BOOK REVIEW

Daron Acemoglu and James A Robinson :
*Why Nations Fail: The origins of Power,
Prosperity, and Poverty*

United States : Crown Publishers, 2012,
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This book consists of fifteen chapters where the first two chapters are devoted to discuss the existing puzzle with respect to the causes of prosperity and poverty among countries and to explain why the hypotheses already developed in the literature fail to explain that difference sufficiently. The authors bring out their main hypothesis in explaining the causes of poverty and prosperity in chapter three where they argue that the difference is mainly due to different political and economic institutions under which economies operate. The authors construct their main hypothesis in chapter four through ten and discuss some case studies in the rest of the book.

In the first chapter, Acemoglu and Robinson (AR) diligently raise readers' curiosity by discussing divergent development experiences between two territories which look almost similar in culture and geography. To that end the first chapter is named as "So close, yet so different". Two cases, one refers to the North: Nogales, Arizona (USA) and South : Nogales, Sonora (Mexico) and other refers to the South and North Korea, are presented in order to point out that the difference cannot be explained by available hypotheses in the literature. Instead, the authors argue the need for a novel approach in identifying the root causes of prosperity and poverty.

In chapter three, AR reject three alternative explanations of why the experience of various countries has been so different: geography, culture, and ignorance of correct policies. The geographical school holds that tropical climates make their peoples to be lazy and lack enthusiasm or, in a more modern variant, tropical climates lead to debilitating diseases and/or soils more subject to erosion and nutrient loss, as argued by Jeffery Sach. These explanations do not hold grounds in the face of unchanged geographical conditions, formerly stagnant economies begin to grow in the same geographical areas at sharply different rates or seemingly geographically disadvantaged countries grow at faster rate than better endowed countries. The culture school

maintains that prevailing values and attitudes such as work ethics, faith in the future, trust, and sometimes the superiority of European value systems that explain why performance varies. However, theories of culture differences fail to explain why areas with the same cultures have different economic outcomes. The authors provide evidence relating to West and East Germany, North and South Korea, and the north and just south of the Mexico-USA border. Also, culture hypothesis fail to explain why countries suddenly start growing in the face of an unchanged, or slowly evolving, culture. According to ignorance hypothesis, the main reason for underdevelopment is the policy failures arising from implementing a wrong set of policies and that school argue countries could grow faster if correct policies are implemented. Markets, incentives, property rights, and fiscal discipline are what generate prosperity and countries that interfere with them will end up in stagnation or poverty. Get rid of monopolies, high tariffs, price controls, and tax disincentives, and countries will prosper.

In chapter four through ten, AR construct the main hypothesis. Accordingly, nations are poor because they do not have institutions which allow them to generate growth potential. They have political institutions in which power is heavily concentrated. Their economic institutions do not create an environment in which a large proportion of the population can share in the benefits. Societies with these characteristics, AR call “extractive.” Countries having extractive institutions do not possess environment in which sustained improvements in prosperity is possible. Sustained improvements in socio-economic condition require technological change. In other words, the society should experience creative destruction where over the years it could produces more with less or the replacement of the old by the new. AR argue that such creative destruction threatens the advantages and the political power of certain groups. Political power is based on restricted access; it is believed by the ruling elites that newcomers and increased competition could threaten the existing power arrangement system.

Against this backdrop AR emphasize the importance of ‘inclusive’ political and economic institutions and showed how such institution could ignite and sustain socio-economic development in a country. Inclusive political institutions are those in which power is widely shared and many groups could participate in the decisions which affect their prosperity and access to public services. Inclusive economic institutions are those which generate widespread opportunities to make investments, opportunities to create new or better products, or opportunities for self-improvement. This depends on secure property rights, an objective system of law, and limited monopoly privileges. According to AR, exclusiveness versus inclusiveness is the result of conscious choice.

In chapter four, AR discuss how small difference and critical junctures in the history have shaped and given birth to different institutional structures that could be seen today in different countries. The book strongly argues that England was the earliest participant in the Industrial Revolution because of its progress in creating inclusive political and economic institutions. AR discuss in details how the Glorious Revolution (1688) greatly expanded the powers which the king could exercise only with the consent of parliament and made government more responsive to a wider set of groups in society. This

revolution gave parliaments a greater say over successions to the throne, limited the right of kings to suspend laws, made monopolies and taxation subject to parliamentary approval, created a broader and more stable tax base allowing the expansion of public services, and created the Bank of England which became a great source of financing for industry. Accordingly, the opening up of England's political and economic institutions was a product of hundreds of years of struggle to limit absolutism and extend political power to a wider range of groups.

Chapter five discusses why growth under extractive institutions is not sustainable. The chapter summarizes economic history of Soviet Union, Congo, Mayan civilization and the other states to build the case that growth under extractive institution is a temporary phenomenon. It is shown that political elites in countries where extractive institutions are in place employ various brutal techniques to accelerate economic growth. However, in the long run, such techniques become boomerang and the society experience total collapse indicating that growth under extractive institution is not sustainable. In chapter six, authors discuss the process of institutional change. By discussing the economic history of Venice and Roman Empire, the book shows how moving to inclusive institutions made it possible for countries to grow and prosper. This chapter gives detailed account with respect to the formation of Venice and Rome moving from republic to empire. However, certain developments in those territories led to shift institutions towards extractive institutions there by collapsing the economic prosperity that was built over the years. The authors maintained that the historical factors shape how institutions develop, but this is not a simple, predetermined, cumulative process. According to them Rome and Venice illustrate how early steps toward inclusivity were reversed.

In the remaining chapters, authors discuss how nations with extractive institutions tend to get into a vicious circle thereby perpetuating in poverty while societies with inclusive institutions, in most cases, get into a virtuous circle. Are nations characterized by extractive institutions condemned to stagnation and poverty? Clearly not according to AR. Limited progress is possible where a strong state has been created which can establish law and order and provide the security for investments or the extraction of valuable natural resources which benefit the few. Extractive societies need something to extract. Soviet Russia was able to generate significant growth for decades by collectivizing agriculture, creating a command and control economy which controlled prices and the allocation of labor and capital, and driving resources out of agriculture into a more productive industrial sector. Years of relatively spectacular growth were created. The system collapsed because it did not offer citizens incentives to save and invest and technological change was thwarted because it threatened existing structures and bureaucrats by requiring that more be produced with fewer amounts of resources. The system could not generate long-term growth on a sustainable basis.

Among the various case studies, one that is on China provides some insights to how economic growth get accelerated when economic institutions moving from extractive ones to more inclusive one regardless of the extractive nature of political institutions.

The coming to power of the Chinese Communist Party in 1949 failed to bring about significant improvements in general prosperity. The temporary advantages of a command and control economy were offset by the economic disasters caused by political initiatives like the Great Leap Forward and the Cultural Revolution. Growth experience was poor compared with the rapid growth achieved in the Soviet Union during its first five decades. In the late 1970s, Chinese leaders came to the belief that significant economic growth could be achieved without endangering the political power of the Communist Party. Reforms began in agriculture with some loosening of compulsory marketing and the control over prices. State enterprises were given more leeway in decisions, and some cities were allowed to attract foreign investment. Labor was allowed some freedom to move into rural industries, the Township Village Enterprises. It is argued that introducing more incentives in agriculture and industry, followed by introducing more foreign investment and technology set China on a path of more rapid growth. These reforms were followed by more secure property rights, allowance for the creation of private enterprises and opening up to foreign trade. The result was that China had one of the world's fastest growth rates over the past three decades. AR's key insight is that China's success will not last. It has been based on increasing inclusiveness in economic institutions, but under continuing extractive political institutions. Rapid growth was made possible by the opportunity to reduce inefficiencies in agriculture, move resources from agriculture to industry and from rural to urban areas, introduce catch-up technologies, and export cheap labor-intensive products. The pervasiveness of favored state enterprises, the dependence of private enterprise on Party goodwill and often on partnerships with state enterprises, the pervasiveness of Party control over the mass media and over political processes mean that the openness and creative destruction that underlie sustained productivity increases will not take place. Growth will inevitably slow.

The main conclusion of the book is that inclusive institutions are essential in sustaining economic growth in an economy. This book argues that institutions shape the behavior of economic agents through incentives and this behavior determines whether the society leads to poverty or prosperity. Inclusive institutions work as pro-growth institutions since they provide incentives for technological improvement, business start-ups, investing on human capital and so on and so forth whereas incentive structure under the extractive institutions does not provide a health business climate. Hence, developing countries should attempt at making their institutions more inclusive so that they could march from poverty to prosperity. This book is an essential reader for anyone who is interested in reading development literature.

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