

STRATHCLYDE

DISCUSSION PAPERS IN ECONOMICS



INSTITUTIONS AND PROSPERITY

BY

COLIN JENNINGS

No. 13-13

***DEPARTMENT OF ECONOMICS
UNIVERSITY OF STRATHCLYDE
GLASGOW***

Institutions and prosperity

A review of Timothy Besley and Torsten Persson, *Pillars of Prosperity: The Political Economics of Development Clusters*, Princeton University Press, Princeton, 2011, pp. 375 and Daron Acemoglu and James A. Robinson, *Why Nations Fail: The Origins of Power, Prosperity and Poverty*, Profile Books, London 2012, pp. 529.

Colin Jennings*

Department of Economics, University of Strathclyde, Glasgow, G4 0GE, UK

Abstract

This article reviews ‘Pillars of Prosperity’ by Timothy Besley and Torsten Persson and ‘Why Nations Fail’ by Daron Acemoglu and James Robinson. Both books are focussed on the role of institutions in determining the wealth of nations and the review compares and contrasts the different approaches contained in the two texts. The review also attempts to locate the texts within the broader literature in development and political economics and to link them to other recent work in these areas.

JEL Classification: D7; N4; O1; O5; P5

Keywords: Institutions; Prosperity

* Tel: +44 141 548 2910; fax: +44 141 548 4445

e-mail address: colin.jennings@strath.ac.uk

This review is published in Volume 29, pp.252-258 of the *European Journal Political Economy* (2013). See the following link <http://www.sciencedirect.com/science/journal/01762680/29>

Ever tried. Ever failed. No matter. Try again. Fail again. Fail better.
Samuel Beckett, *Worstward Ho*, 1983

1. Introduction

It would seem clear that an institutional explanation for the wealth of nations is now the leading one within economics. Institutions encompass the set of political and legal arrangements that provide the environment in which economic activity takes place. This contrasts sharply with the dominant tradition in 20th century economics which attempted to understand prosperity as a technical problem, to work out the best means of improving social welfare under the assumption that the political elite would wish to do so. Along with the largely hidden assumption of a complete set of property rights, economics was thus largely divorced from institutional analysis. Under this approach, where clear disparities in the wealth of nations appear it would be tempting to conclude that is due to a lack of enlightenment. Improved knowledge of economics should provide the platform for future prosperity. Politics and law do not seem to matter. This, of course, is a caricature. Very few economists would have argued that politics does not matter, but they might have said that political analysis was not the remit of the trained economist.

The publication of the two books to be reviewed here, confirms that this perspective is no longer that of the mainstream economics profession. The authors are four of the most prominent economists in the world and they place political analysis at the centre of the economist's approach to understanding the sources of prosperity. Failure to improve institutions generally results in a failure to implement welfare improving policies and thus it is crucial to understand why it has been difficult for poor nations to construct good institutions. Both books should accelerate the deeper inclusion of political analysis in various economics courses, but particularly in public and development economics. While there was an awareness of the public choice argument that the *rules* of the game determined the *play* of the game, public choice analysis has generally been viewed as non-mainstream by the economics profession (even after the award of the Nobel prize to James Buchanan in 1986). These authors are from the very heart of the mainstream. The two books share the same theme, but they are dissimilar in that Besley and Persson's book is written primarily for an academic audience and Acemoglu and Robinson's book is aimed at the general reader, although this is to a large extent a popular follow up to their well-known academic text from 2006.

2. Pillars of prosperity

I will begin with the Besley and Persson text. The book gathers and expands upon a number of academic papers that they have published in the last four years. In a very clear opening chapter (which also provides a useful summary of the whole book), they begin with a quote from Adam Smith who identified '*peace, easy taxes and a tolerable administration of justice*', as the requirements that '*carry a state to the highest degree of opulence from the lowest barbarism*'. So from the start we are reminded that modern *political economics* with its focus on politics is in many ways a return to the concerns of the founders of economics

who distinguished the discipline as *political economy*. The authors are careful to clarify what they take Smith's three pillars of prosperity to mean; 'easy taxes' are for them administratively easy to collect and they are not primarily concerned with constraints imposed by the standard concerns of incentives and political competition; 'peace' means internal to a nation rather than external and 'justice' is primarily concerned with security of contract and property rights. In the period when economics was more divorced from politics, issues such as the underlying ability of the state to tax or the security of property rights were simply assumed. A society that can achieve these capacities will form an 'effective' state from which prosperity can emerge. They define a development cluster as one that exhibits a positive correlation between income per capita, state capacity (a combination of fiscal and legal capacity) and absence of political violence. They demonstrate empirically these correlations and while some readers may be fussy regarding how they measure these features, the evidence does seem fairly compelling. They explain that each subsequent chapter builds upon the one before to expand the core model so as to endogenise previously exogenous variables and to introduce new variables of interest, so that by the end of book a full typology of different kinds of state is provided and by extension gives an explanation for the inequality in prosperity of nations across the globe.

Chapter 2 constructs the core model that is used throughout the book. It presents the conditions required for costly investments in fiscal capacity to be made. The model consists of two periods and two groups consisting of an incumbent and opposition, such that in each period the incumbent (the opposition could become the incumbent in period two) gets to choose spending in public goods and make transfers to the two groups given the constraints created by income, current fiscal capacity and resource income. In period one, the incumbent can choose to invest in fiscal capacity. They will do so if they foresee the benefits created by an increased tax base in period two as compensating for reduced spending on public goods and/or transfers in period one. With this simple set-up, three types of state are identified dependent on whether two conditions hold or not. These are the cohesiveness and the stability conditions. Cohesiveness arises if there are likely to be highly valued public goods and/or if the incumbent knows that if they are removed from power they would still receive a large share of any transfers the new incumbent might make. This may relate to a strong system of checks and balances in the political institutions. The stability condition relates to the likelihood of the incumbent retaining power. If cohesiveness holds, the incumbent will invest in fiscal capacity and this is called a *common-interest state*. If it does not hold they will still invest if political stability is high. This is a *redistributive state* where the incumbent is not worried about losing power and increases fiscal capacity to potentially extract larger transfers from the opposition. If neither condition holds, the state is defined as *weak* and no investment is made in fiscal capacity. Compared with the behaviour of an idealised Pigouvian planner, a common-interest state is efficient; a redistributive state is efficient (though not in a standard utilitarian sense) and a weak state is inefficient. This implies a central problem of commitment in politics. A set of mutually welfare-enhancing institutions often cannot credibly be devised to prevent abuse of power at a later stage. Microfoundations for the model are discussed, various extensions are made and empirical evidence is provided which shows correlations between proxies for parameters in the model that measure cohesiveness and stability and the measure for fiscal capacity (share of total taxes in GDP). Some of the proxies for the parameters are very interesting. For example, a measure of common-interest spending is the proportion of years in external war from 1816-2000. The authors openly admit that the empirical work is purely illustrative, but it is convincing. It also goes against a commonly made argument that a low tax economy is a wealthy economy.

In chapter 3 the authors move on to the second pillar of prosperity; legal capacity. Here the legal system is viewed as ‘market-supporting regulation’ such as protection of property rights. As a result, investments in legal capacity lead to higher incomes. The key finding in this chapter is that investments in fiscal and legal capacity tend to be complementary. Increases in income through the expansion of legal capacity make an increase in fiscal capacity more attractive. If fiscal capacity is expanded, the incentive to invest in legal capacity to increase the tax base is increased. The results therefore are the mirror of those in the previous chapter. Virtuous and vicious cycles emerge given the positive feedback between state capacity and income. Interestingly, natural resources suggest less of a need to invest in capacity and the authors suggest this as a reason for why we may see a lower level of state capacity in resource or aid dependent countries in Africa or parts of Asia. The chapter analyses the possibility of differential application of the law and predation, as opposed to equality in the form of the ‘rule of law’. The empirical analysis is expanded to include a measure of legal capacity and includes legal origins as a means of capturing the cost of investing in legal institutions. Very usefully, the authors locate where their work stands in development economics literature. They argue that the development literature split into underdevelopment due to lack of technology following Solow (1956) or underdevelopment due to resource misallocation following Lewis (1954). This book follows the resource misallocation tradition, but caused in large part by a lack of incentives due to the underlying institutional structure.

Chapters 4 and 5 cover the final of the three pillars; whether a society experiences political violence or not and how this interacts with state capacity to determine prosperity. Political stability is now endogenised as a function of the efforts the two groups make in winning a fight should it happen. Chapter 4 excludes state capacity, holds income exogenous and finds that the same factors that generated state capacity are also likely to generate peace. Highly valued public goods, a credible and relatively even share of political power, non-dependence on natural resources and high income all create the conditions for peace and their opposite values point to civil war or repression (one-sided conflict). Whether violence is mutual or one-sided will depend on the fighting abilities of the two sides and the cost of fighting.

Chapter 5 brings all three pillars of prosperity together and establishes a state space of nine possibilities emerging from the matrix of common-interest, redistributive and weak states on the one hand and peace, repression and civil war on the other. A key finding is that if a state has highly valued public goods and/or a fairly equal distribution of power then they will be both peaceful and a common-interest state. There are no constellations of parameter values that allow for common-interest states that are repressive or in civil war. There are, in contrast, constellations of parameter values that allow for permutations of the six remaining states. The worst of these is a weak state in civil war. Such a state exhibits a lack of commonly held highly valued public goods, poor checks and balances, evenly distributed fighting skills, low cost of fighting and a high level of natural resources. Such a state is the ultimate failed state, but there are variations of unhappy states exhibiting weakness or redistribution on the one hand and/or repression or civil war on the other. Because happy states seem to be happy in only one way (peaceful and common-interest) and unhappy states can be unhappy in six different ways, Besley and Persson label this the Anna Karenina matrix.¹

¹ This follows from the famous opening line of Tolstoy’s novel, “All happy families resemble each other; every unhappy family is unhappy in its own way”.

With the full model in place, the authors in chapter 6 discuss the thorny topic of development assistance within the boundaries that their model has established. As aid is essentially additional to resource rents, unconditional aid will have a similar effect as resource rents and it is not good. In this case, the model predicts it will increase the likelihood of political violence and reduce investments in state capacity. To this extent, it puts the authors in the camp of aid ‘pessimists’ such as Easterly (2006), as opposed to those that they label optimistic ‘traditionalists’ such as Sachs (2005). However, there is an alternative path offered by ‘conditional optimists’ such as Collier (2007) and it is through the effect of technical assistance in improving the value of public good projects that their model would offer support for such intervention. They point to the increasing use of randomised controlled trials (see Banerjee and Duflo, 2011, for an overview) to identify these types of interventions. Obviously interventions that make for cohesive political institutions should in principle be for the good. This could provide a justification for intervention in Afghanistan or Iraq, but there is a major catch. Creating institutional checks and balances is not enough. The institutions need to be credible.

Cohesiveness of institutions had been treated as exogenous throughout the book, but given its central importance in generating prosperity it is treated as endogenous in chapter 7. They identify that political competition is the main determinant as to how cohesive the incumbent may choose the institutions to be. If they feel there is no threat, they are less likely to create checks and balances than if there is a good chance they will lose power in the future. This strongly echoes the Acemoglu and Robinson book. In the final chapter, the key issues in the book are summarised. They construct a Pillars of Prosperity Index. This is done by combining data on income, state capacity and political violence. Given that these are endogenous in their model, they then ask how well the exogenous variables of their model predict the index values. India and China underperform compared to their prediction and an explanation offered is that both countries are ‘catching up’ to the level where their institutions suggest they should be. As regards over-performers such as Singapore and Kuwait, a potential explanation is that the theory says nothing about the good fortune of having benign leaders. They finish with a number of issues, one of which on identity, I will return to later.

The book has provided a core model that provides a set of variables with which the three pillars of prosperity (fiscal, legal and absence of violence) that determine prosperity are endogenised. The model becomes increasingly rich, but the authors write very clearly and order the book in a very manageable way. For example, each chapter keeps the development of the core model nicely separate from extensions that can be made to it. The model proves useful when asking practical questions with regard to development aid and gives insight into the potential for political reform. The authors also make an admirable effort to bring data to the analysis. A major achievement, in my view, is that they have connected the theory and empirics of political violence, where within the existing literature there has been a serious disjoint. It is an ambitious book that must be an essential read for all political economists. It also comes with an excellent guide to the literature at the end of each chapter. For those wanting fixes they should be warned, the ambition of the book lies in explaining lack of prosperity rather than in original suggestions as to how matters can be improved. This is precisely the institutional view of economic prosperity. Only by first understanding how nations came to be the way they are, can we understand better when policy interventions may help or, indeed, given the institutional set-up, may make things worse.

3. Why nations fail

Besley and Persson present an ambitious fusion of political science with economics. Acemoglu and Robinson take the same ingredients and add history to create a simple, but powerful theory for the origins of prosperity. This is explicitly written as a book geared towards a broad audience and brings together the academically targeted work of the co-authors (and others) over fifteen years. This is one of the most enjoyable reads that I have encountered in political science or economics. The ambition is huge. It lays out a clear theory and provides historical examples as evidence, which range across the globe and from the depths of time up to the modern day. I suspect some professional historians may grimace at such a wide-ranging approach, as they may feel that the discussion of each historical case lacks depth and is partial, only seeking evidence that backs the theory. While such a criticism may be valid to a degree, it will not matter to readers (and this includes most economists) who have large gaps in their historical knowledge, and where the knowledge they do possess has not been refined by an over-arching theory. For those readers (and I certainly include myself), this book is deeply thought-provoking and provides a wealth of insight. It is though somewhat pessimistic. Although economics is often labelled the 'dismal science' most economists are actually by inclination fairly optimistic, forever seeking policy changes that will improve the lot of most citizens. Acemoglu and Robinson tell us that such endeavours may be largely hopeless unless the institutional framework is right and this book aims to explain why so many nations do not have the right institutions. Further, institutions are very hard to change and thus the somewhat pessimistic tone.

Acemoglu and Robinson draw the distinction between *extractive* and *inclusive* economic and political institutions, and that extractive economic institutions tend to be caused by extractive political institutions. Inclusive economic institutions '*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 new businesses and allow people to choose their careers.*' (pp.74-75). With these features in place, economic activity and productivity growth will follow. Extractive economic institutions do not provide confidence in private property. They are rife with corruption and theft and there is a strong resistance to change. A key feature of inclusive economic institutions is '*creative destruction*', the acceptance that the new (and more efficient) can replace the old (and inefficient). Given the inefficiency of extractive economic institutions one might expect them to disappear over time. Acemoglu and Robinson's key point is that they are robust because they are supported by extractive political institutions. These are political institutions that concentrate power in the hands of the few, whereas inclusive political institutions are pluralistic and spread political power more evenly. It is in the interest of the powerful elite to deliberately maintain extractive economic institutions because this keeps the potential opposition relatively weak by preventing the unleashing of creative destruction, a consequence of which is that the elite could find themselves replaced politically, just as old economic entities are replaced by new ones. Although the extra wealth created by the formation of inclusive economic institutions should create the possibility of compensating the elite for a loss of power, the elite realise that there is no credible deal that could be struck. Some nations are more fortunate and the elite surrender power either voluntarily or through the use of force and inclusive institutions are thus created.² Given

² *Voluntary* reform of institutions in the Acemoglu and Robinson approach is largely conducted due to outside threats. There is no violence, but the fear of it causes elites to surrender some power. For an interesting contrast, Congleton (2011) in his analysis of western democracy sees much of the institutional changes that were made as

these forces and the existence of virtuous and vicious feedback loops, huge disparities in the wealth of nations have evolved over time. In addition, the poorest nations in the world have been especially cursed in that they failed to develop any meaningful set of institutions. There was very little in the form of political centralisation so as to provide a powerful state. A state which is extractive, but centralised may exhibit a reasonable standard of living, at least for a proportion of its citizens. A state which has not centralised (often due to the battle to obtain control of extraction) will not be able to achieve even that.

The authors spend a chapter rejecting alternative theories, which they label 1) the geography hypothesis; 2) the culture hypothesis and 3) the ignorance hypothesis. Although the authors show considerable respect for the geographical thesis of Diamond (1997), they argue that we only need to observe a town such as Nogales on the Mexican/United States border to see that the huge disparity of wealth either side of the border cannot be explained by geography. Clearly, it is due to one side being in Mexico and the other being in the United States. One could go on and consider North and South Korea and East and West Germany as further examples. They dismiss cultural arguments as a by-product of institutional histories and the ignorance hypothesis is dismissed on the basis that when one digs deeper, one will find that extractive economic institutions that clearly look like very bad ideas given our knowledge of economics, are actually deliberately put in place to preserve extractive political institutions and the power of the elite.

The authors develop a number of themes based around the extractive/inclusive, economic/political, centralised/uncentralised distinctions in order to shed light on the emergence and persistence of institutions and circumstances under which they might change. The primary explanation they give for the experience of Nogales, is the differential institutions that emerged due to colonisation by the Spanish versus colonisation by the British. The British intended to colonise as the Spanish did, exploiting large indigenous populations and the existence of abundant natural resources, but these features did not really exist in the north of the Americas relative to the south. Coercion was not an option for Britain, so wealth would have to be generated through incentives for settlers and incentives came with formalised political rights. These initial experiences of colonisation and the quite different economic and political institutions that subsequently emerged (such as the constitution of the United States) provide an explanation for the current disparity of wealth between North and South America.

A key aspect of Acemoglu and Robinson's analysis is that institutions are persistent, but there are critical junctures when significant change is more likely. An example is the arrival of the Black Death in the 1300's. The shortage of labour made labour more powerful. More powerful labour was accommodated in England, but was repressed in east Europe. A second example is the emergence of Atlantic trade after the discovery of the Americas in the 1600's. The grip of the Crown in England was that bit weaker than in France or Spain and this allowed a merchant class to emerge in England and further extend political pluralism, whereas in France and Spain the monarchs were strengthened. By the time of the Civil War in England and subsequent attempts to restore absolutism, a powerful coalition of resistance had formed which ensured the victory for inclusive institutions. The authors point to the Glorious Revolution of 1688, when the new, invited, King William III accepted the primacy of Parliament, which set the conditions for the inclusive institutions (in particular property

truly voluntary in that they were mutually advantageous both for incumbent elites and opposition groups. For a discussion of Congleton's book, see Tridimas (2012).

rights) that led to the Industrial Revolution. The authors also accept that contingency plays a crucial role. What would have happened if the English had not defeated the Spanish Armada?

We often observe high levels of growth, under what would clearly seem to be extractive institutions. The famous example of the 20th century is the Soviet Union. The authors argue that we should not be deceived into thinking that this is similar (or indeed better) to the type of growth displayed in nations with inclusive institutions. It may be that growth is driven by increased centralisation and coercive reallocation of resources, but it is not sustainable because it does not allow for economic incentives and creative destruction. These cannot be allowed because they will threaten the power of the elite. Eventually growth did peter out in the Soviet Union, as did the state itself. The authors predict that the astonishing growth we observe in China will go the same way unless Chinese institutions become more inclusive. They echo Besley and Persson and suggest that the growth is largely catch-up.

Inclusive institutions can become extractive. The authors point to Rome which moved from being a partially inclusive republic to a principate to a naked empire. What caused this? As soon as inclusiveness starts to slip, and there are large rewards for being in power, infighting will result which in turn accelerates economic decline. The authors dismiss the idea that the Roman settlement of Britain had anything to do with Britain's future inclusive institutions and subsequently the Industrial Revolution. Britain instead was marked by a succession of incremental victories against the Crown and the aristocracy, from the Magna Carta in 1215 up to the Glorious Revolution and beyond to the First Reform Act of 1832, Repeal of the Corn Laws in 1846 and universal suffrage in the 20th century. Why at various points was there not more resistance to this process given that there was always some narrow, powerful group that could benefit from preventing increasing inclusivity? A distinguishing feature of Britain was that opposition to such groups was composed of a broad coalition of interests, so that it could not be the case of one narrow extractive elite being replaced by a new narrow one because the opposition contained groups with contradicting interests. The opposition was also powerful and could issue a credible threat. Building ever more pluralistic institutions, by preventing the potential exploitation of one group prevented the exploitation of all groups. By the time of the Industrial Revolution property rights were secure and creative destruction was unleashed.

In many other examples, creative destruction was actively prevented by the elites. Russia and Austria-Hungary blocked new technologies and infrastructure development because they could see the potential for shifts in power as a result. At least these nations were reasonably centralised, others, such as Somalia, could not even make the investment in the basic functions of a state such as the provision of order for fear that the power of the state once created ends up in opposition hands at a later stage.

In addition to states, such as Rome, which slipped from partial inclusiveness to becoming extractive, a depressing tale is told of states that displayed inclusiveness but were made extractive due to colonisation. The authors argue this was the experience of south-east Asia and sub-Saharan Africa. This had further negative effects in that some societies rationally did not develop further for fear of attracting the attention of colonisers. This book, like Besley and Persson, picks up on the key role of resource misallocation as the source of underdevelopment as identified by Lewis (1954). The optimistic view of the 'dual economy' is that output would be massively increased as labour moves from the traditional economy to the modern technological economy, However, Acemoglu and Robinson convincingly argue that the dual economy is not something that will disappear as a natural result of economic

development, but rather it was the deliberate choice of an extractive elite to establish such a state of affairs. They give the example of Apartheid South Africa operating a dual economy as a means to maintain white control.

Inclusive institutions can be exported and Napoleon emerges as a rather heroic figure in this book. Following the French Revolution and the subsequent Napoleonic wars, significant institutional change of the inclusive kind began to emerge throughout Europe. Bringing these various arguments together we can begin to understand the fact that development is to a large extent geographically clustered, without using a geographical explanation for this observation.

The authors also identify a reason why we do not see much change over time in the ranking of nations by wealth. There are virtuous and vicious cycles between types of institutions. A key aspect of inclusive institutions is that power is more evenly spread so that the stakes tend to be lower, allowing for further inclusiveness. The opposite applies in extractive states. The stakes are very high and if a strong repressive state cannot exert control, civil war and state failure is more likely to follow. Interestingly, when the stakes become lower resistance to change will start to fade. As an example, they argue that migration of blacks from the deep south of the United States and mechanisation of the cotton industry paved the way for the acceptance by whites of the collapse of the Jim Crow laws in the south.

Various types of modern day state failure are discussed. From the lawlessness of Somalia, to the partial inclusive/extractive nations of South America, to the absolutism of Uzbekistan and other states of the ex-Soviet Union. The latter tale of modern day, state organised child labour is deeply depressing. On the other hand, happier stories are told. Botswana appear to have benefitted from the major good luck of having publically motivated leaders, and China at the critical juncture following the death of Mao was fortunate that Deng Xiaoping came to power rather than the 'Gang of Four'.

The book finishes on a rather pessimistic note, at least, pessimistic from an interventionist, aid perspective. They argue that a modern success story, Brazil, was not built on aid but rather, *'the consequence of diverse groups of people building inclusive institutions'* (p. 457). Why label this pessimistic? The reason is that Acemoglu and Robinson demonstrate that institutions change very slowly, so the development economist's instinct that something can be done here and now is misguided and perhaps even misplaced if it causes more harm than good.

There is, though, an uplifting aspect to the book. The central message is really quite simple. Any society that has allowed individuals to flourish has prospered. So underlying any complex story about technology adoption is another more basic story. The reason such technological advances were made, such as the astonishing display of ingenuity during the Industrial Revolution, is that institutions were such that individuals knew that investments in their own ability would be worthwhile. They had rights to their property and could trust the state would not steal their investment *ex post*. The surprising fact of human history is just how difficult it has been to achieve and maintain such societies.

4. Comparative discussion

That the two books overlap and share the same broad themes barely needs stating. Extractive, centralised institutions are analogous to redistributive, repressive states. Nations that fail to

achieve political centralisation are analogous to war infected weak states. Inclusive institutions are analogous to peaceful, common-interest states. Besley and Persson are primarily concerned with setting up a general model that links underlying parameters such as the value of public goods and political institutions to the observation of state capacity and prosperity. Acemoglu and Robinson are more directly concerned with accounting for the nature of political institutions as a battle (or non-battle) between various groups as a means to explain prosperity. Clearly, there is considerable agreement between the two approaches on the central importance of inclusive/cohesive political institutions and that such institutions are difficult to achieve.

Readers of the *European Journal of Political Economy* are also likely to find much of the substance of the argument to be very familiar (although presented quite differently) from the work of the public choice tradition. Besley and Persson are careful to reference works by Buchanan and Tullock and others, but Acemoglu and Robinson do not in this book (or indeed in their 2006 book) reference this literature much beyond the work of Olson. There are clear links though. For example, Tullock (1983) argues that income redistribution is not determined by altruism or a social welfare function but rather is determined through the political process according to how much beneficiaries of redistribution are able to take. This closely mirrors the theories of extraction and redistribution presented in the two books reviewed here. Nonetheless, in response to those that may make the charge that the approaches are not as novel as they might seem, I would argue that the methodologies, the attempt to relate to the data (Besley and Persson), historical case studies (Acemoglu and Robinson) and the details of the theories that are presented are absolutely novel.

There are some differences in emphasis in the two books. The first concerns the role for policy and optimism. Banerjee and Duflo (2011) write a very different book to that of the two reviewed here, in that they look at issues in development at the absolute micro-level. They argue that detailed, micro-level interventions can make a big difference and a theory such as Acemoglu and Robinson's fails to pick this up. This rather more optimistic perspective is picked up in Besley and Persson's approach, in the role played by highly valued public goods as a determinant of state capacity and prosperity. They identify the role for randomised controlled trials (as conducted by Banerjee and Duflo and others) as a means to find such highly valued public goods. Nonetheless, the emphasis on institutions has surely tempered much of the naïve optimism that once existed in development economics. Other authors would agree with Acemoglu and Robinson, but use the institutional perspective to argue for institutional solutions that are available today if we so wish. For example, Acemoglu and Robinson point out that a key reason for the demise of the Jim Crow south was the availability of federal allies in the north. Essentially, if a powerful coalition can be formed, vested interests can be dislodged. This is a similar point made by Collier (2009) who argues for relatively cheap military threats to be made by rich countries against abuse of power in poor countries. This moves the problem beyond national borders to recognise international coalitions. The problem, of course, is selling such an institutional response to the citizens of the rich countries, and if the threat needs to be carried out can the commitment be made credible in the long-term. Another difference in the two texts, I would argue, is the emphasis on geography. Acemoglu and Robinson deny it having a major role, but Besley and Persson implicitly suggest that it may play a major role given the role that natural resource rents play in their model in reducing the incentive to invest in state capacity and to engage in political violence. Natural resources tend to come with a specific geographical location and this implies a role for geography in determining prosperity.

In both books, the ability to achieve collective action plays an important role in the background. Groups must be able to form and be active to achieve political power. Olson (1982) placed the role of collective action at the centre of his theory of national prosperity. By not discussing collective action explicitly, both books may miss a further potential difficulty for the reform of bad institutions. An implicit assumption is that individuals tend to act only in their economic interests. I agree that this is generally the correct assumption, but engaging in collective action may bring into play features that are not obviously in the economic interests of the individual. This relates to the idea of expressive behaviour. In most settings of collective action, individuals are very unlikely to be decisive in determining the outcome of the group action. This means that they are more likely to choose expressively rather than instrumentally, and the former need not be concerned with economic interests (Hamlin and Jennings 2011). Expressive preferences may focus on issues of identity, which run contrary to their instrumental economic interests, but since collective action exaggerates the role of expressive preferences they can dominate the choice of individuals within the group and as a result the group choice overall, (Hillman, 2010). As an example, in China the standard view is that greater political and economic rights will need to be extended to avoid future political turmoil. An alternative view is that the Chinese elite understand expressive logic and this may explain the recent rise in Chinese nationalism. Extractive leaders can use identity as a means to keep the people on side without having to relinquish power. This contrasts sharply with the discussion of identity in Besley and Persson as a force for good if it leads to more homogenous preferences. Bad institutions, therefore, have a further reason for their persistence. Political action means collective action and while this may lead to one major problem (free-riding), a further problem is that free-riding may be overcome by direct expressive benefits and this may lead to expressive support for extractive institutions. This is particularly likely if the elite are especially skilled in manipulating expressive preferences focussed on identity. This idea is absent in both books, but (and I accept there may be a charge of bias), I think it would augment the theories put forward.

5. Concluding comments

Institutions are clearly at the cutting edge of research in political science, economics and beyond. At the time of writing this review, the historian Niall Ferguson is giving the prestigious annual BBC Reith lectures and he places institutions at the centre of his lectures. Indeed, he positively cites Acemoglu and Robinson's book. Interestingly though, the focus of Ferguson's lectures is not on institutions in developing countries, but (building on his 2011 book) the possibility of decline in institutions in developed countries. This is a theme touched upon in Acemoglu and Robinson, but not addressed in Besley and Persson. An easily justifiable defence, of course, would be that their focus was on why some nations fail to achieve prosperity, rather than why some nations achieve it and then proceed to lose it. However, it is clear that there really is no nation that could be described as wholly inclusive or of complete common-interest. While it is the case that there are nations that do not experience political violence, invest in valuable public goods, contain well-developed legal systems and robust systems of checks and balances, it is also the case that they contain groups of aspirant rent-seekers attempting to undermine existing institutions and build, at least, some level of extractive institutions to enrich themselves at the expense of others. Indeed, this is precisely the theme of another high-profile recently published book, Stiglitz (2012). He provocatively argues that the United States has been hijacked by a privileged minority that has been very successful in increasing its wealth through extraction rather than production.

So there is, in truth, no fully inclusive, common-interest state. Rather, it is a constant battle to maintain relatively good institutions. If this battle is not fought extractive institutions will take their place. With this in mind, I wonder if we should expand our set of literary allusions. The Anna Karenina matrix clearly makes sense in the context of Besley and Persson's analysis. However, do happy nations really resemble each other? Does Switzerland really resemble the United States? More pertinently, is there any nation that is really happy? All nations struggle with market and political failures, and none solve these problems as well as might be hoped. Those that are prosperous seem to have been *better at failing*. Perhaps, the quotation from Samuel Beckett at the start of this review is a more apposite reflection of reality than that of Tolstoy's and it also reminds us that institutions are ultimately human creations, requiring human effort. Difficult though it might be, in nations where institutions are demonstrably bad people can still try to improve them and where relatively good institutions have been forged, citizens need to be vigilant and protect them against the powers of extraction.

Acknowledgements

I wish to thank Arye Hillman and an anonymous referee for their helpful comments.

References

- Acemoglu, D., Robinson, J.A., 2006. Economic Origins of Dictatorship and Democracy. Cambridge University Press, New York NY.
- Banerjee, A.V., Duflo, E. 2011. Poor Economics. Public Affairs, New York NY.
- Collier, P., 2007. The Bottom Billion. Oxford University Press, Oxford.
- Collier, P., 2009. Wars, Guns and Votes: Democracy in Dangerous Places. Bodley Head, London.
- Congleton, R., 2011. Perfecting Parliament: Constitutional Reform and the Origins of Western Democracy. Cambridge University Press, New York NY.
- Diamond, J., 1997. Guns, Germs and Steel: The Fates of Human Societies. W.W. Norton, New York NY.
- Easterly, W., 2006. The White Man's Burden: Why the West's efforts to aid the rest have done so much ill and so little good. Penguin Books, New York NY.
- Ferguson, N., 2011. Civilization: The West and the Rest. Penguin Books, New York NY.
- Hamlin, A., Jennings, C., 2011. Expressive political behaviour: Foundations, scope and implications. British Journal of Political Science 41, 645-670.
- Hillman, A.L., 2010. Expressive behaviour in economics and politics. European Journal of Political Economy 26, 403-418.
- Lewis, W.A., 1954. Economic development with unlimited supplies of labour. The Manchester School 22, 129-191.
- Olson, M., 1982. The Rise and Decline of Nations. Yale University Press. New Haven.
- Sachs, J., 2005. The End of Poverty: Economic Possibilities for Our Time. Penguin Books, New York NY.
- Solow, R., 1956. A contribution to the theory of economic growth. Quarterly Journal of Economics 70, 65-94.
- Stiglitz, J., 2012. The Price of Inequality: How today's divided society endangers our future. W.W. Norton, New York NY.
- Tridimas, G., 2012. How democracy was achieved: A review of Roger Congleton, Perfecting Parliament: Constitutional Reform and the Origins of Western Democracy, European Journal of Political Economy 28, 651-658.
- Tullock, G., 1983. Economics of Income Redistribution. Kluwer-Nijhoff, Boston MA.