"In this stunningly wide-ranging book, Acemoglu and Robinson ask a simple but vital question: why do some nations become rich and others remain poor? Their answer is also simple—because some polities develop more inclusive political institutions. What is remarkable about the book is the crispness and clarity of the writing, the elegance of the argument, and the remarkable richness of historical detail. This book is a must-read at a moment when governments right across the Western world must come up with the political will to deal with a debt crisis of unusual proportions."

—Steve Pincus, Bradford Durfee Professor of History and International and Area Studies, Yale University

"The authors convincingly show that countries escape poverty only when they have appropriate economic institutions, especially private property and competition. More originally, they argue countries are more likely to develop the right institutions when they have an open pluralistic political system with competition for political office, a widespread electorate, and openness to new political leaders. This intimate connection between political and economic institutions is the heart of their major contribution and has resulted in a study of great vitality on one of the crucial questions in economics and political economy."

—Gary S. Becker, Nobel laureate in economics, 1992

"This is not only a fascinating and interesting book: it is a really important one. The highly original research that Professors Acemoglu and Robinson have done, and continue to do, on how economic forces, politics, and policy choices evolve together and constrain each other, and how institutions affect that evolution, is essential to understanding the successes and failures of societies and nations. And here, in this book, these insights come in a highly accessible, indeed riveting form. Those who pick this book up and start reading will have trouble putting it down."

—Michael Spence, Nobel laureate in economics, 2001

"In this delightfully readable romp through four hundred years of history, two of the giants of contemporary social science bring us an inspiring and important message: it is freedom that makes the world rich. Let tyrants everywhere tremble!"

—Ian Morris, Stanford University, author of *Why the West Rules—for Now*

"Acemoglu and Robinson pose the fundamental question concerning the development of the bottom billion. Their answers are profound, lucid, and convincing."

—Paul Collier, Professor of Economics, Oxford University, and author of *The Bottom Billion*

Why Nations Fail

THE ORIGINS OF POWER, PROSPERITY, AND POVERTY

Daron Acemoglu and

James A. Robinson

CURRENCY
NEW YORK

15.

Understanding Prosperity and Poverty

Historical Origins

There are huge differences in living standards around the world. Even the poorest citizens of the United States have incomes and access to health care, education, public services, and economic and social opportunities that are far superior to those available to the vast mass of people living in sub-Saharan Africa, South Asia, and Central America. The contrast of South and North Korea, the two Nogaleses, and the United States and Mexico reminds us that these are relatively recent phenomena. Five hundred years ago, Mexico, home to the Aztec state, was certainly richer than the polities to the north, and the United States did not pull ahead of Mexico until the nineteenth century. The gap between the two Nogaleses is even more recent. South and North Korea were economically, as well as socially and culturally, indistinguishable before the country was divided at the 38th parallel after the Second World War. Similarly, most of the huge economic differences we observe around us today emerged over the last two hundred years.

Did this all need to be so? Was it historically—or geographically or culturally or ethnically—predetermined that Western Europe, the United States, and Japan would become so much richer than sub-Saharan Africa, Latin America, and China over the last two hundred years or so? Was it inevitable that the Industrial Revolution would get under way in the eighteenth century in Britain, and then spread to

Western Europe and Europe's offshoots in North America and Australasia? Is a counterfactual world where the Glorious Revolution and the Industrial Revolution take place in Peru, which then colonizes Western Europe and enslaves whites, possible, or is it just a form of historical science fiction?

To answer—in fact, even to reason about—these questions, we need a theory of why some nations are prosperous while others fail and are poor. This theory needs to delineate both the factors that create and retard prosperity and their historical origins. This book has proposed such a theory. Any complex social phenomenon, such as the origins of the different economic and political trajectories of hundreds of polities around the world, likely has a multitude of causes, making most social scientists shun monocausal, simple, and broadly applicable theories and instead seek different explanations for seemingly similar outcomes emerging in different times and areas. Instead we've offered a simple theory and used it to explain the main contours of economic and political development around the world since the Neolithic Revolution. Our choice was motivated not by a naïve belief that such a theory could explain everything, but by the belief that a theory should enable us to focus on the parallels, sometimes at the expense of abstracting from many interesting details. A successful theory, then, does not faithfully reproduce details, but provides a useful and empirically well-grounded explanation for a range of processes while also clarifying the main forces at work.

Our theory has attempted to achieve this by operating on two levels. The first is the distinction between extractive and inclusive economic and political institutions. The second is our explanation for why inclusive institutions emerged in some parts of the world and not in others. While the first level of our theory is about an institutional interpretation of history, the second level is about how history has shaped institutional trajectories of nations.

Central to our theory is the link between inclusive economic and political institutions and prosperity. Inclusive economic institutions that enforce property rights, create a level playing field, and encourage investments in new technologies and skills are more conducive to economic growth than extractive economic institutions that are structured to extract resources from the many by the few and that fail to protect property rights or provide incentives for economic activity. Inclusive economic institutions are in turn supported by, and support, inclusive political institutions, that is, those that distribute political power widely in a pluralistic manner and are able to achieve some amount of political centralization so as to establish law and order, the foundations of secure property rights, and an inclusive market economy. Similarly, extractive economic institutions are synergistically linked to extractive political institutions, which concentrate power in the hands of a few, who will then have incentives to maintain and develop extractive economic institutions for their benefit and use the resources they obtain to cement their hold on political power.

These tendencies do not imply that extractive economic and political institutions are inconsistent with economic growth. On the contrary, every elite would, all else being equal, like to encourage as much growth as possible in order to have more to extract. Extractive institutions that have achieved at least a minimal degree of political centralization are often able to generate some amount of growth. What is crucial, however, is that growth under extractive institutions will not be sustained, for two key reasons. First, sustained economic growth requires innovation, and innovation cannot be decoupled from creative destruction, which replaces the old with the new in the economic realm and also destabilizes established power relations in politics. Because elites dominating extractive institutions fear creative destruction, they will resist it, and any growth that germinates under extractive institutions will be ultimately short lived. Second, the ability of those who dominate extractive institutions to benefit greatly at the expense of the rest of society implies that political power under extractive institutions is highly coveted, making many groups and individuals fight to obtain it. As a consequence, there will be powerful forces pushing societies under extractive institutions toward political instability.

The synergies between extractive economic and political institutions create a vicious circle, where extractive institutions, once in place, tend to persist. Similarly, there is a virtuous circle associated with inclusive economic and political institutions. But neither the vicious nor the virtuous circle is absolute. In fact, some nations live under inclusive institutions today because, though extractive institutions have been the norm in history, some societies have been able to break the mold and transition toward inclusive institutions. Our explanation for these transitions is historical, but not historically predetermined. Major institutional change, the requisite for major economic change, takes place as a result of the interaction between existing institutions and critical junctures. Critical junctures are major events that disrupt the existing political and economic balance in one or many societies, such as the Black Death, which killed possibly as much as half the population of most areas in Europe during the fourteenth century; the opening of Atlantic trade routes, which created enormous profit opportunities for many in Western Europe; and the Industrial Revolution, which offered the potential for rapid but also disruptive changes in the structure of economies around the world.

Existing institutional differences among societies themselves are a result of past institutional changes. Why does the path of institutional change differ across societies? The answer to this question lies in institutional drift. In the same way that the genes of two isolated populations of organisms will drift apart slowly because of random mutations in the so-called process of evolutionary or genetic drift, two otherwise similar societies will also drift apart institutionally—albeit, again, slowly. Conflict over income and power, and indirectly over institutions, is a constant in all societies. This conflict often has a contingent outcome, even if the playing field over which it transpires is not level. The outcome of this conflict leads to institutional drift. But this is not necessarily a cumulative process. It does not imply that the small differences that emerge at some point will necessarily become larger over time. On the contrary, as our discussion of Roman Britain in chapter 6 illustrates, small differences open up, and then disappear, and then reappear again. However, when a critical juncture arrives, these small differences that have emerged as a result of institutional drift may be the small differences that matter in leading otherwise quite similar societies to diverge radically.

We saw in chapters 7 and 8 that despite the many similarities between England, France, and Spain, the critical juncture of the Atlantic trade had the most transformative impact on England because of such small differences—the fact that because of developments during the fifteenth and sixteenth centuries, the English Crown could not control all overseas trade, as this trade was mostly under Crown monopoly in France and Spain. As a result, in France and Spain, it was the monarchy and the groups allied with it who were the main beneficiaries of the large profits created by Atlantic trade and colonial expansion, while in England it was groups strongly opposed to the monarchy who gained from economic opportunities thrown open by this critical juncture. Though institutional drift leads to small differences, its interplay with critical junctures leads to institutional divergence, and thus this divergence then creates the now more major institutional differences that the next critical juncture will affect.

History is key, since it is historical processes that, via institutional drift, create the differences that may become consequential during critical junctures. Critical junctures themselves are historical turning points. And the vicious and virtuous circles imply that we have to study history to understand the nature of institutional differences that have been historically structured. Yet our theory does not imply historical determinism—or any other kind of determinism. It is for this reason that the answer to the question we started with in this chapter is no: there was no historical necessity that Peru end up so much poorer than Western Europe or the United States.

To start with, in contrast with the geography and culture hypotheses, Peru is not condemned to poverty because of its geography or culture. In our theory, Peru is so much poorer than Western Europe and the United States today because of its institutions, and to understand the reasons for this, we need to understand the historical process of institutional development in Peru. As we saw in the second chapter, five hundred years ago the Inca Empire, which occupied contemporary Peru, was richer, more technologically sophisticated, and more politically centralized than the smaller polities occupying North America. The turning point was the way in which this area was colonized and how this contrasted with the colonization of North

America. This resulted not from a historically predetermined process but as the contingent outcome of several pivotal institutional developments during critical junctures. At least three factors could have changed this trajectory and led to very different long-run patterns.

First, institutional differences within the Americas during the fifteenth century shaped how these areas were colonized. North America followed a different institutional trajectory than Peru because it was sparsely settled before colonization and attracted European settlers who then successfully rose up against the elite whom entities such as the Virginia Company and the English Crown had tried to create. In contrast, Spanish conquistadors found a centralized, extractive state in Peru they could take over and a large population they could put to work in mines and plantations. There was also nothing geographically predetermined about the lay of the land within the Americas at the time the Europeans arrived. In the same way that the emergence of a centralized state led by King Shyaam among the Bushong was a result of a major institutional innovation, or perhaps even of political revolution, as we saw in chapter 5, the Inca civilization in Peru and the large populations in this area resulted from major institutional innovations. These could instead have taken place in North America, in places such as the Mississippi Valley or even the northeastern United States. Had this been the case, Europeans might have encountered empty lands in the Andes and centralized states in North America, and the roles of Peru and the United States could have been reversed. Europeans would then have settled in areas around Peru, and the conflict between the majority of settlers and the elite could have led to the creation of inclusive institutions there instead of in North America. The subsequent paths of economic development would then likely have been different.

Second, the Inca Empire might have resisted European colonialism, as Japan did when Commodore Perry's ships arrived in Edo Bay. Though the greater extractiveness of the Inca Empire in contrast with Tokugawa, Japan, certainly made a political revolution akin to the Meiji Restoration less likely in Peru, there was no historical necessity that the Inca completely succumb to European domination. If they had been able to resist and even institutionally modernize in response to the threats, the whole path of the history of the New World, and with it the entire history of the world, could have been different.

Third and most radically, it is not even historically or geographically or culturally predetermined that Europeans should have been the ones colonizing the world. It could have been the Chinese or even the Incas. Of course, such an outcome is impossible when we look at the world from the vantage point of the fifteenth century, by which time Western Europe had pulled ahead of the Americas, and China had already turned inward. But Western Europe of the fifteenth century was itself an outcome of a contingent process of institutional drift punctuated by critical junctures, and nothing about it was inevitable. Western European powers could not have surged ahead and conquered the world without several historic turning points. These included the specific path that feudalism took, replacing slavery and weakening the power of monarchs on the way; the fact that the centuries following the turn of the first millennium in Europe witnessed the development of independent and commercially autonomous cities; the fact that European monarchs were not as threatened by, and consequently did not try to discourage, overseas trade as the Chinese emperors did during the Ming dynasty; and the arrival of the Black Death, which shook up the foundations of the feudal order. If these events had transpired differently, we could be living in a very different world today, one in which Peru might be richer than Western Europe or the United States.

NATURALLY, THE PREDICTIVE POWER of a theory where both small differences and contingency play key roles will be limited. Few would have predicted in the fifteenth or even the sixteenth centuries, let alone in the many centuries following the fall of the Roman Empire, that the major breakthrough toward inclusive institutions would happen in Britain. It was only the specific process of institutional drift and the nature of the critical juncture created by the opening of Atlantic trade that made this possible. Neither would many have believed in the midst of the Cultural Revolution during the 1970s that China would soon be on a path toward radical changes in its economic institutions and subsequently on a breakneck growth trajectory. It is similarly impossible to predict with any certainty what the lay of the land will be in five hundred years. Yet these are not shortcomings of our theory. The historical account we have presented so far indicates that any approach based on historical determinism—based on geography, culture, or even other historical factors—is inadequate. Small differences and contingency are not just part of our theory; they are part of the shape of history.

Even if making precise predictions about which societies will prosper relative to others is difficult, we have seen throughout the book that our theory explains the broad differences in the prosperity and poverty of nations around the world fairly well. We will see in the rest of this chapter that it also provides some guidelines as to what types of societies are more likely to achieve economic growth over the next several decades.

First, vicious and virtuous circles generate a lot of persistence and sluggishness. There should be little doubt that in fifty or even a hundred years, the United States and Western Europe, based on their inclusive economic and political institutions, will be richer, most likely considerably richer, than sub-Saharan Africa, the Middle East, Central America, or Southeast Asia. However, within these broad patterns there will be major institutional changes in the next century, with some countries breaking the mold and transitioning from poor to rich.

Nations that have achieved almost no political centralization, such as Somalia and Afghanistan, or those that have undergone a collapse of the state, such as Haiti did over the last several decades—long before the massive earthquake there in 2010 led to the devastation of the country's infrastructure—are unlikely either to achieve growth under extractive political institutions or to make major changes toward inclusive institutions. Instead, nations likely to grow over the next several decades—albeit probably under extractive institutions—are those that have attained some degree of political centralization. In sub-Saharan Africa this includes Burundi, Ethiopia, Rwanda, nations with long histories of centralized states, and Tanzania, which has managed to build such centralization, or at least put in place some of the prerequisites for centralization, since independence. In Latin America, it includes Brazil, Chile, and Mexico, which have not only achieved political centralization but also made significant strides toward nascent pluralism. Our theory would suggest that sustained economic growth is very unlikely in Colombia.

Our theory also suggests that growth under extractive political institutions, as in China, will not bring sustained growth, and is likely to run out of steam. Beyond these cases, there is much uncertainty. Cuba, for example, might transition toward inclusive institutions and experience a major economic transformation, or it may linger on under extractive political and economic institutions. The same is true of North Korea and Burma (Myanmar) in Asia. Thus, while our theory provides the tools for thinking about how institutions change and the consequences of such changes, the nature of this change—the role of small differences and contingency—makes more precise predictions difficult.

Even greater caution is necessary in drawing policy recommendations from this broad account of the origins of prosperity and poverty. In the same way that the impact of critical junctures depends on existing institutions, how a society will respond to the same policy intervention depends on the institutions that are in place. Of course, our theory is all about how nations can take steps toward prosperity—by transforming their institutions from extractive to inclusive. But it also makes it very clear from the outset that there are no easy recipes for achieving such a transition. First, the vicious circle implies that changing institutions is much harder than it first appears. In particular, extractive institutions can re-create themselves under different guises, as we saw with the iron law of oligarchy in chapter 12. Thus the fact that the extractive regime of President Mubarak was overturned by popular protest in February 2011 does not guarantee that Egypt will move onto a path to more inclusive institutions. Instead extractive institutions may re-create themselves despite the vibrant and hopeful pro-democracy movement. Second, because the contingent path of history implies that it is difficult to know whether a particular interplay of

critical junctures and existing institutional differences will lead toward more inclusive or extractive institutions, it would be heroic to formulate general policy recommendations to encourage change toward inclusive institutions. Nevertheless, our theory is still useful for policy analysis, as it enables us to recognize bad policy advice, based on either incorrect hypotheses or inadequate understanding of how institutions can change. In this, as in most things, avoiding the worst mistakes is as important as—and more realistic than—attempting to develop simple solutions. Perhaps this is most clearly visible when we consider current policy recommendations encouraging "authoritarian growth" based on the successful Chinese growth experience of the last several decades. We next explain why these policy recommendations are misleading and why Chinese growth, as it has unfolded so far, is just another form of growth under extractive political institutions, unlikely to translate into sustained economic development.

THE IRRESISTIBLE CHARM OF AUTHORITARIAN GROWTH

Dai Guofang recognized the coming urban boom in China early on. New highways, business centers, residences, and skyscrapers were sprawling everywhere around China in the 1990s, and Dai thought this growth would only pick up speed in the next decade. He reasoned that his company, Jinagsu Tieben Iron and Steel, could capture a large market as a low-cost producer, especially compared with the inefficient state-owned steel factories. Dai planned to build a true steel giant, and with support from the local party bosses in Changzhou, he started building in 2003. By March 2004, however, the project had been stopped by order of the Chinese Communist Party in Beijing, and Dai was arrested for reasons never clearly articulated. The authorities may have presumed that they would find some incriminating evidence in Dai's accounts. In the event, he spent the next five years in jail and home detention, and was found guilty on a minor charge in 2009. His real crime was to start a large project that would compete with state-sponsored companies and do so without the approval of the higher-ups in the Communist Party. This was certainly the lesson that others drew from the case.

The Communist Party's reaction to entrepreneurs such as Dai should not be a surprise. Chen Yun, one of Deng Xiaoping's closest associates and arguably the major architect behind the early market reforms, summarized the views of most party cadres with a "bird in a cage" analogy for the economy: China's economy was the bird; the party's control, the cage, had to be enlarged to make the bird healthier and more dynamic, but it could not be unlocked or removed, lest the bird fly away. Jiang Zemin, shortly after becoming general secretary of the Communist Party in 1989, the most powerful position in China, went even further and summarized the party's suspicion of entrepreneurs by characterizing them as "self-employed traders and peddlers [who] cheat, embezzle, bribe and evade taxation." Throughout the 1990s, even as foreign investment was pouring into China and state-owned enterprises were encouraged to expand, private entrepreneurship was greeted with suspicion, and many entrepreneurs were expropriated or even jailed. Jiang Zemin's view of entrepreneurs, though in relative decline, is still widespread in China. In the words of a Chinese economist, "Big state companies can get involved in huge projects. But when private companies do so, especially in competition with the state, then trouble comes from every corners [*sic*]."

While scores of private companies are now profitably operating in China, many elements of the economy are still under the party's command and protection. Journalist Richard McGregor reports that on the desk of the head of each of the biggest state companies in China stands a red phone. When it rings, it is the party calling with orders on what the company should do, where it should invest, and what its targets will be. These giant companies are still under the command of the party, a fact we are reminded of when the party decides to shuffle their chief executives, fire them, or promote them, with little explanation.

These stories of course do not deny that China has made great strides toward inclusive economic institutions, strides that underpin

its spectacular growth rates over the past thirty years. Most entrepreneurs have some security, not least because they cultivate the support of local cadres and Communist Party elites in Beijing. Most state-owned enterprises seek profits and compete in international markets. This is a radical change from the China of Mao. As we saw in the previous chapter, China was first able to grow because under Deng Xiaoping there were radical reforms away from the most extractive economic institutions and toward inclusive economic institutions. Growth has continued as Chinese economic institutions have been on a path toward greater inclusiveness, albeit at a slow pace. China is also greatly benefiting from its large supply of cheap labor and its access to foreign markets, capital, and technologies.

Even if Chinese economic institutions are incomparably more inclusive today than three decades ago, the Chinese experience is an example of growth under extractive political institutions. Despite the recent emphasis in China on innovation and technology, Chinese growth is based on the adoption of existing technologies and rapid investment, not creative destruction. An important aspect of this is that property rights are not entirely secure in China. Every now and then, just like Dai, some entrepreneurs are expropriated. Labor mobility is tightly regulated, and the most basic of property rights, the right to sell one's own labor in the way one wishes, is still highly imperfect. The extent to which economic institutions are still far from being truly inclusive is illustrated by the fact that only a few businessmen and -women would even venture into any activity without the support of the local party cadre or, even more important, of Beijing. The connection between business and the party is highly lucrative for both. Businesses supported by the party receive contracts on favorable terms, can evict ordinary people to expropriate their land, and violate laws and regulations with impunity. Those who stand in the path of this business plan will be trampled and can even be jailed or murdered.

The all-too-present weight of the Communist Party and extractive institutions in China remind us of the many similarities between Soviet growth in the 1950s and '60s and Chinese growth today, though there are also notable differences. The Soviet Union achieved growth under extractive economic institutions and extractive political institutions because it forcibly allocated resources toward industry under a centralized command structure, particularly armaments and heavy industry. Such growth was feasible partly because there was a lot of catching up to be done. Growth under extractive institutions is easier when creative destruction is not a necessity. Chinese economic institutions are certainly more inclusive than those in the Soviet Union, but China's political institutions are still extractive. The Communist Party is all-powerful in China and controls the entire state bureaucracy, the armed forces, the media, and large parts of the economy. Chinese people have few political freedoms and very little participation in the political process.

Many have long believed that growth in China would bring democracy and greater pluralism. There was a real sense in 1989 that the Tiananmen Square demonstrations would lead to greater opening and perhaps even the collapse of the communist regime. But tanks were unleashed on the demonstrators, and instead of a peaceful revolution, history books now call it the Tiananmen Square Massacre. In many ways, Chinese political institutions became more extractive in the aftermath of Tiananmen; reformers such as Zhao Ziyang, who as general secretary of the Communist Party lent his support to the students in Tiananmen Square, were purged, and the party clamped down on civil liberties and press freedom with greater zeal. Zhao Ziyang was put under house arrest for more than fifteen years, and his public record was gradually erased, so that he would not be even a symbol for those who supported political change.

Today the party's control over the media, including the Internet, is unprecedented. Much of this is achieved through self-censorship: media outlets know that they should not mention Zhao Ziyang or Liu Xiaobo, the government critic demanding greater democratization, who is still languishing in prison even after he was awarded the Nobel Peace Prize. Self-censorship is supported by an Orwellian apparatus that can monitor conversations and communications, close Web sites and newspapers, and even selectively block access to individual news stories on the Internet. All of this was on display when news about corruption charges against the son of the general secretary of the party since 2002, Hu Jintao, broke out in 2009. The party's

apparatus immediately sprang into action and was not only able to prevent Chinese media from covering the case but also managed to selectively block stories about the case on the *New York Times* and *Financial Times* Web sites.

Because of the party's control over economic institutions, the extent of creative destruction is heavily curtailed, and it will remain so until there is radical reform in political institutions. Just as in the Soviet Union, the Chinese experience of growth under extractive political institutions is greatly facilitated because there is a lot of catching up to do. Income per capita in China is still a fraction of that in the United States and Western Europe. Of course, Chinese growth is considerably more diversified than Soviet growth; it doesn't rely on only armaments or heavy industry, and Chinese entrepreneurs are showing a lot of ingenuity. All the same, this growth will run out of steam unless extractive political institutions make way for inclusive institutions. As long as political institutions remain extractive, growth will be inherently limited, as it has been in all other similar cases.

The Chinese experience does raise several interesting questions about the future of Chinese growth and, more important, the desirability and viability of authoritarian growth. Such growth has become a popular alternative to the "Washington consensus," which emphasizes the importance of market and trade liberalization and certain forms of institutional reform for kick-starting economic growth in many less developed parts of the world. While part of the appeal of authoritarian growth comes as a reaction to the Washington consensus, perhaps its greater charm—certainly to the rulers presiding over extractive institutions—is that it gives them free rein in maintaining and even strengthening their hold on power and legitimizes their extraction.

As our theory highlights, particularly in societies that have undergone some degree of state centralization, this type of growth under extractive institutions is possible and may even be the most likely scenario for many nations, ranging from Cambodia and Vietnam to Burundi, Ethiopia, and Rwanda. But it also implies that like all examples of growth under extractive political institutions, it will not be sustained.

In the case of China, the growth process based on catch-up, import of foreign technology, and export of low-end manufacturing products is likely to continue for a while. Nevertheless, Chinese growth is also likely to come to an end, particularly once China reaches the standards of living level of a middle-income country. The most likely scenario may be for the Chinese Communist Party and the increasingly powerful Chinese economic elite to manage to maintain their very tight grip on power in the next several decades. In this case, history and our theory suggest that growth with creative destruction and true innovation will not arrive, and the spectacular growth rates in China will slowly evaporate. But this outcome is far from preordained; it can be avoided if China transitions to inclusive political institutions before its growth under extractive institutions reaches its limit. Nevertheless, as we will see next, there is little reason to expect that a transition in China toward more inclusive political institutions is likely or that it will take place automatically and painlessly.

Even some voices within the Chinese Communist Party are recognizing the dangers on the road ahead and are throwing around the idea that political reform—that is, a transition to more inclusive political institutions, to use our terminology—is necessary. The powerful premier Wen Jiabao has recently warned of the danger that economic growth will be hampered unless political reform gets under way. We think Wen's analysis is prescient, even if some people doubt his sincerity. But many in the West do not agree with Wen's pronouncements. To them, China reveals an alternative path to sustained economic growth, one under authoritarianism rather than inclusive economic and political institutions. But they are wrong. We have already seen the important salient roots of Chinese success: a radical change in economic institutions away from rigidly communist ones and toward institutions that provide incentives to increase productivity and to trade. Looked at from this perspective, there is nothing fundamentally different about China's experience relative to that of countries that have managed to take steps away from extractive and toward inclusive economic institutions, even when this takes place under extractive political institutions, as in the Chinese case. China

has thus achieved economic growth not thanks to its extractive political institutions, but despite them: its successful growth experience over the last three decades is due to a radical shift away from extractive economic institutions and toward significantly more inclusive economic institutions, which was made more difficult, not easier, by the presence of highly authoritarian, extractive political institutions.

A DIFFERENT TYPE of endorsement of authoritarian growth recognizes its unattractive nature but claims that authoritarianism is just a passing stage. This idea goes back to one of the classical theories of political sociology, the theory of modernization, formulated by Seymour Martin Lipset. Modernization theory maintains that all societies, as they grow, are headed toward a more modern, developed, and civilized existence, and in particular toward democracy. Many followers of modernization theory also claim that, like democracy, inclusive institutions will emerge as a by-product of the growth process. Moreover, even though democracy is not the same as inclusive political institutions, regular elections and relatively unencumbered political competition are likely to bring forth the development of inclusive political institutions. Different versions of modernization theory also claim that an educated workforce will naturally lead to democracy and better institutions. In a somewhat postmodern version of modernization theory, *New York Times* columnist Thomas Friedman went so far as to suggest that once a country got enough McDonald's restaurants, democracy and institutions were bound to follow. All this paints an optimistic picture. Over the past sixty years, most countries, even many of those with extractive institutions, have experienced some growth, and most have witnessed notable increases in the educational attainment of their workforces. So, as their incomes and educational levels continue to rise, one way or another, all other good things, such as democracy, human rights, civil liberties, and secure property rights, should follow.

Modernization theory has a wide following both within and outside academia. Recent U.S. attitudes toward China, for example, have been shaped by this theory. George H. W. Bush summarized U.S. policy toward Chinese democracy as "Trade freely with China and time is on our side." The idea was that as China traded freely with the West, it would grow, and that growth would bring democracy and better institutions in China, as modernization theory predicted. Yet the rapid increase in U.S.-China trade since the mid-1980s has done little for Chinese democracy, and the even closer integration that is likely to follow during the next decade will do equally little.

The attitudes of many about the future of Iraqi society and democracy in the aftermath of the U.S.-led invasion were similarly optimistic because of modernization theory. Despite its disastrous economic performance under Saddam Hussein's regime, Iraq was not as poor in 2002 as many sub-Saharan African nations, and it had a comparatively well-educated population, so it was believed to be ripe ground for the development of democracy and civil liberties, and perhaps even what we would describe as pluralism. These hopes were quickly dashed as chaos and civil war descended upon Iraqi society.

Modernization theory is both incorrect and unhelpful for thinking about how to confront the major problems of extractive institutions in failing nations. The strongest piece of evidence in favor of modernization theory is that rich nations are the ones that have democratic regimes, respect civil and human rights, and enjoy functioning markets and generally inclusive economic institutions. Yet interpreting this association as supporting modernization theory ignores the major effect of inclusive economic and political institutions on economic growth. As we have argued throughout this book, it is the societies with inclusive institutions that have grown over the past three hundred years and have become relatively rich today. That this accounts for what we see around us is shown clearly if we look at the facts slightly differently: while nations that have built inclusive economic and political institutions over the last several centuries have achieved sustained economic growth, authoritarian regimes that have grown more rapidly over the past sixty or one hundred years, contrary to what Lipset's modernization theory would claim, have not become more democratic. And this is in fact not surprising. Growth under extractive institutions is possible precisely because it doesn't necessarily or

automatically imply the demise of these very institutions. In fact, it is often generated because those in control of the extractive institutions view economic growth as not a threat but a support to their regime, as the Chinese Communist Party has done since the 1980s. It is also not surprising that growth generated by increases in the value of the natural resources of a nation, such as in Gabon, Russia, Saudi Arabia, and Venezuela, is unlikely to lead to a fundamental transformation of these authoritarian regimes toward inclusive institutions.

The historical record is even less generous to modernization theory. Many relatively prosperous nations have succumbed to and supported repressive dictatorships and extractive institutions. Both Germany and Japan were among the richest and most industrialized nations in the world in the first half of the twentieth century, and had comparatively well-educated citizens. This did not prevent the rise of the National Socialist Party in Germany or a militaristic regime intent on territorial expansion via war in Japan—making both political and economic institutions take a sharp turn toward extractive institutions. Argentina was also one of the richest countries in the world in the nineteenth century, as rich as or even richer than Britain, because it was the beneficiary of the worldwide resource boom; it also had the most educated population in Latin America. But democracy and pluralism were no more successful, and were arguably less successful, in Argentina than in much of the rest of Latin America. One coup followed another, and as we saw in chapter 11, even democratically elected leaders acted as rapacious dictators. Even more recently there has been little progress toward inclusive economic institutions, and as we saw in chapter 13, twenty-first-century Argentinian governments can still expropriate their citizens' wealth with impunity.

All of this highlights several important ideas. First, growth under authoritarian, extractive political institutions in China, though likely to continue for a while yet, will not translate into sustained growth, supported by truly inclusive economic institutions and creative destruction. Second, contrary to the claims of modernization theory, we should not count on authoritarian growth leading to democracy or inclusive political institutions. China, Russia, and several other authoritarian regimes currently experiencing some growth are likely to reach the limits of extractive growth before they transform their political institutions in a more inclusive direction—and in fact, probably before there is any desire among the elite for such changes or any strong opposition forcing them to do so. Third, authoritarian growth is neither desirable nor viable in the long run, and thus should not receive the endorsement of the international community as a template for nations in Latin America, Asia, and sub-Saharan Africa, even if it is a path that many nations will choose precisely because it is sometimes consistent with the interests of the economic and political elites dominating them.

You Can't Engineer Prosperity

Unlike the theory we have developed in this book, the ignorance hypothesis comes readily with a suggestion about how to "solve" the problem of poverty: if ignorance got us here, enlightening and informing rulers and policymakers can get us out, and we should be able to "engineer" prosperity around the world by providing the right advice and by convincing politicians of what is good economics. In chapter 2, when we discussed this hypothesis, we showed how the experience of Ghana's prime minister Kofi Busia in the early 1970s underscored the fact that the main obstacle to the adoption of policies that would reduce market failures and encourage economic growth is not the ignorance of politicians, but the incentives and constraints they face from the political and economic institutions in their societies. Nevertheless, the ignorance hypothesis still rules supreme in Western policymaking circles, which, almost to the exclusion of anything else, focus on how to engineer prosperity.

These engineering attempts come in two flavors. The first, often advocated by international organizations such as the International Monetary Fund, recognizes that poor development is caused by bad economic policies and institutions, and then proposes a list of improvements these international organizations attempt to induce poor countries to adopt. (The Washington consensus makes up one such list.) These improvements focus on sensible things such as macroeconomic stability and seemingly attractive macroeconomic goals such as

a reduction in the size of the government sector, flexible exchange rates, and capital account liberalization. They also focus on more microeconomic goals, such as privatization, improvements in the efficiency of public service provision, and perhaps also suggestions as to how to improve the functioning of the state itself by emphasizing anticorruption measures. Though on their own many of these reforms might be sensible, the approach of international organizations in Washington, London, Paris, and elsewhere is still steeped in an incorrect perspective that fails to recognize the role of political institutions and the constraints they place on policymaking. Attempts by international institutions to engineer economic growth by hectoring poor countries into adopting better policies and institutions are not successful because they do not take place in the context of an explanation of why bad policies and institutions are there in the first place, except that the leaders of poor countries are ignorant. The consequence is that the policies are not adopted and not implemented, or are implemented in name only.

For example, many economies around the world ostensibly implementing such reforms, most notably in Latin America, stagnated throughout the 1980s and '90s. In reality, such reforms were foisted upon these countries in contexts where politics went on as usual. Hence, even when reforms were adopted, their intent was subverted, or politicians used other ways to blunt their impact. All this is illustrated by the "implementation" of one of the key recommendations of international institutions aimed at achieving macroeconomic stability, central bank independence. This recommendation either was implemented in theory but not in practice or was undermined by the use of other policy instruments. It was quite sensible in principle. Many politicians around the world were spending more than they were raising in tax revenue and were then forcing their central banks to make up the difference by printing money. The resulting inflation was creating instability and uncertainty. The theory was that independent central banks, just like the Bundesbank in Germany, would resist political pressure and put a lid on inflation. Zimbabwe's president Mugabe decided to heed international advice; he declared the Zimbabwean central bank independent in 1995. Before this, the inflation rate in Zimbabwe was hovering around 20 percent. By 2002 it had reached 140 percent; by 2003, almost 600 percent; by 2007, 66,000 percent; and by 2008, 230 million percent! Of course, in a country where the president wins the lottery (pages 368–373), it should surprise nobody that passing a law making the central bank independent means nothing. The governor of the Zimbabwean central bank probably knew how his counterpart in Sierra Leone had "fallen" from the top floor of the central bank building when he disagreed with Siaka Stevens (page 344). Independent or not, complying with the president's demands was the prudent choice for his personal health, even if not for the health of the economy. Not all countries are like Zimbabwe. In Argentina and Colombia, central banks were also made independent in the 1990s, and they actually did their job of reducing inflation. But since in neither country was politics changed, political elites could use other ways to buy votes, maintain their interests, and reward themselves and their followers. Since they couldn't do this by printing money anymore, they had to use a different way. In both countries the introduction of central bank independence coincided with a big expansion in government expenditures, financed largely by borrowing.

The second approach to engineering prosperity is much more in vogue nowadays. It recognizes that there are no easy fixes for lifting a nation from poverty to prosperity overnight or even in the course of a few decades. Instead, it claims, there are many "micro-market failures" that can be redressed with good advice, and prosperity will result if policymakers take advantage of these opportunities—which, again, can be achieved with the help and vision of economists and others. Small market failures are everywhere in poor countries, this approach claims—for example, in their education systems, health care delivery, and the way their markets are organized. This is undoubtedly true. But the problem is that these small market failures may be only the tip of the iceberg, the symptom of deeper-rooted problems in a society functioning under extractive institutions. Just as it is not a coincidence that poor countries have bad macroeconomic policies, it is not a coincidence that their educational systems do not work well. These market failures may not be due solely to ignorance.

The policymakers and bureaucrats who are supposed to act on well-intentioned advice may be as much a part of the problem, and the many attempts to rectify these inefficiencies may backfire precisely because those in charge are not grappling with the institutional causes of the poverty in the first place.

These problems are illustrated by intervention engineered by the nongovernmental organization (NGO) Seva Mandir to improve health care delivery in the state of Rajasthan in India. The story of health care delivery in India is one of deep-rooted inefficiency and failure. Government-provided health care is, at least in theory, widely available and cheap, and the personnel are generally qualified. But even the poorest Indians do not use government health care facilities, opting instead for the much more expensive, unregulated, and sometimes even deficient private providers. This is not because of some type of irrationality: people are unable to get any care from government facilities, which are plagued by absenteeism. If an Indian visited his government-run facility, not only would there be no nurses there, but he would probably not even be able to get in the building, because health care facilities are closed most of the time.

In 2006 Seva Mandir, together with a group of economists, designed an incentive scheme to encourage nurses to turn up for work in the Udaipur district of Rajasthan. The idea was simple: Seva Mandir introduced time clocks that would stamp the date and time when nurses were in the facility. Nurses were supposed to stamp their time cards three times a day, to ensure that they arrived on time, stayed around, and left on time. If such a scheme worked, and increased the quality and quantity of health care provision, it would be a strong illustration of the theory that there were easy solutions to key problems in development.

In the event, the intervention revealed something very different. Shortly after the program was implemented, there was a sharp increase in nurse attendance. But this was very short lived. In a little more than a year, the local health administration of the district deliberately undermined the incentive scheme introduced by Seva Mandir. Absenteeism was back to its usual level, yet there was a sharp increase in "exempt days," which meant that nurses were not actually around—but this was officially sanctioned by the local health administration. There was also a sharp increase in "machine problems," as the time clocks were broken. But Seva Mandir was unable to replace them because local health ministers would not cooperate.

Forcing nurses to stamp a time clock three times a day doesn't seem like such an innovative idea. Indeed, it is a practice used throughout the industry, even Indian industry, and it must have occurred to health administrators as a potential solution to their problems. It seems unlikely, then, that ignorance of such a simple incentive scheme was what stopped its being used in the first place. What occurred during the program simply confirmed this. Health administrators sabotaged the program because they were in cahoots with the nurses and complicit in the endemic absenteeism problems. They did not want an incentive scheme forcing nurses to turn up or reducing their pay if they did not.

What this episode illustrates is a micro version of the difficulty of implementing meaningful changes when institutions are the cause of the problems in the first place. In this case, it was not corrupt politicians or powerful businesses undermining institutional reform, but rather, the local health administration and nurses who were able to sabotage Seva Mandir's and the development economists' incentive scheme. This suggests that many of the micro-market failures that are apparently easy to fix may be illusory: the institutional structure that creates market failures will also prevent implementation of interventions to improve incentives at the micro level. Attempting to engineer prosperity without confronting the root cause of the problems—extractive institutions and the politics that keeps them in place—is unlikely to bear fruit.

THE FAILURE OF FOREIGN AID

Following the September 11, 2001, attacks by Al Qaeda, U.S.-led forces swiftly toppled the repressive Taliban regime in Afghanistan, which was harboring and refusing to hand over key members of Al Qaeda. The Bonn Agreement of December 2001 between leaders of the former Afghan mujahideen who had cooperated with the U.S. forces and key members of the Afghan diaspora, including Hamid Karzai, created a plan for the establishment of a democratic regime. A first step was the nationwide grand assembly, the Loya Jirga, which elected Karzai to lead the interim government. Things were looking up for Afghanistan. A majority of the Afghan people were longing to leave the Taliban behind. The international community thought that all that Afghanistan needed now was a large infusion of foreign aid. Representatives from the United Nations and several leading NGOs soon descended on the capital, Kabul.

What ensued should not have been a surprise, especially given the failure of foreign aid to poor countries and failed states over the past five decades. Surprise or not, the usual ritual was repeated. Scores of aid workers and their entourages arrived in town with their own private jets, NGOs of all sorts poured in to pursue their own agendas, and high-level talks began between governments and delegations from the international community. Billions of dollars were now coming to Afghanistan. But little of it was used for building infrastructure, schools, or other public services essential for the development of inclusive institutions or even for restoring law and order. While much of the infrastructure remained in tatters, the first tranche of the money was used to commission an airline to shuttle around UN and other international officials. The next thing they needed were drivers and interpreters. So they hired the few English-speaking bureaucrats and the remaining teachers in Afghan schools to chauffeur and chaperone them around, paying them multiples of current Afghan salaries. As the few skilled bureaucrats were shunted into jobs servicing the foreign aid community, the aid flows, rather than building infrastructure in Afghanistan, started by undermining the Afghan state they were supposed to build upon and strengthen.

Villagers in a remote district in the central valley of Afghanistan heard a radio announcement about a new multimillion-dollar program to restore shelter to their area. After a long while, a few wooden beams, carried by the trucking cartel of Ismail Khan, famous former warlord and member of the Afghan government, were delivered. But they were too big to be used for anything in the district, and the villagers put them to the only possible use: firewood. So what had happened to the millions of dollars promised to the villagers? Of the promised money, 20 percent of it was taken as UN head office costs in Geneva. The remainder was subcontracted to an NGO, which took another 20 percent for its own head office costs in Brussels, and so on, for another three layers, with each party taking approximately another 20 percent of what was remaining. The little money that reached Afghanistan was used to buy wood from western Iran, and much of it was paid to Ismail Khan's trucking cartel to cover the inflated transport prices. It was a bit of a miracle that those oversize wooden beams even arrived in the village.

What happened in the central valley of Afghanistan is not an isolated incident. Many studies estimate that only about 10 or at most 20 percent of aid ever reaches its target. There are dozens of ongoing fraud investigations into charges of UN and local officials siphoning off aid money. But most of the waste resulting from foreign aid is not fraud, just incompetence or even worse: simply business as usual for aid organizations.

The Afghan experience with aid was in fact probably a qualified success compared to others. Throughout the last five decades, hundreds of billions of dollars have been paid to governments around the world as "development" aid. Much of it has been wasted in overhead and corruption, just as in Afghanistan. Worse, a lot of it went to dictators such as Mobutu, who depended on foreign aid from his Western patrons both to buy support from his clients to shore up his regime and to enrich himself. The picture in much of the rest of sub-Saharan Africa was similar. Humanitarian aid given for temporary relief in times of crises, for example, most recently in Haiti and Pakistan, has certainly been more useful, even though its delivery, too, has been marred in similar problems.

Despite this unflattering track record of "development" aid, foreign aid is one of the most popular policies that Western governments, international organizations such as the United Nations, and NGOs of different ilk recommend as a way of combating poverty around the world. And of course, the cycle of the failure of foreign aid repeats itself over and over again. The idea that rich Western countries should provide large amounts of "developmental aid" in order to solve the

problem of poverty in sub-Saharan Africa, the Caribbean, Central America, and South Asia is based on an incorrect understanding of what causes poverty. Countries such as Afghanistan are poor because of their extractive institutions—which result in lack of property rights, law and order, or well-functioning legal systems and the stifling dominance of national and, more often, local elites over political and economic life. The same institutional problems mean that foreign aid will be ineffective, as it will be plundered and is unlikely to be delivered where it is supposed to go. In the worst-case scenario, it will prop up the regimes that are at the very root of the problems of these societies. If sustained economic growth depends on inclusive institutions, giving aid to regimes presiding over extractive institutions cannot be the solution. This is not to deny that, even beyond humanitarian aid, considerable good comes out of specific aid programs that build schools in areas where none existed before and that pay teachers who would otherwise go unpaid. While much of the aid community that poured into Kabul did little to improve life for ordinary Afghans, there have also been notable successes in building schools, particularly for girls, who were entirely excluded from education under the Taliban and even before.

One solution—which has recently become more popular, partly based on the recognition that institutions have something to do with prosperity and even the delivery of aid—is to make aid "conditional." According to this view, continued foreign aid should depend on recipient governments meeting certain conditions—for example, liberalizing markets or moving toward democracy. The George W. Bush administration undertook the biggest step toward this type of conditional aid by starting the Millennium Challenge Accounts, which made future aid payments dependent on quantitative improvements in several dimensions of economic and political development. But the effectiveness of conditional aid appears no better than the unconditional kind. Countries failing to meet these conditions typically receive as much aid as those that do. There is a simple reason: they have a greater need for aid of either the developmental or humanitarian kind. And quite predictably, conditional aid seems to have little effect on a nation's institutions. After all, it would have been quite surprising for somebody such as Siaka Stevens in Sierra Leone or Mobutu in the Congo suddenly to start dismantling the extractive institutions on which he depended just for a little more foreign aid. Even in sub-Saharan Africa, where foreign aid is a significant fraction of many governments' total budget, and even after the Millennium Challenge Accounts, which increased the extent of conditionality, the amount of additional foreign aid that a dictator can obtain by undermining his own power is both small and not worth the risk either to his continued dominance over the country or to his life.

But all this does not imply that foreign aid, except the humanitarian kind, should cease. Putting an end to foreign aid is impractical and would likely lead to additional human suffering. It is impractical because citizens of many Western nations feel guilt and unease about the economic and humanitarian disasters around the world, and foreign aid makes them believe that something is being done to combat the problems. Even if this something is not very effective, their desire for doing it will continue, and so will foreign aid. The enormous complex of international organizations and NGOs will also ceaselessly demand and mobilize resources to ensure the continuation of the status quo. Also, it would be callous to cut the aid given to the neediest nations. Yes, much of it is wasted. But if out of every dollar given to aid, ten cents makes it to the poorest people in the world, that is ten cents more than they had before to alleviate the most abject poverty, and it might still be better than nothing.

There are two important lessons here. First, foreign aid is not a very effective means of dealing with the failure of nations around the world today. Far from it. Countries need inclusive economic and political institutions to break out of the cycle of poverty. Foreign aid can typically do little in this respect, and certainly not with the way that it is currently organized. Recognizing the roots of world inequality and poverty is important precisely so that we do not pin our hopes on false promises. As those roots lie in institutions, foreign aid, within the framework of given institutions in recipient nations, will do little to spur sustained growth. Second, since the development of inclusive economic and political institutions is key, using the existing flows of foreign aid at least in part to facilitate such development would be

useful. As we saw, conditionality is not the answer here, as it requires existing rulers to make concessions. Instead, perhaps structuring foreign aid so that its use and administration bring groups and leaders otherwise excluded from power into the decision-making process and empowering a broad segment of population might be a better prospect.

EMPOWERMENT

May 12, 1978, seemed as if it were going to be a normal day at the Scânia truck factory in the city of São Bernardo in the Brazilian state of São Paulo. But the workers were restless. Strikes had been banned in Brazil since 1964, when the military overthrew the democratic government of President João Goulart. But news had just broken that the government had been fixing the national inflation figures so that the rise in the cost of living had been underestimated. As the 7:00 a.m. shift began, workers put down their tools. At 8:00 a.m., Gilson Menezes, a union organizer working at the plant, called the union. The president of the São Bernardo Metalworkers was a thirty-three-year-old activist called Luiz Inácio Lula da Silva ("Lula"). By noon Lula was at the factory. When the company asked him to persuade the employees to go back to work, he refused.

The Scânia strike was the first in a wave of strikes that swept across Brazil. On the face of it these were about wages, but as Lula later noted,

> I think we can't separate economic and political factors. . . . The . . . struggle was over wages, but in struggling for wages, the working class won a political victory.

The resurgence of the Brazilian labor movement was just part of a much broader social reaction to a decade and a half of military rule. The left-wing intellectual Fernando Henrique Cardoso, like Lula destined to become president of Brazil after the re-creation of democracy, argued in 1973 that democracy would be created in Brazil by the many social groups that opposed the military coming together. He said that what was needed was a "reactivation of civil society . . . the professional associations, the trade unions, the churches, the student organizations, the study groups and the debating circles, the social movements"—in other words, a broad coalition with the aim of re-creating democracy and changing Brazilian society.

The Scânia factory heralded the formation of this coalition. By late 1978, Lula was floating the idea of creating a new political party, the Workers' Party. This was to be the party not just of trade unionists, however. Lula insisted that it should be a party for all wage earners and the poor in general. Here the attempts of union leaders to organize a political platform began to coalesce with the many social movements that were springing up. On August 18, 1979, a meeting was held in São Paulo to discuss the formation of the Workers' Party, which brought together former opposition politicians, union leaders, students, intellectuals, and people representing one hundred diverse social movements that had begun to organize in the 1970s across Brazil. The Workers' Party, launched at the São Judas Tadeo restaurant in São Bernardo in October 1979, would come to represent all these diverse groups.

The party quickly began to benefit from the political opening that the military was reluctantly organizing. In the local elections of 1982, it ran candidates for the first time, and won two races for mayor. Throughout the 1980s, as democracy was gradually re-created in Brazil, the Workers' Party began to take over more and more local governments. By 1988 it controlled the governments in thirty-six municipalities, including large cities such as São Paulo and Porto Alegre. In 1989, in the first free presidential elections since the military coup, Lula won 16 percent of the vote in the first round as the party's candidate. In the runoff race with Fernando Collor, he won 44 percent.

In taking over many local governments, something that accelerated in the 1990s, the Workers' Party began to enter into a symbiotic relationship with many local social movements. In Porto Alegre the first Workers' Party administration after 1988 introduced "participatory budgeting," which was a mechanism for bringing ordinary citizens

into the formulation of the spending priorities of the city. It created a system that has become a world model for local government accountability and responsiveness, and it went along with huge improvements in public service provision and the quality of life in the city. The successful governance structure of the party at the local level mapped into greater political mobilization and success at the national level. Though Lula was defeated by Fernando Henrique Cardoso in the presidential elections of 1994 and 1998, he was elected president of Brazil in 2002. The Workers' Party has been in power ever since.

The formation of a broad coalition in Brazil as a result of the coming together of diverse social movements and organized labor has had a remarkable impact on the Brazilian economy. Since 1990 economic growth has been rapid, with the proportion of the population in poverty falling from 45 percent to 30 percent in 2006. Inequality, which rose rapidly under the military, has fallen sharply, particularly after the Workers' Party took power, and there has been a huge expansion of education, with the average years of schooling of the population increasing from six in 1995 to eight in 2006. Brazil has now become part of the BRIC nations (Brazil, Russia, India, and China), the first Latin American country actually to have weight in international diplomatic circles.

THE RISE OF BRAZIL since the 1970s was not engineered by economists of international institutions instructing Brazilian policymakers on how to design better policies or avoid market failures. It was not achieved with injections of foreign aid. It was not the natural outcome of modernization. Rather, it was the consequence of diverse groups of people courageously building inclusive institutions. Eventually these led to more inclusive economic institutions. But the Brazilian transformation, like that of England in the seventeenth century, began with the creation of inclusive political institutions. But how can society build inclusive political institutions?

History, as we have seen, is littered with examples of reform movements that succumbed to the iron law of oligarchy and replaced one set of extractive institutions with even more pernicious ones. We have seen that England in 1688, France in 1789, and Japan during the Meiji Restoration of 1868 started the process of forging inclusive political institutions with a political revolution. But such political revolutions generally create much destruction and hardship, and their success is far from certain. The Bolshevik Revolution advertised its aim as replacing the exploitative economic system of tsarist Russia with a more just and efficient one that would bring freedom and prosperity to millions of Russians. Alas, the outcome was the opposite, and much more repressive and extractive institutions replaced those of the government the Bolsheviks overthrew. The experiences in China, Cuba, and Vietnam were similar. Many noncommunist, top-down reforms fared no better. Nasser vowed to build a modern egalitarian society in Egypt, but this led only to Hosni Mubarak's corrupt regime, as we saw in chapter 13. Robert Mugabe was viewed by many as a freedom fighter ousting Ian Smith's racist and highly extractive Rhodesian regime. But Zimbabwe's institutions became no less extractive, and its economic performance has been even worse than before independence.

What is common among the political revolutions that successfully paved the way for more inclusive institutions and the gradual institutional changes in North America, in England in the nineteenth century, and in Botswana after independence—which also led to significant strengthening of inclusive political institutions—is that they succeeded in empowering a fairly broad cross-section of society. Pluralism, the cornerstone of inclusive political institutions, requires political power to be widely held in society, and starting from extractive institutions that vest power in a narrow elite, this requires a process of empowerment. This, as we emphasized in chapter 7, is what sets apart the Glorious Revolution from the overthrow of one elite by another. In the case of the Glorious Revolution, the roots of pluralism were in the overthrow of James II by a political revolution led by a broad coalition consisting of merchants, industrialists, the gentry, and even many members of the English aristocracy not allied with the Crown. As we have seen, the Glorious Revolution was facilitated by the prior mobilization and empowerment of a broad coalition, and more important, it in turn led to the further empowerment of an even

broader segment of society than what came before—even though clearly this segment was much less broad than the entire society, and England would remain far from a true democracy for more than another two hundred years. The factors leading to the emergence of inclusive institutions in the North American colonies were also similar, as we saw in the first chapter. Once again, the path starting in Virginia, Carolina, Maryland, and Massachusetts and leading up to the Declaration of Independence and to the consolidation of inclusive political institutions in the United States was one of empowerment for increasingly broader segments in society.

The French Revolution, too, is an example of empowerment of a broader segment of society, which rose up against the *ancien régime* in France and managed to pave the way for a more pluralistic political system. But the French Revolution, especially the interlude of the Terror under Robespierre, a repressive and murderous regime, also illustrates how the process of empowerment is not without its pitfalls. Ultimately, however, Robespierre and his Jacobin cadres were cast aside, and the most important inheritance from the French Revolution became not the guillotine but the far-ranging reforms that the revolution implemented in France and other parts of Europe.

There are many parallels between these historical processes of empowerment and what took place in Brazil starting in the 1970s. Though one root of the Workers' Party is the trade union movement, right from its early days, leaders such as Lula, along with the many intellectuals and opposition politicians who lent their support to the party, sought to make it into a broad coalition. These impulses began to fuse with local social movements all over the country, as the party took over local governments, encouraging civic participation and causing a sort of revolution in governance throughout the country. In Brazil, in contrast with England in the seventeenth century or France at the turn of the eighteenth century, there was no radical revolution igniting the process of transforming political institutions at one fell swoop. But the process of empowerment that started in the factories of São Bernardo was effective in part because it translated into fundamental political change at the national level—for example, the transitioning out of military rule to democracy. More important, empowerment at the grass-roots level in Brazil ensured that the transition to democracy corresponded to a move toward inclusive political institutions, and thus was a key factor in the emergence of a government committed to the provision of public services, educational expansion, and a truly level playing field. As we have seen, democracy is no guarantee that there will be pluralism. The contrast of the development of pluralistic institutions in Brazil to the Venezuelan experience is telling in this context. Venezuela also transitioned to democracy after 1958, but this happened without empowerment at the grass-roots level and did not create a pluralistic distribution of political power. Instead, corrupt politics, patronage networks, and conflict persisted in Venezuela, and in part as a result, when voters went to the polls, they were even willing to support potential despots such as Hugo Chávez, most likely because they thought he alone could stand up to the established elites of Venezuela. In consequence, Venezuela still languishes under extractive institutions, while Brazil broke the mold.

WHAT CAN BE DONE to kick-start or perhaps just facilitate the process of empowerment and thus the development of inclusive political institutions? The honest answer of course is that there is no recipe for building such institutions. Naturally there are some obvious factors that would make the process of empowerment more likely to get off the ground. These would include the presence of some degree of centralized order so that social movements challenging existing regimes do not immediately descend into lawlessness; some preexisting political institutions that introduce a modicum of pluralism, such as the traditional political institutions in Botswana, so that broad coalitions can form and endure; and the presence of civil society institutions that can coordinate the demands of the population so that opposition movements can neither be easily crushed by the current elites nor inevitably turn into a vehicle for another group to take control of existing extractive institutions. But many of these factors are historically predetermined and change only slowly. The Brazilian case illustrates how civil society institutions and associated party organizations can be built from the ground up, but this process is slow, and how successful it can be under different circumstances is not well understood.

One other actor, or set of actors, can play a transformative role in the process of empowerment: the media. Empowerment of society at large is difficult to coordinate and maintain without widespread information about whether there are economic and political abuses by those in power. We saw in chapter 11 the role of the media in informing the public and coordinating their demands against forces undermining inclusive institutions in the United States. The media can also play a key role in channeling the empowerment of a broad segment of society into more durable political reforms, again as illustrated in our discussion in chapter 11, particularly in the context of British democratization.

Pamphlets and books informing and galvanizing people played an important role during the Glorious Revolution in England, the French Revolution, and the march toward democracy in nineteenth-century Britain. Similarly, media, particularly new forms based on advances in information and communication technology, such as Web blogs, anonymous chats, Facebook, and Twitter, played a central role in Iranian opposition against Ahmadinejad's fraudulent election in 2009 and subsequent repression, and they seem to be playing a similarly central role in the Arab Spring protests that are ongoing as this manuscript is being completed.

Authoritarian regimes are often aware of the importance of a free media, and do their best to fight it. An extreme illustration of this comes from Alberto Fujimori's rule in Peru. Though originally democratically elected, Fujimori soon set up a dictatorial regime in Peru, mounting a coup while still in office in 1992. Thereafter, though elections continued, Fujimori built a corrupt regime and ruled through repression and bribery. In this he relied heavily on his right-hand man, Valdimiro Montesinos, who headed the powerful national intelligence service of Peru. Montesinos was an organized man, so he kept good records of how much the administration paid different individuals to buy their loyalty, even videotaping many actual acts of bribery. There was a logic to this. Beyond just recordkeeping, this evidence made sure that the accomplices were now on record and would be considered as guilty as Fujimori and Montesinos. After the fall of the regime, these records fell into the hands of journalists and authorities. The amounts are revealing about the value of the media to a dictatorship. A Supreme Court judge was worth between $5,000 and $10,000 a month, and politicians in the same or different parties were paid similar amounts. But when it came to newspapers and TV stations, the sums were in the millions. Fujimori and Montesinos paid $9 million on one occasion and more than $10 million on another to control TV stations. They paid more than $1 million to a mainstream newspaper, and to other newspapers they paid any amount between $3,000 and $8,000 per headline. Fujimori and Montesinos thought that controlling the media was much more important than controlling politicians and judges. One of Montesinos's henchmen, General Bello, summed this up in one of the videos by stating, "If we do not control the television we do not do anything."

The current extractive institutions in China are also crucially dependent on Chinese authorities' control of the media, which, as we have seen, has become frighteningly sophisticated. As a Chinese commentator summarized, "To uphold the leadership of the Party in political reform, three principles must be followed: that the Party controls the armed forces; the Party controls cadres; and the Party controls the news."

But of course a free media and new communication technologies can help only at the margins, by providing information and coordinating the demands and actions of those vying for more inclusive institutions. Their help will translate into meaningful change only when a broad segment of society mobilizes and organizes in order to effect political change, and does so not for sectarian reasons or to take control of extractive institutions, but to transform extractive institutions into more inclusive ones. Whether such a process will get under way and open the door to further empowerment, and ultimately to durable political reform, will depend, as we have seen in many different instances, on the history of economic and political institutions, on many small differences that matter and on the very contingent path of history.

Acknowledgments

This book is the culmination of fifteen years of collaborative research, and along the way we have accumulated a great deal of practical and intellectual debts. Our greatest debt is to our long-term collaborator Simon Johnson, who coauthored many of the key scientific papers that shaped our understanding of comparative economic development.

Our other coauthors, with whom we have worked on related research projects, played a significant role in the development of our views, and we would like to particularly thank in this capacity Philippe Aghion, Jean-Marie Baland, María Angélica Bautista, Davide Cantoni, Isaías Chaves, Jonathan Conning, Melissa Dell, Georgy Egorov, Leopoldo Fergusson, Camilo García-Jimeno, Tarek Hassan, Sebastián Mazzuca, Jeffrey Nugent, Neil Parsons, Steve Pincus, Pablo Querubín, Rafael Santos, Konstantin Sonin, Davide Ticchi, Ragnar Torvik, Juan Fernando Vargas, Thierry Verdier, Andrea Vindigni, Alex Wolitzky, Pierre Yared, and Fabrizio Zilibotti.

Many other people played very important roles in encouraging, challenging, and critiquing us over the years. We would particularly like to thank Lee Alston, Abhijit Banerjee, Robert Bates, Timothy Besley, John Coatsworth, Jared Diamond, Richard Easterlin, Stanley Engerman, Peter Evans, Jeff Frieden, Peter Gourevitch, Stephen Haber, Mark Harrison, Elhanan Helpman, Peter Lindert, Karl Ove Moene, Dani Rodrik, and Barry Weingast.

Two people played a particularly significant role in shaping our views and encouraging our research, and we would like to take this