DARON ACEMOGLU AND JAMES ROBINSON

# 1.2 WHY NATIONS FAIL

## The Origins of Power, Prosperity, and Poverty

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In this excerpt from their book, *Why Nations Fail*, Daron Acemoglu and James Robinson introduce their strategy of using the comparative method to answer a big "why" question. Their question is similar to that of Jared Diamond, introduced in the previous reading: why are some countries so much richer than others? In the excerpt that follows, you will see them consider several major theories of comparative economic development. Their own theory emphasizes institutions. Indeed, they suspect that "inclusive economic and political institutions" foster growth, whereas "extractive" institutions keep countries poor. This is not simply a speculative idea, but rather hypotheses they aim to test by logically comparing cases and seeing whether this theory explains the observed patterns better than competing explanations. How do they do this?

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### SO CLOSE AND YET SO DIFFERENT

#### THE ECONOMICS OF THE RIO GRANDE

The city of Nogales is cut in half by a fence. If you stand by it and look north, you'll see Nogales, Arizona, located in Santa Cruz County. The income of the average household there is about $30,000 a year. Most teenagers are in school, and the majority of the adults are high school graduates. Despite all the arguments people make about how deficient the U.S. health care system is, the population is relatively healthy, with high life expectancy by global standards. Many of the residents are above age sixty-five and have access to Medicare. It's just one of the many services the government provides that most take for granted, such as electricity, telephones, a sewage system, public health, a road network linking them to other cities in the area and to the rest of the United States, and, last but not least, law and order. The people of Nogales, Arizona, can go about their daily activities without fear for life or safety and not constantly afraid of theft, expropriation, or other things that might jeopardize their investments in their businesses and houses. Equally important, the residents of Nogales, Arizona, take it for granted that, with all its inefficiency and occasional corruption, the government is their agent. They can vote to replace their mayor, congressmen, and senators; they vote in the presidential elections that determine who will lead their country. Democracy is second nature to them.

Life south of the fence, just a few feet away, is rather different. While the residents of Nogales, Sonora, live in a relatively prosperous part of Mexico, the income of the average household there is about one-third that in Nogales, Arizona. Most adults in Nogales, Sonora, do not have a high school degree, and many teenagers are not in school. Mothers have to worry about high rates of infant mortality. Poor public health conditions mean it's no surprise that the residents of Nogales, Sonora, do not live as long as their northern neighbors. They also don't have access to many public amenities. Roads are in bad condition south of the fence. Law and order is in worse condition. Crime is high, and opening a business is a risky activity. Not only do you risk robbery, but getting all the permissions and greasing all the palms just to open is no easy endeavor.

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Acemoglu, Daron and James Robinson. 2012. *Why Nations Fail*. New York: Crown Business.

Residents of Nogales, Sonora, live with politicians' corruption and ineptitude every day.

In contrast to their northern neighbors, democracy is a very recent experience for them. Until the political reforms of 2000, Nogales, Sonora, just like the rest of Mexico, was under the corrupt control of the Institutional Revolutionary Party, or Partido Revolucionario Institucional (PRI).

How could the two halves of what is essentially the same city be so different? There is no difference in geography, climate, or the types of diseases prevalent in the area, since germs do not face any restrictions crossing back and forth between the United States and Mexico. Of course, health conditions are very different, but this has nothing to do with the disease environment; it is because the people south of the border live with inferior sanitary conditions and lack decent health care.

But perhaps the residents are very different. Could it be that the residents of Nogales, Arizona, are grandchildren of migrants from Europe, while those in the south are descendants of Aztecs? Not so. The backgrounds of people on both sides of the border are quite similar. After Mexico became independent from Spain in 1821, the area around "Los dos Nogales" was part of the Mexican state of Vieja California and remained so even after the Mexican–American War of 1846–1848. Indeed, it was only after the Gadsden Purchase of 1853 that the U.S. border was extended into this area. It was Lieutenant N. Michler who, while surveying the border, noted the presence of the "pretty little valley of Los Nogales." Here, on either side of the border, the two cities rose up. The inhabitants of Nogales, Arizona, and Nogales, Sonora, share ancestors, enjoy the same food and the same music, and, we would hazard to say, have the same "culture."

Of course, there is a very simple and obvious explanation for the differences between the two halves of Nogales that you've probably long since guessed: the very border that defines the two halves. Nogales, Arizona, is in the United States. Its inhabitants have access to the economic institutions of the United States, which enable them to choose their occupations freely, acquire schooling and skills, and encourage their employers to invest in the best technology, which leads to higher wages for them. They also have access to political institutions that allow them to take part in the democratic process, to elect their representatives, and replace them if they misbehave. In consequence, politicians provide the basic services (ranging from public health to roads to law and order) that the citizens demand. Those of Nogales, Sonora, are not so lucky. They live in a different world shaped by different institutions. These different institutions create very disparate incentives for the inhabitants of the two Nogaleses and for the entrepreneurs and businesses willing to invest there. These incentives created by the different institutions of the Nogaleses and the countries in which they are situated are the main reason for the differences in economic prosperity on the two sides of the border.

Why are the institutions of the United States so much more conducive to economic success than those of Mexico or, for that matter, the rest of Latin America? The answer to this question lies in the way the different societies formed during the early colonial period. An institutional divergence took place then, with implications lasting into the present day. To understand this divergence we must begin right at the foundation of the colonies in North and Latin America.

## TOWARD A THEORY OF WORLD INEQUALITY

We live in an unequal world. The differences among nations are similar to those between the two parts of Nogales, just on a larger scale. In rich countries, individuals are healthier, live longer, and are much better educated. They also have access to a range of amenities and options in life, from vacations to career paths, that people in poor countries can only dream of. People in rich countries also drive on roads without potholes, and enjoy toilets, electricity, and running water in their houses. They also typically have governments that do not arbitrarily arrest or harass them; on the contrary, the governments provide services, including education, health care, roads, and law and order. Notable, too, is the fact that the citizens vote in elections and have some voice in the political direction their countries take.

The great differences in world inequality are evident to everyone, even to those in poor countries, though many lack access to television or the Internet.

It is the perception and reality of these differences that drive people to cross the Rio Grande or the Mediterranean Sea illegally to have the chance to experience rich-country living standards and opportunities. This inequality doesn't just have consequences for the lives of individual people in poor countries; it also causes grievances and resentment, with huge political consequences in the United States and elsewhere. Understanding why these differences exist and what causes them is our focus in this book. Developing such an understanding is not just an end in itself, but also a first step toward generating better ideas about how to improve the lives of billions who still live in poverty.

The disparities on the two sides of the fence in Nogales are just the tip of the iceberg. As in the rest of northern Mexico, which benefits from trade with the United States, even if not all of it is legal, the residents of Nogales are more prosperous than other Mexicans, whose average annual household income is around $5,000. This greater relative prosperity of Nogales, Sonora, comes from maquiladora manufacturing plants centered in industrial parks, the first of which was started by Richard Campbell, Jr., a California basket manufacturer. The first tenant was Coin-Art, a musical instrument company owned by Richard Bosse, owner of the Artley flute and saxophone company in Nogales, Arizona. Coin-Art was followed by Memorex (computer wiring); Avent (hospital clothing); Grant (sunglasses); Chamberlain (a manufacturer of garage door openers for Sears); and Samsonite (suitcases). Significantly, all are U.S.-based businesses and businessmen, using U.S. capital and know-how. The greater prosperity of Nogales, Sonora, relative to the rest of Mexico, therefore, comes from outside.

The differences between the United States and Mexico are in turn small compared with those across the entire globe. The average citizen of the United States is seven times as prosperous as the average Mexican and more than ten times as the resident of Peru or Central America. She is about twenty times as prosperous as the average inhabitant of sub-Saharan Africa, and almost forty times as those living in the poorest African countries such as Mali, Ethiopia, and Sierra Leone. And it's not just the United States. There is a small but growing group of rich countries—mostly in Europe and North America, joined by Australia, Japan, New Zealand, Singapore, South Korea, and Taiwan—whose citizens enjoy very different lives from those of the inhabitants of the rest of the globe.

The reason that Nogales, Arizona, is much richer than Nogales, Sonora, is simple; it is because of the very different institutions on the two sides of the border, which create very different incentives for the inhabitants of Nogales, Arizona, versus Nogales, Sonora. The United States is also far richer today than either Mexico or Peru because of the way its institutions, both economic and political, shape the incentives of businesses, individuals, and politicians. Each society functions with a set of economic and political rules created and enforced by the state and the citizens collectively. Economic institutions shape economic incentives: the incentives to become educated, to save and invest, to innovate and adopt new technologies, and so on. It is the political process that determines what economic institutions people live under, and it is the political institutions that determine how this process works. For example, it is the political institutions of a nation that determine the ability of citizens to control politicians and influence how they behave. This in turn determines whether politicians are agents of the citizens, albeit imperfect, or are able to abuse the power entrusted to them, or that they have usurped, to amass their own fortunes and to pursue their own agendas, ones detrimental to those of the citizens. Political institutions include but are not limited to written constitutions and to whether the society is a democracy. They include the power and capacity of the state to regulate and govern society. It is also necessary to consider more broadly the factors that determine how political power is distributed in society, particularly the ability of different groups to act collectively to pursue their objectives or to stop other people from pursuing theirs.

As institutions influence behavior and incentives in real life, they forge the success or failure of nations. Individual talent matters at every level of society, but even that needs an institutional framework to transform it into a positive force. Bill Gates, like other legendary figures in the information technology industry (such as Paul Allen, Steve Ballmer, Steve Jobs, Larry Page, Sergey Brin, and Jeff Bezos), had immense talent and ambition. But he ultimately responded to incentives. The schooling system in the United States enabled Gates and others like him to acquire a unique set of skills to complement their talents. The economic institutions in the United States enabled these men to start companies with ease, without facing insurmountable barriers. Those institutions also made the financing of their projects feasible. The U.S. labor markets enabled them to hire qualified personnel, and the relatively competitive market environment enabled them to expand their companies and market their products. These entrepreneurs were confident from the beginning that their dream projects could be implemented: they trusted the institutions and the rule of law that these generated and they did not worry about the security of their property rights. Finally, the political institutions ensured stability and continuity. For one thing, they made sure that there was no risk of a dictator taking power and changing the rules of the game, expropriating their wealth, imprisoning them, or threatening their lives and livelihoods. They also made sure that no particular interest in society could warp the government in an economically disastrous direction, because political power was both limited and distributed sufficiently broadly that a set of economic institutions that created the incentives for prosperity could emerge.

This book will show that while economic institutions are critical for determining whether a country is poor or prosperous, it is politics and political institutions that determine what economic institutions a country has. Ultimately the good economic institutions of the United States resulted from the political institutions that gradually emerged after 1619. Our theory for world inequality shows how political and economic institutions interact in causing poverty or prosperity, and how different parts of the world ended up with such different sets of institutions. Our brief review of the history of the Americas begins to give a sense of the forces that shape political and economic institutions. Different patterns of institutions today are deeply rooted in the past because once society gets organized in a particular way, this tends to persist. We'll show that this fact comes from the way that political and economic institutions interact.

This persistence and the forces that create it also explain why it is so difficult to remove world inequality and to make poor countries prosperous. Though institutions are the key to the differences between the two Nogaleses and between Mexico and the United States, that doesn't mean there will be a consensus in Mexico to change institutions. There is no necessity for a society to develop or adopt the institutions that are best for economic growth or the welfare of its citizen, because other institutions may be even better for those who control politics and political institutions. The powerful and the rest of society will often disagree about which set of institutions should remain in place and which ones should be changed. Carlos Slim would not have been happy to see his political connections disappear and the entry barriers protecting his business fizzle—no matter that the entry of new businesses would enrich millions of Mexicans. Because there is no such consensus, what rules society ends up with is determined by politics: who has power and how this power can be exercised. Carlos Slim has the power to get what he wants. Bill Gates's power is far more limited. That's why our theory is about not just economics but also politics. It is about the effects of institutions on the success and failure of nations—thus the economics of poverty and prosperity; it is also about how institutions are determined and change over time, and how they fail to change even when they create poverty and misery for millions—thus the politics of poverty and prosperity.