The essence of successful nations

Lydia Bevege reviews a fascinating study that explains why some nations fail and others succeed.

Tolstoy famously wrote that while happy families are all alike, unhappy families are uniquely unhappy in their own way. In their latest book, MIT economist Daron Acemoglu and Harvard political scientist James Robinson have found the Russian novelist’s adage holds true for nations as well.

As Ronald Bailey argued in his review for Reason magazine, Why Nations Fail might be better titled Why Some Nations Succeed, as its real value lies in its analysis of the conditions required for a country to develop stability and prosperity. Their answer, institutions, is compellingly simple.

Acemoglu and Robinson coin a neat phrase to describe the respective attributes of successful and failing states—‘inclusive institutions’ versus ‘extractive institutions’. They argue that when nations develop ‘inclusive’ political institutions, ‘inclusive’ economic institutions follow suit to create a virtuous circle, propelling the nation towards success. On the other hand, if nations continue to labour under ‘extractive’ political institutions, ‘extractive’ economic institutions will also emerge to form a vicious circle that prevents the country from reaching prosperity.

The author’s list of factors that define inclusive political institutions reads like a catalogue of the best achievements of Western Civilisation: democratic governance, the rule of law, property rights and a degree of political centralisation.

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The development of these political institutions snowballs towards open markets, free trade and the fostering of an entrepreneurial spirit—what the authors define as inclusive economic institutions.

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The book helps explain why other regions have lagged in economic development too. Most of Europe was slow to industrialise because their political institutions were still dominated by the arbitrary rule of monarchies. South American countries remained mired in poverty for years following independence from imperial powers, and are largely still counted as developing rather than developed countries. Asia’s autocracies such as North Korea and Burma are leagues behind their liberalised neighbours on almost all measures.

Prosperity continues to evade many of these nations—they have that much in common. Yet each have their own unique set of economic and political woes. Whether it be brutal dictatorship or oligarchs masquerading as democratically elected leaders, there are dozens of variations of illiberal political and economic institutions that dot the developing world.

Why Nations Fail: The Origins of Power, Prosperity and Poverty

by Daron Acemoglu and James Robinson

From time to time regimes may be overthrown, but all too often this only represents the transferral of wealth and power from one group of elites to another. The vicious cycle repeats itself, because when economic institutions are extractive—when tariffs are high and protection and monopoly are bestowed upon political allies—political power becomes inextricably linked to economic wealth.

The extractive versus inclusive institutions model provides a far more convincing explanation of the differences between rich and poor countries than other popular theories that have gained currency over the years. The authors tear the ‘geography hypothesis’ to shreds—the idea that poor countries are poor because of where they are located on the globe—as proposed by Jared Diamond and popularised by Jeffrey Sachs. They similarly rebuke theories that attempt to link prosperity to cultural values, or to some sort of knowledge gap among elites in the third world that well-meaning Westerners can fill. Theories of geography, culture or ignorance cannot explain why Botswana is not Zimbabwe, why South Korea is not North Korea, or why the neighbouring border towns of Nogales, Mexico and Nogales, Arizona are so fundamentally different. A theory based on institutional difference can.

Six years ago former World Bank economist William Easterly published his controversial book *White Man’s Burden*, provocatively sub-titled ‘why the West’s efforts to aid the rest have done so much ill and so little good.’ The book caused outrage in the development community for its blistering attack on the success—or lack thereof—of aid programs delivered by well-meaning Westerners in developing countries. Easterly argued that aid cannot make poverty history, and that NGOs ought to have more modest agendas rather than seeking to solve poverty in one fell swoop.

In many ways *Why Nations Fail* consolidates the missing piece of information in the ongoing quest to eliminate poverty in the third world. When seen through the model of inclusive and extractive institutions developed by Acemoglu and Robinson, it seems breathtakingly obvious why Western aid efforts have failed so abysmally to eradicate poverty. Ongoing economic growth can only occur when political and economic institutions are free—something sorely lacking in Sub-Saharan Africa and other countries that remain mired in poverty. Without the complex incentive structures of inclusive institutions that allow people to flourish, poor people the world over are unlikely to find prosperity.

For a country like Australia, which has enjoyed the fruits of inclusive institutions for much of its history, the book still has some valuable lessons. The authors chart how a fear of creative destruction has led leaders across the world and throughout history to turn away from the virtuous circle of free economic and political institutions, instead choosing to protect vested interests. History is littered with examples of societies who never quite break the mould or who reverse development in the name of protection from the forces of creative destruction. The authors argue it is possible for countries to slip out of the virtuous circle if inclusive economic and political institutions are impeded. Australian policy-makers would do well to remember this.

*Why Nations Fail* can be overly technical at times, but its sweeping narrative provides a convincing explanation of why the gap between the haves and have-nots persists throughout the world today. The book marshals a wealth of historical and other data to prove it is no coincidence that wealthy nations are also liberal democracies. Acemoglu and Robinson provide a comprehensive catalogue of the successes experienced by countries when they adopt free markets and democracy in tandem, and the failures of those who don’t.

At a time when only 40 per cent of young Australians believe that democracy is preferable to any other kind of government, this book is an important and timely reminder of why we ought to be grateful for our institutional heritage.