Sink or swim

MAXINE BERG

Daron Acemoglu and James A. Robinson

WHY NATIONS FAIL

The origins of power, prosperity and poverty

464pp. Profile. £25.

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Douglas W. Allen

THE INSTITUTIONAL REVOLUTION

Measurement and the economic emergence of the modern world

296pp. University of Chicago Press. $30; distributed in the UK by Wiley. £19.50.

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These two books raise the same question: why are some countries so rich, and others so poor? The answer, according to both, lies in understanding not just capital, technology and property rights, but the institutions designed to maximize wealth and the costs of establishing and maintaining them. In the late 1950s and early 1960s, Ronald Coase introduced us to "transactions costs"; later, Douglass North and Robert Paul Thomas explained "the rise of the Western world" through Europe's unique development of institutions based in belief systems, cognition and norms which fostered economic growth. More recently Avner Greif showed us the world of trust, risk and rules, which allowed for the long-distance trade that transformed the medieval world, and the late Nobel laureate Elinor Ostrom introduced us to the evolution of institutions for collective action. *Why Nations Fail* and *The Institutional Revolution* offer further, very different approaches to the role of institutions in the history of economies.

Why Nations Fail attempts a grand narrative political economy of institutions to explain the wealth and poverty of nations. Daron Acemoglu and James A. Robinson, glowingly endorsed by leading American economists and historians, tell us that economics is not enough; we need to include politics and power relations in our explanations. They convey the political story through a history of extractive and inclusive institutions, that is, institutions that concentrate power in the hands of an elite by "extracting" resources from those excluded, and institutions that give a share of power to the people. They compare these institutions over long chronologies and wide geographical spaces, from the Roman Republic, fourteenth-century Venice and eighteenth-century Britain, to twentieth-century Latin America, Africa, the Soviet Union, South Korea, the United States and China. Their book joins the large comparative global narratives published over the past fifteen years: Jared Diamond's *Guns, Germs, and Steel* (1997), David Landes's *The Wealth and Poverty of Nations* (1998) and Kenneth Pomeranz's *The Great Divergence: China, Europe, and the Making of the Modern World* (2000). To the comparative frameworks of environment, economy and culture, Acemoglu and Robinson now add an alternative explanation based in politics and power.

Inclusive institutions that "enforce property rights, create a level playing field, and encourage investment in new technology and skill" developed from early limited inclusiveness to generate virtuous circles and a "process of positive feedback". By contrast, regions of sub-Saharan Africa, for example Sierra Leone and Ethiopia, have been victims of "vicious circles", where regimes prevailing over extractive institutions were overthrown only to be replaced by others.

Acemoglu and Robinson recount a history of diamond mining in Kono in Eastern Sierra Leone, and contrast this with the success story of Bechuanaland, which became Botswana after independence in 1966. The alluvial diamond fields discovered in eastern Sierra Leone in 1930 led to conflict over their so-called democratic diamonds, mined by panning in the rivers. The access of many to the diamond fields was soon replaced by a monopoly, granted to De Beers, the South African diamond mining company, and after independence in 1970 to a nationalized monopoly whose revenues were looted by a corrupt dictatorship. Botswana's case, by contrast, is a story of the Tswana chiefs' success in preventing takeover of their territories by Cecil Rhodes. Acemoglu and Robinson explain that this was possible owing to the political authority of the chiefs, political centralization and collective decision-making. After independence, there was rapid growth based first on the cattle economy and livestock trade, then on minerals, especially diamonds. But in this case mineral rights were invested in the

Diamond prospectors in Koidu, Kono district, eastern Sierra Leone, April 2012

nation, not the tribe. Wealth from the diamond trade stimulated a further process of state centralization, and revenues paid for the state bureaucracy, infrastructure and education. However, this simplistic comparison glosses over the greater complexities of tribal divisions in Sierra Leone over Botswana.

Other vignettes take us back to the eighteenth-century British state. There is frequent reference to the achievements of the Glorious Revolution after which, it is claimed, government adopted a set of economic institutions that provided incentives for investment, trade and innovation, and which enforced property rights, protected law and order, ended arbitrary taxation, and abolished monopolies. But these large claims sit uncomfortably with the existence of state institutions to monopolize trade, such as the Navigation Acts, which prevented foreign ships from transporting goods from outside Europe to England and her colonies. Likewise the Calico Acts banned the use and wear in Britain of imported Asian textiles, and indeed of any garment of printed, painted or dyed calico. The result was to encourage Britain's early cotton industry – based initially in fustians, a combination of cotton and linen – and to constrain India's cotton trade. The East India Company was not a success story in the contemporary effort to "abolish monopolies". It might be better to think of the British state slowly developing at least some "inclusive" institutions at home, while actively deploying "extractive" ones abroad.

Argument by way of vignettes so simplified they descend at time to caricature does not help us with the big issue the book claims to address: the role of politics and the role of the state in the creation of wealth. The book offers little direct discussion of what the state does. Reference to "facilitating activities" in very vague terms does not fill this gap. But the real problem for this long and wide global history of institutions is China, where a centralized state and "extractive political institutions" have generated the highest growth rates in the world. *Why Nations Fail* is ultimately directed towards the unconvincing prediction that China's growth cannot be sustained because it is not based in free-market capitalism and "inclusive" democratic institutions.

Economies work with institutions at many levels, including practices that seem irrational and certainly not "inclusive". Samuel Pepys made his career in the world of patronage and public service as Clerk of the Acts in the Navy, then as chief Secretary to the Admiralty; as a member of Trinity House he took benefits from private lighthouses. He also frequently recounted "losing his labour", waiting on aristocratic patrons in efforts to conduct his business. What are the connections among aristocrats, duels, private lighthouses and private police forces in the conduct of early modern economies? Douglas W. Allen, in *The Institutional Revolution*, brings together a whole series of customs and behaviours we now associate with irrational premodern practices, and shows the part they played as informal institutions to ensure the provision of civil service goods before the nineteenth century.

Courts, public finance, sheriffs, notaries public, and military services between the fifteenth and the nineteenth centuries were provided through institutions based on trust or sale of offices. This is another world we can understand through "institutional economics". Allen defines his "Institutional Revolution" as the series of changes in public governance between the eighteenth and nineteenth centuries that reduced the costs of maintaining the rules and rights governing economic behaviour. Premodern systems of trust prevailed for hundreds of years, then changed rapidly and fundamentally in the later eighteenth century. These changes came about when they did because of technological changes governing the significance and variability of time, distance and power sources in the economy. Nature, randomness and variance had been the key constraints of pre-modern economies; now their part was reduced by new technologies affecting power sources, time and weights and measures.

The early modern aristocracy was at the core of an institutional system of patronage and trust. It controlled civil offices, and was controlled in turn by institutions limiting access to its ranks. Access to the group was controlled through "hostage capital", a type of social capital which had to be built up and maintained to prevent the permanent punishment of social exclusion. Observable indications of such hostage capital were the country house and the park, the conspicuous consumption in hunts, balls and horse races; and voluntary community service. Unobservable markers were in codes of conduct; social exclusion fell to those who declined a duel or failed to perform a duty – for instance, the naval captain who failed to engage the enemy.

Douglas Allen argues that a series of technological changes between the eighteenth and the first half of the nineteenth centuries allowed greater control over variation. Watches and marine chronometers, accurate maps, steam power, the breach-loading gun, shipping innovations, the telegraph and other techniques of measuring and monitoring reduced the need for institutions based so closely on trust and hostage capital. New institutions arose centred on professional, trained armies and navies, an independent judiciary and public policing, and a salaried civil administration, while the new technologies reduced the transaction costs of "variation". The result was a public bureaucracy and a civil administration, key parts of the functioning of a modern state and the everyday life of an efficient economy.

Certainly those developments of public bureaucracy have reduced the pervasive role of patronage, but "hostage capital" is still with us. For example, those "inclusive" economic institutions so admired by Daron Acemoglu and James Robinson in the US have not provided the equal public access to healthcare and education that should be the marker of rich and successful nations.