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## NEW INSTITUTIONAL ECONOMICS' PERSPECTIVE ON WEALTH AND POVERTY OF NATIONS. CONCISE REVIEW AND GENERAL REMARKS ON ACEMOGLU AND ROBINSON'S CONCEPT

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### Abstract

*Many thinkers made attempts to explain differences in economic development between countries, and point out what should be done to foster development. We review briefly some spectacular theories focused on these fundamental problems. We use the tools of economic analysis and the methods characteristic especially for institutional economics and economic history. However, the paper's central aim is to analyse and assess one of the newest voices in that still open discussion coming from Acemoglu and Robinson and presented in their "Why Nation Failed? The Origins of Power, Prosperity, and Poverty". Their book is brimmed with compelling illustrations, which we acknowledge as its strongest point. While the accuracy and coherence of their generalisations leave much to be desired. The analysis of those examples let to infer that the most important element encouraging or hampering economic development is the common participation of the people in economic and political processes.*

**Keywords:** new institutional economics, inclusive institutions, extractive institutions, economic development, Daron Acemoglu and James A. Robinson

**JEL classification:** N20, O50, B53

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### 1. INTRODUCTION

One of the goals of the paper is to review briefly some spectacular theories focused on the analysis including a few fundamental economic questions. Why did some national economies manage to succeed, while the others failed? Can economic prosperity and poverty be viewed as a consequence of specific cultural patterns? And finally, how to effectively create effective economic institutions and eliminate the destroying ones? These questions may be answered from the research perspective of various fields of economics. However, we would rather use the tools of economic analysis and the methods characteristic of institutional economics. In addition, we could not omit the contributions from economic history, the history of political systems, economic and political thought, and jurisprudence.

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Regarding the aim and scope of the paper, an interdisciplinary approach seems to be indispensable. Nevertheless, the underpinnings of the article's theoretical framework lie into the scientific output of institutional economics and economic history, whose one of the main research goals is to identify the factors determining the socio-economic development. In the two recent decades, many scientific investigations have been based on the so-called "triangle paradigm", i.e. on the some kind of balance between economy, society and policy. This approach has been promoted both at the national and global level. Viewed from such a perspective, the close collaboration between history and economics appears to be unavoidable. Both sciences should make the good use of the new analytical tools and methods as well. That is why economic history ought to gain from the contributions of the history of political systems and jurisprudence. It should not separate itself from the history of economic doctrines and economic theory. What is worth underlining, is the fact that one of the most promising paths towards integration of social sciences leads through the multidimensional role of institutions in social, political and economic life.

## 2. CONCISE REVIEW OF MOST SPECTACULAR WORKS ON WEALTH AND POVERTY OF NATIONS

Global financial crisis, which began in 2008, apart from the disruptions in economies of most countries in the world, led to the impairment of the authority of economists, and to some extent to the impairment of the subject of economics itself. The following questions were posed: what were the causes of the crisis, who is responsible for its outbreak, how does the crisis differ from the previous ones, is the world on the verge of another great depression? Also, the question arose why politicians and economists responsible for economic policy did not warn in time against the oncoming threat. Academics and publicists discussed heatedly the reason why, despite the continuous development of the theory of economics and the advancement of research methods applied by economists, once again they failed to prevent perturbation in the world economy. Such voices in a sense forced the economists and policymakers to account for the circumstances. It is striking, however, that diagnoses and recipes for recovery presented in specialized journals as well as in the media directed at the wide public were significantly diversified.

Similar heterogeneity is characteristic of explaining the development differences between countries. However, the explanation of the nature of this problem is so difficult, as it has to take into account the long period analysis of the economic performance of many countries. Moreover, the last global financial crisis has once again launched a growth of economists' interest in this crucial topic. But the problem of the causes of wealth and poverty in the world has been the subject of investigation of thinkers since the beginning of economics as a scientific discipline. Already the father of economics and economic history – Adam Smith – entitled his *opus magnum* (issued in 1776) "An Inquiry into the Nature and Causes of the Wealth of Nations". After World War II, with the growing popularity of theories of economic growth, an increasing group of scientists began to adopt a global perspective. To apply such theories, they had to deal with the issue of huge disparities of income in the world. Within the framework of development economics it was sought to explain the differences between industrialized, capitalist states and the poor ones that have just entered the path of growth. This issue used to be a primary consideration of Gunnar Myrdal's work – with a title directly referring to the work of Smith – "Asian Drama: An Inquiry into the Poverty of Nations" (published in 1968).

Today we are still trying to answer the question: how did individual countries and societies come to a state in which there are today? Many new inspiring works devoted to this

subject were issued at the turn of the second and third millennium. Amongst the authors analysing the question were both economic historians (Rondo Cameron, David Landes, Angus Maddison, Robert Allen, Gregory Clark, Alan Beattie) and economists of institutional school (Douglass C. North, Mancur Olson, Deepak Lal, Joseph Stiglitz, Jeffrey Sachs, Angus Deaton). Amongst the authors Daron Acemoglu and James A. Robinson's new work "Why Nations Fail. The Origins of Power, Prosperity and Poverty" enjoys a special position. The authors, using a number of historical examples, tried to explain the sources of differences between rich and poor countries (Acemoglu and Robinson, 2013, p. 3). The work refers to other classical lectures on economic history in recent years such as: "Wealth and Poverty of Nations. Why Some Are So Rich and Some So Poor" by David S. Landes; "A Concise Economic History of the World: From the Paleolithic to the Present" by Rondo Cameron and Larry Neal; Angus Maddison's studies (including the "World Economy. A Millennial Perspective") or to "False Economy. A Surprising Economic History of the World" by Alan Beattie. Causes of inequality in the world were also explained by Robert C. Allen in his "Global Economic History".

After reading the elaborates mentioned above, it can be concluded that there is no single leading cause of inequality in the world but one needs to indicate the importance of a wide variety of factors: geographical which are associated with technological development reducing burdens of "bad geography" (Allen, 2011, p. 14); cultural "that provides the key to path dependence" (North, 1994, p. 364) but understood rather as developing the skills of individuals in order to break down cultural barriers, which can be achieved by better education; institutional (including political and legal ones) as well as associated with the extraordinary "accidents of history" (e.g. a revolution or a sudden change of the government). It should be emphasized that most of the authors looked for various factors determining the causes of wealth and poverty, not trying to make evaluation which of them have bigger or smaller impact on the level of economic development. Besides the contemporary "classics" of economic history, the issue of global wealth and poverty was raised by many influential economists in the third millennium. A common feature of the majority of conceptions undertaking development issues was the belief that institutional changes were inevitable. The greatest differences occurred between the followers of liberalism, spontaneous order supporters: e.g. Deepak Lal (2006) who is a continuator of the thought of Friedrich August von Hayek and Milton Friedman, and supporters of formal solutions who argued that the lack of planning on a global scale increases inequality and hinders development: e.g. Joseph Stiglitz (2002), Paul Krugman (2004) or Jeffrey Sachs (2005). The latter position ought to be considered as a mainstream in modern development economics.

The participants of the contemporary debate on global poverty argue that it is extremely difficult to go off the course from particular path of development, but governments should be advised to adhere to some golden rules they should follow: not to isolate the economy from the rest of the world; to plan the development of their cities, but at the same time not to delegate too much power to local governments in order to keep the unity of the state; not to follow the obsessive belief in the importance of religion; not to justify the authority that ignores property rights and the rule-of-law. As far as poor countries are concerned, they should worry less about trade policy and more about customs procedures; focus on the fight against the destructive corruption but worry less about "predictable bribes"; and last, but not least: be aware when the country enters the wrong path as soon as possible to escape from it (Beattie, 2009, p. 300). These are issues institutional economics can comment on. Difficulties of entering the correct path of development do not increase with the advancement of the world economy's

integration. On the contrary – one could observe new examples of winning states. Globalization multiplies the opportunities of the countries ruled by competent elites, but also causes the broadening of gaps between those which are successful and those which are not. Many new studies on global wealth and poverty abandon traditional narrative of undisturbed chronology. Instead, they focus on particular sectors of the global economy and the case studies of their development paths. For numerous contemporary authors, it is far more important to elucidate the relationships and differences, success and defeat, prosperity and crisis, center and periphery rather than show the full image.

### **3. INCLUSIVE AND EXTRACTIVE INSTITUTIONS. THE CORE CONCEPT OF ACEMOGLU AND ROBINSON**

Another important aim of the paper is to explain the role of political and economic inclusive and extractive institutions. Those terms were introduced by two outstanding scientists, Daron Acemoglu (MIT professor in economics, J.B. Clark's medal winner) and James A. Robinson (Harvard University professor in economics and political sciences), in their book "Why Nations Fail. The Origins of Power, Prosperity and Poverty" (2013). The authors claim that "[c]ountries differ in their economic success because of their different institutions, the rules influencing how the economy works, and the incentives that motivate people" (Acemoglu and Robinson, 2013, p. 73). Their conception lies within the boundaries of the new institutional economics and the authors were largely inspired by the theory of development proposed by Douglass C. North, who was one of the most recognizable representatives of that stream. It is worth stressing, that Acemoglu and Robinson applied their ideas to a vast historical and geographical research horizon, referring to specific examples of economic and political institutions from different periods and countries (mostly Anglo-Saxon, the UK and the USA, but also Latin-American, such as Argentina, Brazil, Mexico, Peru, not to mention China, Russia, including the Soviet period, and numerous African countries). Despite their wide approach, Acemoglu and Robinson's work lacks of information about institutional experiences from the Central-Eastern Europe, namely such countries as Poland (although mentioned once in the whole book) or Romania.

The Acemoglu and Robinson's concept should unquestionably be placed at the institutional end of the spectrum of the theories of economic development. The authors leave it without a shadow of doubt, announcing the core of their book as being "about the effects of institutions on the success and failure of nations – thus the economics of poverty and prosperity" (Acemoglu and Robinson, 2013, p. 44). Their mantra-frequently repeated message is that institutions are the crux of the matter: they are important for both economic development and growth, and as such are the key factor to explain differences in economic performance over the centuries. Incidentally, the very words 'institution'/'institutions' repeat themselves more than thousand times on 500+ pages (1265 times, to be precise).

However, for those, who are acquainted with the institutional economics analysis and institutional theories of economic development in particular, Acemoglu and Robinson's "institutions matter" declaration may look a bit confusing at the first glance. The source of this bafflement is in the meaning attached to the very word "institution" and their assessment of the "culture hypothesis".

The crucial issue which remains to be analysed in the greater details is Acemoglu and Robinson's recipe for economic success. The already presented aspects of their concept imply their solution must be related to the institutions, political and economic. Yet, what

kind of institutions and in which manner should be established to improve economic performance? As it has been pointed in the first section of the article, the vast majority of contemporary scholars engaged in the research on economic growth and development agrees with the classical economists' diagnosis that to increase wealth of nations the most beneficial social environment is the one based on economic freedom and the rule-of-law. Over time the theorists of liberalism add to this picture political liberties and democracy. Acemoglu and Robinson are in this group. They claim the institutional order "must feature secure private property, an unbiased system of law, and a provision of public services that provides a level playing field in which people can exchange and contract; it also must permit the entry of the new businesses and allow people to choose their careers" (Acemoglu and Robinson, 2013, pp. 74-75). However, this "old wine" is poured into new bottles, as in their own words "[t]he central thesis of this book is that economic growth and prosperity are associated with inclusive economic and political institutions, while extractive institutions typically lead to stagnation and poverty" (Acemoglu and Robinson, 2013, p. 91).

It turns out the key dividing line is the split between inclusive and extractive institutions. But what are they? Those notions are not defined precisely, though it may be concluded that the inclusive institutions are those which allow for greater participation both on the economic and political dimension of social life, while extractive may be seen as barriers to entry that eliminate some groups from economic or/and political arenas. Inclusive political institutions "make power broadly distributed in society and constrain its arbitrary exercise". Whereas the inclusive economic institutions are "those that allow and encourage participation by the great mass of people in economic activities that make best use of their talents and skills and that enable individuals to make the choices they wish" (Acemoglu and Robinson, 2013, pp. 74-75). On the contrary, extractive institutions "are designed to extract incomes and wealth from one subset of society to benefit a different subset" (Acemoglu and Robinson, 2013, p. 76). The notions 'extractive state' and 'extractive institutions' appeared as early as in the article published with Simon Johnson (Acemoglu *et al.*, 2001, pp. 1370,1376).

The socio-economic system based on inclusive institutions is the one, which gives incentives for economic activity and as such, it fosters "economic activity, productivity growth, and economic prosperity". An impact of extractive institutions is exactly the opposite. Still, the effect of institutional order for the economic performance should not be regarded as a decisive criterion whether the particular set of institutions is extractive or inclusive. In fact, the systems founded on both types may generate some growth. Acemoglu and Robinson even stress that in many extractive states longer or shorter periods of economic prosperity occur. What is more, economic growth may be somehow supported by the governing elites of the extractive states, since it is in their own interest to have more wealth produced to be extracted. The difference between economic growth which takes place in the systems of extractive or inclusive institutions is that in the former case (i.e. under extractive institutions) the growth is never long-lasting and sustainable. The reason is in the very character of this institutional framework that hinders free initiative and impedes technological progress which is the essential prerequisites of economic growth. How long such a growth may happen is too difficult to predict, however, in the light of the examples Acemoglu and Robinson provide, it may be concluded that those periods of economic progress in extractive states might even spread over a couple of centuries at times. As it happened in the case of Maya culture or Roman Empire (Acemoglu and Robinson, 2013, pp. 143-149, 157-176).

It means the establishment of the inclusive institutions is not a necessary precondition of economic development, however, without them the pace of growth is slower. Looking from this

perspective, it would be interesting to invert the line of reasoning and ask about the character of the institutional order in those countries which are going through long-term difficulties with economic performance (as e.g. Japan or the EU15 countries). Japan is ranked 20<sup>th</sup> in Heritage Foundation 2015 Annual Index of Economic Freedom per 178 countries evaluated, whereas the EU15 countries except for Greece, Italy and France are placed in the upper quarter of the ranking. According to the Freedom House last report all those countries are assessed as “Free” with highest scores (excepting Greece) in both ‘civil rights’ and ‘political freedom’ categories (Miller and Kim, 2015, pp. 21-26). May this be read as a sign of those states major problems with the inclusiveness of their institutions even if it seems they are both market-orientated and democratic? It is not our intention to provide an answer to such a question, but rather to indicate that a bit surprisingly, Acemoglu and Robinson’s theory coax to ponder not only over the causes why nations fail, but also over the current state of the most advanced economies of the world.

Turning back to the analysis of the content of Acemoglu and Robinson’s concept, they stand by their thesis that the political institutions determine the economic ones. Furthermore, they claim the positive feedbacks may be noticed in both cases, which means the extractive political institutions lead to the extractive political rules, and the inclusive political institutions facilitate the emergence and maintenance of the inclusive economic ones. The former situation they name “the vicious circle”, while the latter is labelled “the virtuous” one. The tendency to support the same genre of institutions in the case of the extractive institutions is explained by (1) the ruling elites fear of possible reallocation of political power that might be caused by the changes of the character of economic institutions and (2) their actions to belay their political supremacy by protecting the economic benefits they are able to obtain thanks to their influence on the economic rules. In turn, in the case of the inclusive institutional framework, the safety net results from the political influence of many groups which participate in defining new rules and regulations and are able to care for their own economic interests in that very manner.

Yet, if we accept that those two “circles” operate, how was it actually possible to break the self-reinforcing mechanism of economic failures and step into the path to prosperity? To begin with, Acemoglu and Robinson admit that changing an institutional drift is never easy. What is needed is a critical juncture, which, as it has been mentioned before, may be caused by some fundamental changes in technology or turbulences in the international environment significant enough to shake the distribution of political power in society. However, not every critical juncture leads to the changes in the type of institutions. When it comes to the extractive states, besides this fortunate one (i.e. a change from the extractive to inclusive institutions), there are two more probable scenarios: the survival of the ruling group or a success of a new extractive one. Such a new group can even modify some institutions, though not their extractive essence. In other words, the people governing a given state may change, but the institutional order they create in many cases remains extractive.

To make the matter worse, the path of institutional change is not possible to predict. It means, what Acemoglu and Robinson avow, that “[t]he outcome of political conflict is never certain, and even if in hindsight we see many historical events as inevitable, the path of history is contingent” (Acemoglu and Robinson, 2013, p. 332). It should be indicated though that in the case of Acemoglu a change of approach may be noticed, since in his “Introduction to Modern Economic Growth” (2009) he stated: “Such a study will not only help explain why some societies choose or end up with institutions that do not encourage economic growth, but it will also enable us to make predictions about institutional change” (Acemoglu, 2009, p. 121).

So is there anything that may be done to increase the odds of turning the path of nation’s development to the inclusive institutions’ side? Unfortunately, as it turns out, not much.

Acemoglu and Robinson accentuate (1) the endeavours to create broad coalitions or social movements, which can effectively support the changes toward inclusive states, (2) 'the presence of some degree of centralised order', (3) previous experiences with political pluralism and civil society, even if on a moderate scale, (4) free media (partially free at least), and (5) having luck (without giving any closer hints how to obtain such a desirable outcome) (Acemoglu and Robinson, 2013, pp. 306, 460-462). The problem is the content of all the above points refers rather to the favourable circumstances, not the guidelines what may be done to bring about the change. The authors of "Why Nations Fail" are aware of that and brave enough to admit "[t]he honest answer of course is that there is no recipe for building such institutions" (Acemoglu and Robinson, 2013, p. 460). Thus the applied side of their own concept they seek mostly in showing that, contrary to the beliefs of many experts and economic advisers it is simply not possible to "engineer prosperity". And that is why they issue a stern warning on the economic and humanitarian assistance and foreign aid organised via international organisations by pointing to impossibility to initiate economic development with the external help without deep changes in the underdeveloped countries, institutional order and the scandalous wastage of the engaged resources, which is striking in comparison to the level of destitution of those to whom it should be headed (Acemoglu and Robinson, 2013, pp. 450-456). Hence, fully accepting this critique, it must be stated that when it comes to the practical dimension of their theory, unfortunately there is not much that may be particularly useful. In assessing the postulates stemming from the culture hypothesis Acemoglu bitterly remarked that "any advice to a society that it should change its culture is almost vacuous" (Acemoglu, 2009, p. 112). Yet his own calling to have broad coalitions, centralised order, previous experiences with political pluralism and civil society, access to free media and luck regrettably is vacuous no less.

#### 4. CONCLUSIONS

Following Acemoglu and Robinson's idea, it should be repeated that economic success is not just the result of geographical location, terrain, possession of water resources, natural resources, cultural perspective, religion, or luck, but economic decisions affecting the activation of inclusive economic institutions, which are an outcome of political choices. According to Acemoglu, : "Though this sort of institutional perspective has a long pedigree, it is actually interesting that most of what's written in both the popular media and academia emphasize other factors, such as the geography or cultural perspectives, or things such as enlightened leadership (how clever leaders and good economic advisers are crucial for economic success)" (The World in Crisis). The decisions of authorities have a huge impact on enabling institutions to include new social groups in economic activity and exert strong influence on removal of the institutions that exclude a part of society out of these activities.

Inspired by the concept of Acemoglu and Robinson, new studies can be argued in favour of the decisive influence of institutions on the economic status of each country: whether inclusive or extractive, political or economic. Acemoglu and Robinson's concept is to be considered an institutional interpretation of history as it tries to answer the question of how history shapes the institutional development paths of nations. The theory of "path dependence" is used also as a reference point. This approach can be exploited for analysis of all development processes particularly sensitive to their own history and strongly dependent on their previous course.

It is worth to highlight the long-term effects of inclusive and extractive institutions and compare the systems in many selected countries during different historical periods. Only the study conducted over a wide spatial and temporal depiction (using the Fernand Braudel's term –

*longue durée*) can result in answering questions set above. The possible confirmation of the occurrence of similar inclusive and extractive institutions in the countries under study can help understand the difficulties in quick and smooth achieving by one state the development levels of other states (*the catching-up process*). On the other hand, the results may help in raising the awareness of the societies, scientific elites and, especially, the political elites, that widening the area of influence of inclusive institutions is the only chance of obtaining sustainable development. We accept the arguments of Witold Kula (one of the most influential Polish economic historian) who postulated to refrain from monographic descriptions of institutions themselves and promoted the primacy of macroeconomic issues. He voted for giving priority to long-term research instead of closing the narrow limits of time and for striving to create a typology and formulate generalizations understood as the discovery of regularities (Kula, 1983, p. 753).

The results of Acemoglu and Robinson's book should be valuable for policy makers in the countries analysed and should be used in the educational policy of governments, especially by comparing the outcome with the results yielded by the authors for selected countries. In this case, social sciences have a large role to play in shaping public policy, the importance of which increases with socio-economic development. After studying Acemoglu and Robinson's concept the readers should also refer to the meaning of cultural factors, the role of religion or, in general terms, the significance of institutions in the development of societies. It is worth "to identify them in the context of the discussed problems of wealth and poverty of nations, reminding the reader in a way that the non-solved question has been a major issue of economic research for years, put on a kind of pedestal of the problems analysed in economics by the father of the discipline – Adam Smith" (Dzionek-Kozłowska and Matera, 2015, p. 9).

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