoritarian regime and civil war.

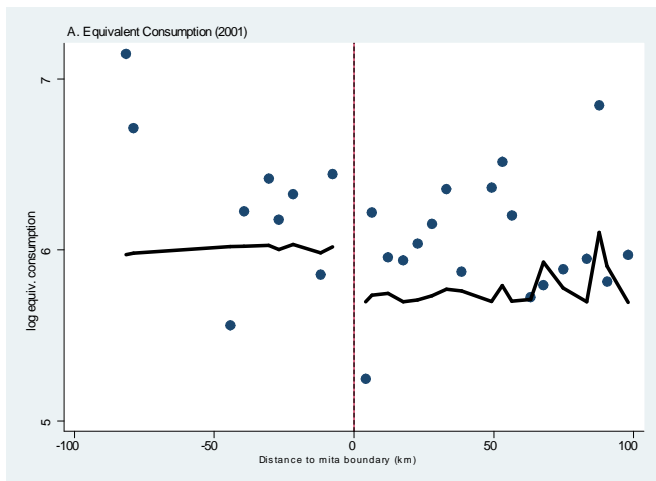
How One Makes Money

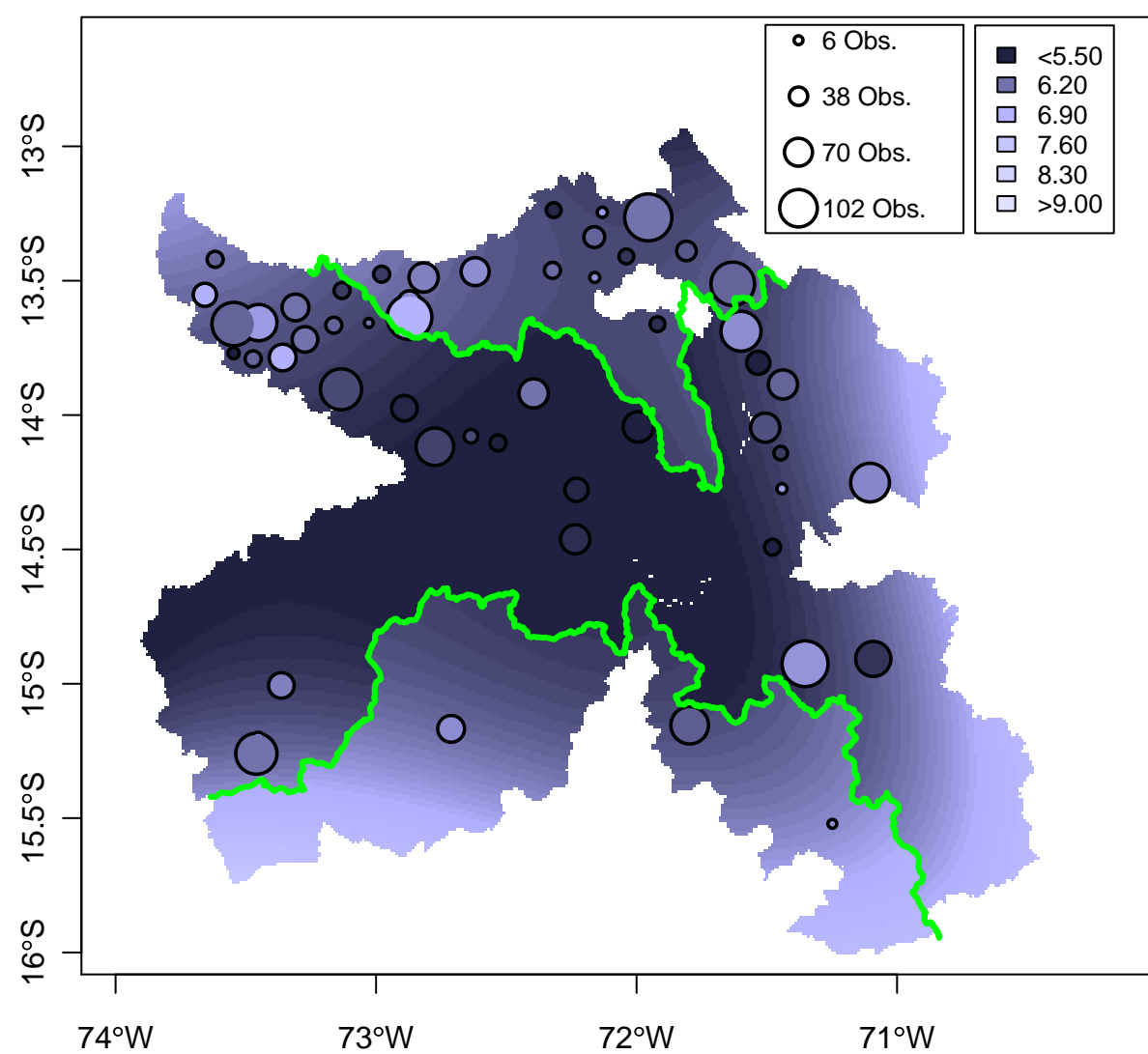


The World's Three Wealthiest Men

Legacy of Colonial Times (continued)

Regression discontinuity effects of *Mita* from Dell (2008).





Towards Institutional Reform

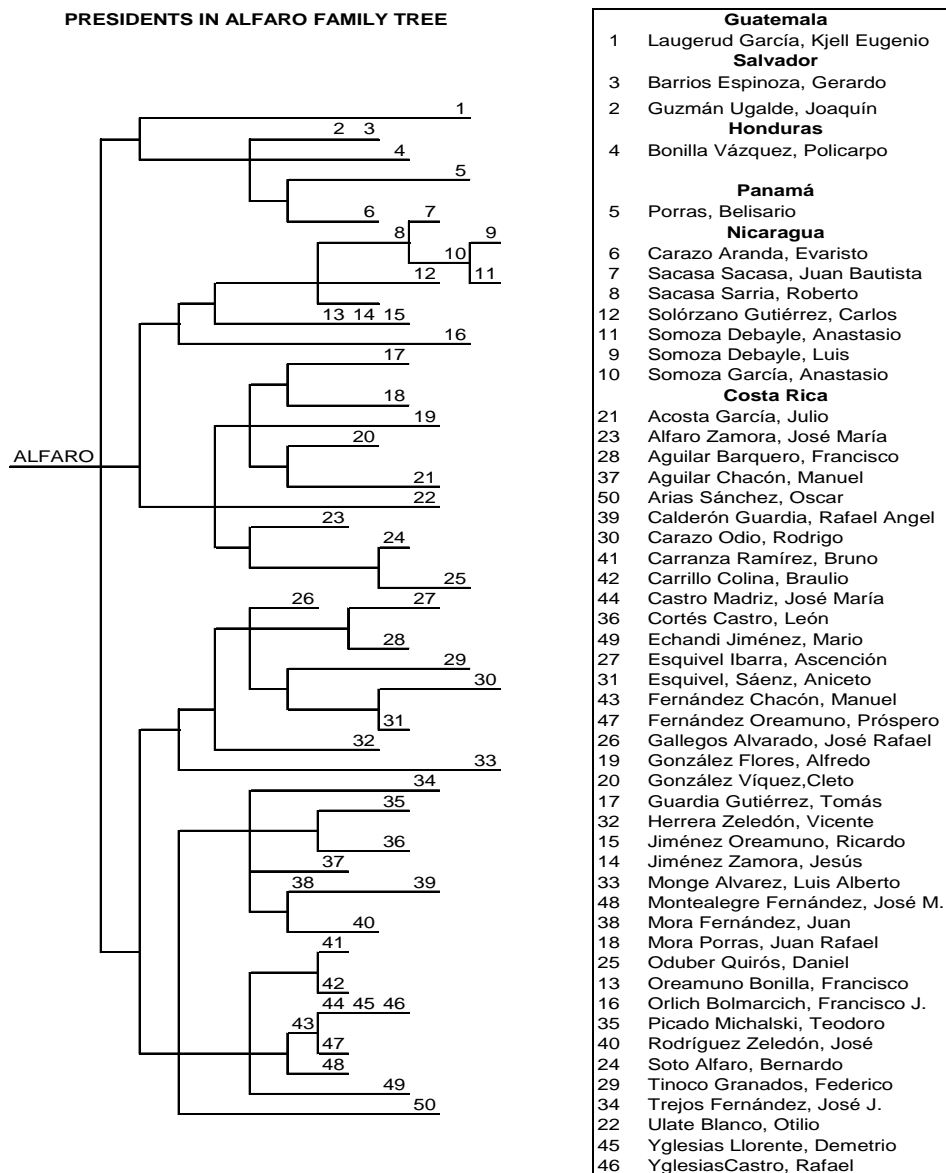
- Major pitfalls on the road.
 - The iron law of oligarchy.
 - Total and persistent lack of political centralization.
 - De jure but not de facto reform.
 - The seesaw effect.
 - The new (populist) despotism.

Persistence of Elites

Mayors of Sobral, Ceará, Brazil 1890-2000

Dr. Vicente César Ferreira Gomes	1890
Cel. José Ferreira Gomes	1892
Rosendo Augusto de Siqueira	1892/1902
Dr. Alfredo Marinho de Andrade	1902/1904
Cel. José Ignácio Alves Parente	1904/1908
Cel. Frederico Gomes Parente	1908/1912
Cel. José Cândido Gomes Parente	1912/1914
Francisco Porfírio da Ponte	1914
Cel. Frederico Gomes Parente	1914/1916
Dr. José Jacome de Oliveira	1916/1920
Henrique Rodrigues de Albuquerque	1920/1923
Antonio Mendes Carneiro	1923
Ernesto Marinho de Albuquerque	1924/1928
Dr. José Jacome de Oliveira	1928/1930
Monsenhor Fortunato Alves Linhares	1928/1930
Arthur da silveira Borges	1930/1932
Ten. Floriano Machado	1932
Dr. Paulo de Almeida Sanford	1932
Alpheu Ribeiro Aboim	1933
Dr. Leocádio de Araújo Costa	1934/1935
Ataliba Daltro Barreto	1935
Vicente Antenor Ferreira Gomes	1935/1944
Dr. João de Alencar Mello	1944/1945
Dr. Amaud Ferreira Baltar	1945
Randal Pompeu de Saboya Magalhães	1945/1946
Dr. João de Alencar Mello	1946
Dr. José Gerardo Frota Parente	1947
Ataliba Daltro Barreto	1947/1948
Dr. Jacynto Antunes Pereira da Silva	1948/1951
Antônio Frota Cavalcante	1951/1955
Dr. Paulo de Almeida Sanford	1955/1959
Padre José Palhano de Sabóia	1959/1963
Cesário Barreto Lima	1963/1967
Jerônimo Medeiros Prado	1967/1971
Joaquim Barreto Lima	1971/1973
José Parente Prado	1973/1977
José Euclides Ferreira Gomes Júnior	1977/1983
Joaquim Barreto Lima	1983/1988
José Parente Prado	1989/1993
Ricardo Barreto Dias	1993/1994
Aldenor Façanha Júnior	1994/1996
Cid Ferreira Gomes	1997/2000

Presidents of Central America descended from the Conquistador Cristóbal de Alfaro



Source: Samuel Stone (1990) The heritage of the conquistadors: ruling classes in Central America from the Conquest to the Sandinistas, Lincoln: University of Nebraska Press, p. 153.

The Iron Law of Oligarchy

LAND REFORM IN FOURTEEN LATIN AMERICAN SOCIETIES.¹

<i>Country³</i>	<i>Date program began</i>	<i>Number of families benefited</i>	<i>Number of hectares distributed or confirmed</i>	<i>Approximate percent of farm families benefited²</i>
Bolivia	1955	208,181	9,740,681	45
Brazil	1964	46,457	957,106	1
Chile	1965	15,800	2,093,300	4
Colombia	1961	91,937	2,832,312	6
Costa Rica	1963	3,889	60,055	3
Dominican Republic	1963	9,717	46,082	3
Ecuador	1964	27,857	152,115	6
Guatemala	1955	26,500	166,734	5
Honduras	1963	5,843	90,642	2
Mexico	1916	2,525,811	59,413,656	67
Nicaragua	1964	8,117	357,989	5
Panama	1963	2,594	37,339	3
Peru	1961	31,600	850,522	3
Venezuela	1959	117,286	4,605,594	25

The Iron Law of Oligarchy (continued)

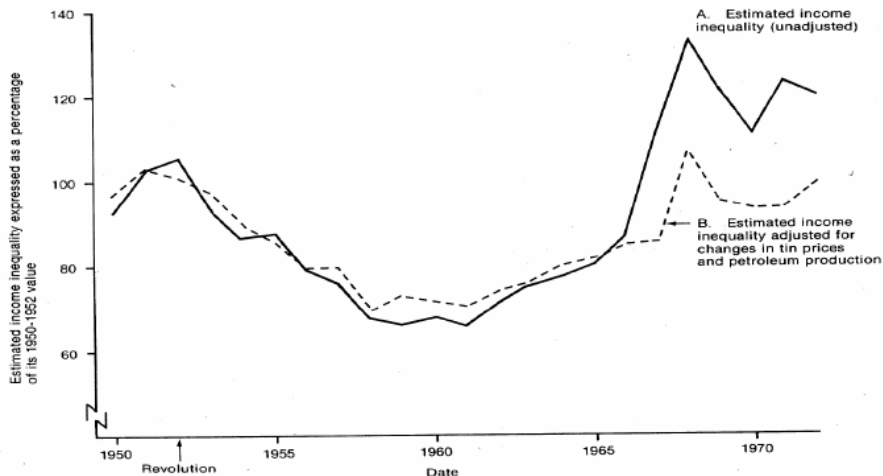


Figure 6.7 Estimated income inequality in Bolivia, 1950–1972. Inequality is measured by the standard deviation and expressed as a percentage of its 1950–1952 value. Alternative estimates with

The State?



“What I said is that 35% of the Congress was elected in areas where there were states of the Self-Defense groups, in those states we were the ones collecting taxes, we delivered justice, and we had the military and territorial control of the region and all the people who wanted to go into politics had to come and deal with the political representatives we had there.”
- Salvatore Mancuso

Does a Reform Mean Anything?

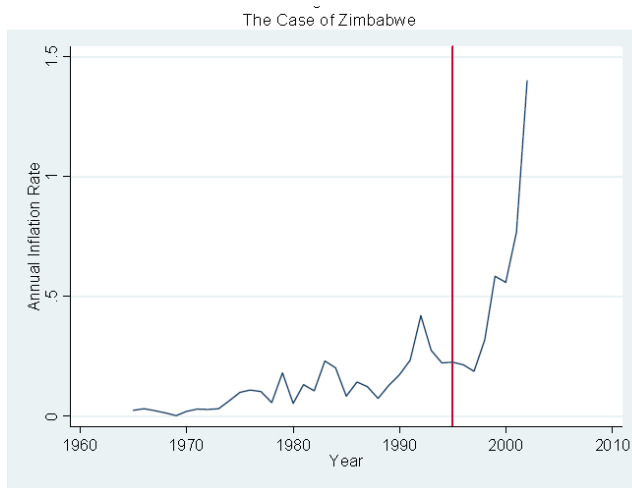
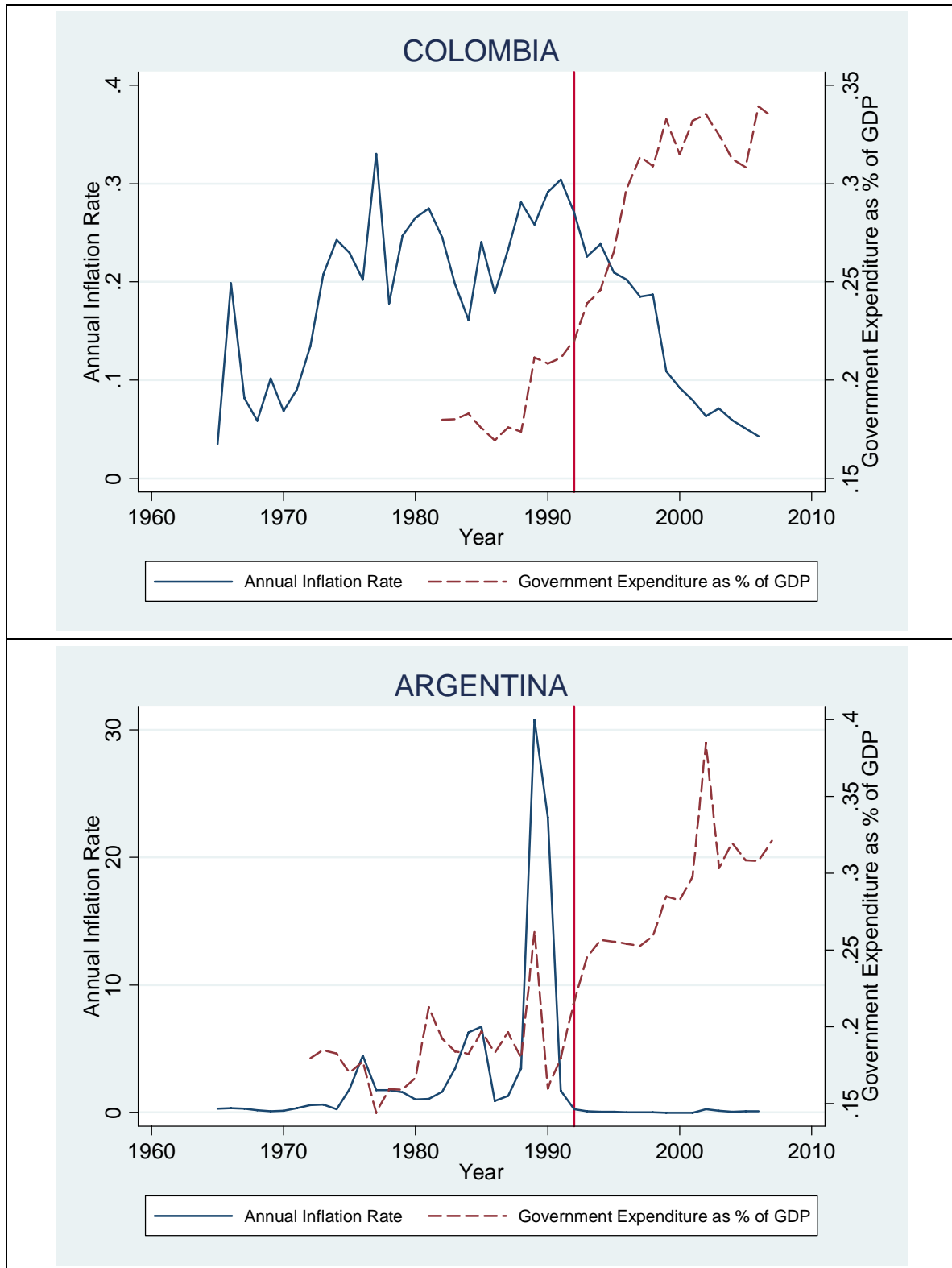


Figure 2
The See-Saw Effect



Note: Annual Inflation Rate (scale on the left vertical axis) corresponds to the annual variation in the consumer price index reported in the International Financial Statistics (IMF). Government expenditure data (scale on the right vertical axis) are from World Economic Outlook (IMF). Vertical line shows the year of major Central Bank reform taken from Jácome and Vasquez (2005).

The New Despotism?

- This is not an illogical movement. How to balance it?



Growth under Extractive Institutions Version 2.0?

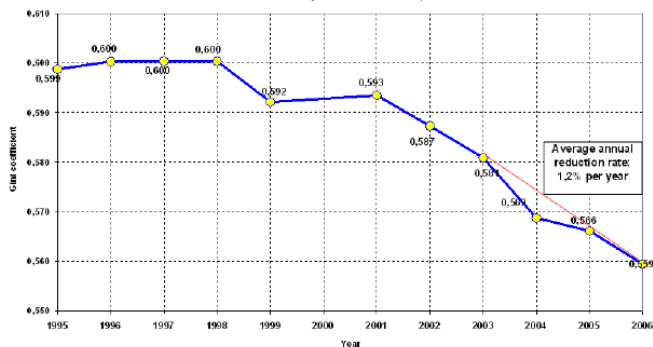
- New calls for authoritarian growth under the banner of “Beijing consensus”.
- No longer sustainable given the extent of political conflict in much of Latin America.
- Not that much room for growth under extractive institutions given the income levels in countries such as Chile, Argentina or Brazil.

How to Move Forward?

- Beyond resource-based and catch-up growth.
- Innovation and growth based on creative destruction will be key.
 - These cannot be achieved under extractive institutions are weak inclusive institutions.
 - Secure property rights, level playing field and broad-based participation in the economy will be key.
 - But these in turn have to rely on **pluralism** in the political arena
- Many parts of Latin America, including Chile, are taking strong steps towards pluralism the road is a bumpy one.

The Rise of Pluralism?

Figure 2.2: Evolution of inequality in *per capita* income: Brazil, 1995-2006 (Gini coefficient)

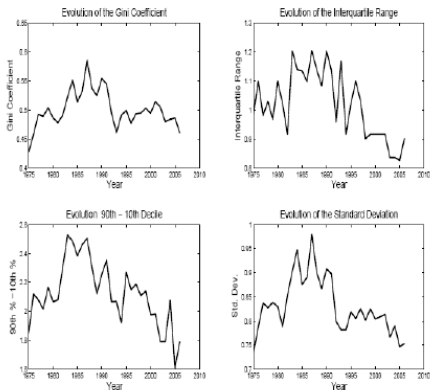


Source: Estimates based on Pesquisa Nacional por Amostra de Domicílios (PNAD) - 1995 to 2006.

Source: Barros, Ricardo, Mirela de Carvalho, Samuel Franco and Rosane Mendonça (2008)
 "Markets, the State and the Dynamics of Inequality: Brazil's Case Study," UNDP study.

The Rise of Pluralism? (continued)

Inequality in Chile, 1975-2005



Source: Eberhard, Juan and Eduardo Engel (2008) "Decreasing Wage Inequality In Chile," Unpublished, Yale University.