

WHY NATIONS FAIL

by Ed O'Rourke

According Livy, the Roman Empire conquered the world in self defense.

-Edward Gibbon

The nationalist not only does not disapprove of atrocities committed by his own side, but he has a remarkable capacity for not even hearing about them.

-George Orwell

Since Adam Smith's classic *Wealth of Nations*, scholars have wondered why some societies can prosper and others cannot. Some societies are successful for a while and then fail. Max Weber in *The Protestant Ethic and the Spirit of Capitalism* noted that predominately Protestant countries were more prosperous than Catholic countries. Others had the same idea that a country's culture was a major obstacle. Values learned from Confucius, Hinduism pointed to passive acceptance. Others noted that resource scarcity, tropical diseases, and poor soil (geographical factors) were insurmountable obstacles. Jared Diamond noted that eleven thousand years ago, all society had about the same living standard. In *Guns, Germs and Steel*, he indentified geographical factors that enabled Europeans to rise to power and begin to dominate the world in the 16th century. These studies shed light on obstacles to be overcome.

Daron Acemoglu and James A. Robinson in their book *Why Nations Fail* set out to explain world inequality and to show an economic model that is successful. Their answer is in institutions. They divide economics into two categories: extractive and inclusive. In the extractive model, governments develop raw materials and agricultural products. A citizen's property can be seized in whole or in part at any time without recourse. The Roman Empire and the Soviet Union are two prime examples. Extractive economies can generate goods and services in abundance for a long time, but the social price is high. During the Roman Empire's last

centuries, slavery was more common. National income in the Soviet Union increased by 6% per year from 1928 to 1960. This is amazing considering the losses Russia incurred during the Second World War. By the 1970s, the Soviet economy had become stagnant. The Soviets did a good job in space exploration and weapons. The AK47 is a well known masterpiece.

However, the industry overall was value-subtracted. The raw materials to make a car, for example, fetched a higher price than the car itself.

In the early 1990s, petroleum prices were only about \$10 per barrel. Since petroleum was a major revenue source for a stagnant economy, there was little that the authorities could do to contain popular unrest. Since Gorbachev did not feel like enforcing a police state and filling the gulags again, the Supreme Soviet on December 26, 1991 dissolved the Soviet Union.

For Acemoglu and Robinson, the answer lies in inclusive institutions rather than cultural and geographical aspects. Early in the book, they point to Nogales, Arizona, USA and Nogales, Sonora, Mexico. The climate and culture are the same in both cities. The difference is that those in Arizona have a responsive government in a strong state or nation. Those in Nogales Sonora have about a third the living standard and a government that is corrupt and cannot protect its citizens. The authors later point to West Germany and East Germany from 1945 to 1989 and to North and South Korea.

In a longer historical view, culture is not a decisive factor. Max Weber did not look to the Italian city states such as Venice during the Middle Ages. Venice especially was a thriving commercial and maritime power. At least before the 2008 meltdown, Ireland had a higher living standard than Great Britain. India and China had sophisticated civilizations in the Middle Ages when Medieval Europe was a dirty, dangerous, and unhealthy backwater. Medieval Muslim societies in the Middle East and Spain offered thriving civilizations with achievements in sciences, the arts, medicine, and mathematics. The word algebra is derived from an Arabic word.

What economically successful societies need are pluralistic institutions that protect property rights and give incentives to individuals on an even-handed basis. They have to allow what economists call creative destruction and can deal with new groups gaining political power and others falling behind. There are several examples. With the arrival of the automobile and the tractor, the demand for horses and their carriages declined. When Texas Instruments introduced the hand held calculator, the slide rule and the hand cranked calculators quickly became museum

pieces. Frequently in history, powerful groups fight tooth and nail to block innovation. Free market advocates talk about innovation until the cows come home, but the result is usually some minor feature which may or may not be an improvement. Automobile manufacturers said that the proposed Automobile Safety Act in 1965 would doom the industry. For some years, they have lobbied against improved emissions standards and improved mileage.

The petrochemical industry is worse. Ignoring the scientific consensus on global warming, the national support for brutal dictatorships in the Middle East and elsewhere, they receive \$4 billion per year in subsidies. At the same time, they scream about crumbs off the tables subsidies for alternative energy. They sponsor Astroturf groups to say that global warming is not caused by humans. They pay scientists to prepare talking points to cause confusion because they cannot generate scientific papers that pass muster.

The authors offer many examples showing authoritarian governments deliberately rejecting technology because new groups, merchants, union members, lawyers would organize and demand political and economic changes and leave current groups such as major landowners with less clout.

From superficial observation, you would have thought that the Industrial Revolution would have started in China. They had an organized state. Marco Polo saw how much more advanced China was than Europe. They were the first with a clock, the compass, gunpowder, paper, paper money, and sophisticated iron work. However, merchants were always in a precarious position. Innovations in the society had to be approved by the government.

When Emperor Hongnu came to power in 1368, he severely limited foreign trade and executed merchants who violated his orders. Fearing that contact with foreigners would bring about destabilizing social and economic pressures, he allowed only trade approved by him. In 1433, Emperor Xuande prohibited all foreign trade and forbade building ocean going ships. This prohibition continued until 1537.

In the Ottoman Empire, the sultan prohibited the printing press for Arabic works. The prohibition lasted until 1727. In 1800, only 2-3% in the Ottoman Empire were literate. At the same time in England about 60% of the men and 40% of the women could read.

In Tsarist Russia and the Hungarian section of the Austrian-Hungarian Empire, government authorities deliberately limited railroad development.

In the short term, they were right to restrict development and reject foreign influence. Brazil's dictator from 1930-1945, Getulio Vargas brought Brazil into the Second World War after Axis submarines sunk Brazilian ships. During the war, Americans invested in Brazil to develop the war effort. The Brazilian and American navies worked together to sweep Axis submarines from the South Atlantic. The Brazilian Army fought in Italy. During the war, citizens noted the discrepancy – fighting for liberty in the South Atlantic and Europe and not having it at home. When the army returned home, they and others overthrew the government. Of course, the wisest arrangement is to have an open society and be unafraid of political, social, and economic developments.

Just as important as having a strong government is to have an honest one. Many people have the idea that dictatorships are efficient. Evidence shows the opposite. In *Inside the Third Reich*, Hitler's armaments minister, Albert Speer, told about corruption and duplication that a free press would have exposed. Porfilio Diaz, Mexico's dictator from 1876 to 1911, routinely seized land and granted monopolies to political supporters. The prosperity that he generated only reached the richest.

Here are my recommendations for a revised amplified edition of *Why Nations Fail*:

- 1) Write a chapter about the US, the current Meltdown and the One Percent.
- 2) Invite scholars in different countries to write a chapter about their country. Books for Bolivia, for example, would have a commentary on Bolivia.
- 3) I offer solutions for most developing countries based on my experiences in Colombia. The rich must pay their share to get honest public servants and competent police and a first class education. Simplify transactions, clarify the laws, demand that regulated entities, the banks, insurance companies and others treat the public efficiently and courteously. Since I know many cases where people do not pay their debts, institute a small claims court.
- 4) Since the Spanish language edition does not have an index, prepare one for the next edition.

Others have advocated the importance to having a strong honest state to promote prosperity. What Acemoglu and Robinson have done is to develop an overwhelming case with more than

500 pages and historical examples that go back almost two thousand years. I have the feeling that this book will be a classic.

Main source:

Daron Acemoglu and James A. Robinson, *Why Nations Fail*, New York, Crown Publishers, 2012, 544 pages.

Ed O'Rourke is a retired certified public accountant currently living in Medellin, Colombia. This article is material for a book that he is writing, *World Peace – The Roadmap: You Can Get to There from Here*.