

# Why Nations Succeed

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James A. Robinson

Harvard

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## Recap: The Main Questions of Why Nations Fail

- Why is it that some parts of the world are much richer and more successful economically than other parts of the world?
- What can poor countries do to make themselves richer?
- My book *Why Nations Fail* (with Daron Acemoglu) proposes a theory based on differences in economic and political institutions.
- Institutions are defined as the rules (both formal - written laws and the constitution - and informal - like social norms) that structure economic, political and social life and generate different patterns of incentives, rewards, benefits and costs.

## A Simple Example

How did the two richest men in the World, Bill Gates and Carlos Slim make their money?

- Proximate explanations:
  - Gates: Innovation, entrepreneurship in software and with the Microsoft company.
  - Slim: Monopolies starting with Telmex.
- Deeper Reasons - both men are remarkable people, but their energies were channeled in different directions by the different institutional environments in which they live.
  - In the US innovation is the way to make great wealth.
  - In Mexico instead, innovation is less well rewarded than monopolies because there are so many barriers to entry.
- These have very different consequences for society: Gates created huge positive externalities generating far more wealth than his income. The OECD estimated Slim's monopolies reduced Mexican income by US\$70bn, far more than his fortune.
- Lying behind these differences are politics.

# Towards a Theory of Institutions

- **Inclusive economic institutions:** Create incentives and opportunities for the broad mass of the population. A level playing field and a rule of law based on universal principles.
- **Inclusive political institutions:** Political institutions allowing broad participation—*pluralism*—and placing constraints and checks on politicians.
  - But also some degree of *political centralization* (strong and effective state) for the states to be able to effectively enforce law and order.
- **Extractive economic institutions:** Create incentives and opportunities for a few, none for most. Barriers to entry and a tilted playing field and the absence of the rule of law.
- **Extractive political institutions:** Political institutions concentrating power in the hands of a few, without constraints, checks and balances.

# An Inclusive Economic Institution

## Innovation Drives Long-Run Growth

- The 19th Century US Patent system.
- Great example of how to harness the talent and creativity of a society - inclusion!

# 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**.

# 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**.

# Synergies

		Economic Institutions	
		Inclusive	Extractive
Political Institutions	Inclusive	↻	← ↓
	Extractive	↑ →	↻



# The Chinese Model?

- How does China fit into this in more detail?
- Part of it perfectly - the trigger for economic growth was obviously the movement towards more inclusive economic institutions which started with the deregulation of agriculture in 1978.
- Part of it not so perfectly - Chinese growth has been overseen by extractive political institutions.
- But couldn't the Chinese Communist Party just be committed to promoting inclusive economic institutions? Could a dictatorship with such enlightened leaders create an economic superpower?

# No

- Creating inclusive economic institutions can be part of a political project and enlightened leaders can want to develop and modernize their countries: Botswana (Seretse Khama), Singapore (Lee Kuan Yew), South Korea (Park Chung Hee) and Tunisia (Habib Bourguiba).
- Yet to be sustainable it has to be accompanied by increased pluralism:

*"It is in vain to say that enlightened statesmen will be able to adjust these clashing interests, and render them all subservient to the public good. Enlightened statesmen will not always be at the helm.*

*If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself." James Madison (1788)*

# The Persistent Illusion of Autocratic Success

Maybe not in Nigeria...

- Africa has not had a happy history with 'autocratic growth' (few exceptions, Rwanda..) and this is deeply related to extractive institutions - absence of an effective state.
- Political pluralism is messy and chaotic but it works when in conjuncture with an effective state.
- Alexis de Tocqueville understood this very well in his book *Democracy in America* he was initially horrified at how chaotic and populist democracy was but he ended up concluding

*"Democracy does not give the most skilful government to the people, but it does what the most skilful government is powerless to create; it spreads a restive activity through the whole social body, a superabundant force, an energy that never exists without it .. [it] can bring forth marvels. These are its true advantages."*

# The Emergence of World Inequality

- Started by the Industrial Revolution which was created by the emergence of inclusive institutions in Britain.
- Disseminated very unevenly because different parts of the world have very different institutions:
  - European settler colonies in North America and Australasia had developed inclusive institutions by a different route.
  - Western European institutions diverged from Britain in the 17th Century but were not too different where it mattered.
  - Some East Asian economies, like Japan or South Korea were able to endogenously transition to inclusive institutions.
  - Many nations (e.g., Eastern Europe, Ottoman Empire) had long existing extractive institutions.
  - Others had extractive institutions imposed upon them by European colonial powers (creation of 'Dual economies' in Southern Africa).

# African Development

- From my perspective Africa is poor because it has suffered from a long history of extractive economic and political institutions.
- These are part of deeply rooted historical processes
  - The slow development of centralized political entities compared to Eurasia (e.g., the Tiv)
  - The negative impact of the slave trade (devastating institutional impact in Nigeria, e.g. the Long Ju-ju oracle of Arochukwu)
  - Extractive nature of colonial rule
  - The legacy of colonialism since independence

# Negative Institutional Legacies of Colonialism

.. and some Nigerian Examples

- 1 Perverse effects of particular colonial institutions, such as agricultural marketing boards (yes!).
- 2 Colonialism created an arbitrary state system which has led to political conflicts (Biafra, Boko Haram?), instability and dictatorship.
- 3 Colonial authorities created “gate-keeper states” which were only interested in ruling rather than in developing the countries and these have left a path dependent legacy.
- 4 The political authoritarianism of the colonial state is a direct source of the authoritarianism that has plagued Africa (Smith and Mugabe).
- 5 Structure of colonial indirect rule warped local institutions of accountability making traditional leaders more autocratic (the Warrant chiefs).
- 6 Colonialism created and shaped identities and cleavages in dysfunctional ways (Hutu and Tutsi, Igbo).

# The Nigerian Legacy after 1960

- Extractive political institutions
  - Dictatorship and military regimes
  - Weak state unable to raise taxes, enforce law, control violence
- Extractive economic institutions
  - Marketing boards and farmers
  - Undersupply of public goods
  - Large amount of predation by the state, insecure property rights
  - Monopolies for the politically connected
- Result was economic decline

# Turning Nigeria Around

## The Broader Evidence

- Need to move towards inclusive institutions.
- Our framework emphasizes that this is not a technocratic economic problem, this is a political problem.
- Focus first on developing inclusive political institutions and the economics will sort itself out.
- All countries which now have inclusive institutions historically had extractive institutions. How did they change them?
- We emphasize the emergence of a **broad coalition** which pushes for and underpins inclusive institutions (e.g. The British Glorious Revolution of 1688).



# Turning Nigeria Around

## The History since 1999

- Since 1999 Nigeria has progressed towards inclusive institutions in both ways
  - Democratization of 1999 with President Obasanjo. The remarkable success of the recent election.
  - Strengthening of the state (reforms at the center under Minister Okonjo-Iweala, the fight against ebola, regional successes in Lagos State).
  - Broader impact on inclusion in the private sector?
- Nigeria did not create a pseudo-democracy in the 1990s like many other African nations (Angola, Cameroon,...). This is a great success story (along with Ghana, Kenya, Sierra Leone).
- The result has been an increase in economic growth.

## Problems for the Transition

- Democratization of 1999 not forced by a broad coalition in society but by the collapse of the kleptocratic military regime of Sani Abacha following his death in 1998.
- Problems with the functionality of the state
  - inability to contain Boko Haram
  - the suspension of Governor Sanusi for announcing that \$20bn in oil revenues were missing.
- Problems with the quality of democracy - still a long way from pluralism
  - James Madison emphasized that elections have to be embedded in a broader institutional architecture to avoid populism and clientelism.
- The main challenge is to avoid getting stuck (with crony capitalism...)

# Problems of Building Inclusive Political Institutions

		Distribution of Power	
		Narrow	Pluralistic
State Institutions	Ineffective	Extractive → ↓?	↓?
	Effective	→?	Inclusive

# The Complicated Transition

- Critical to think about the inter-relationships between the two dimensions of political institutions.
- Trying to create pluralism without thinking how the state works:
  - Iraq today. The failed Russian transition in the 1990s. Mexico: democracy has led to a unravelling of state functionality. Latin American style populism (Argentina, Venezuela..)
- Trying to build the state without pluralism.
  - The Chinese non-model... (and others like it Rwanda ...)
- The successful cases do both at the same time and then developing state capacity and pluralism become synergistic - e.g. Britain historically.
- Need to build a broad coalition to underpin inclusive political institutions (North-South election results in 2015 very important) critical role for the business sector to act collectively (transition to growth in India in the 1980s).