

INAF U6164:

Political Economy of Development: Africa and the World

Week 4: Institutions

Instructor: Chris Blattman

Announcements

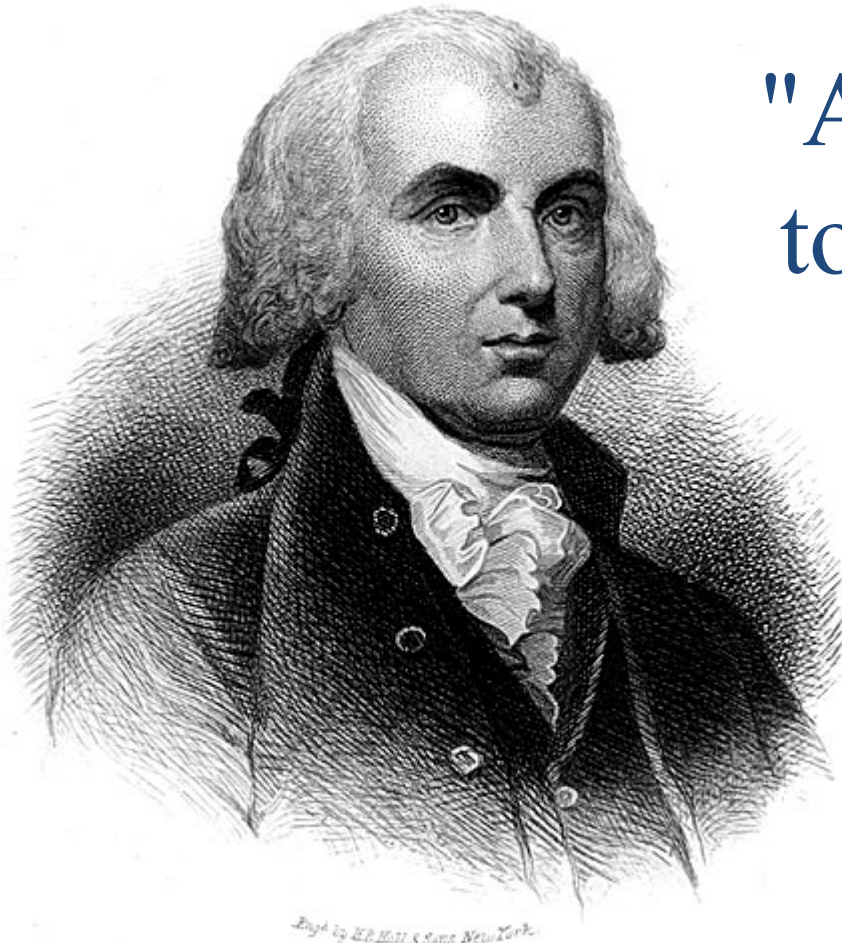
- Written assignment 1: Feb 18
 - Optional
 - Must do 3 in the semester
 - You will want to do at least one before midterm
 - Read goals and instructions
 - See Marion's handout

1. What is an institution?

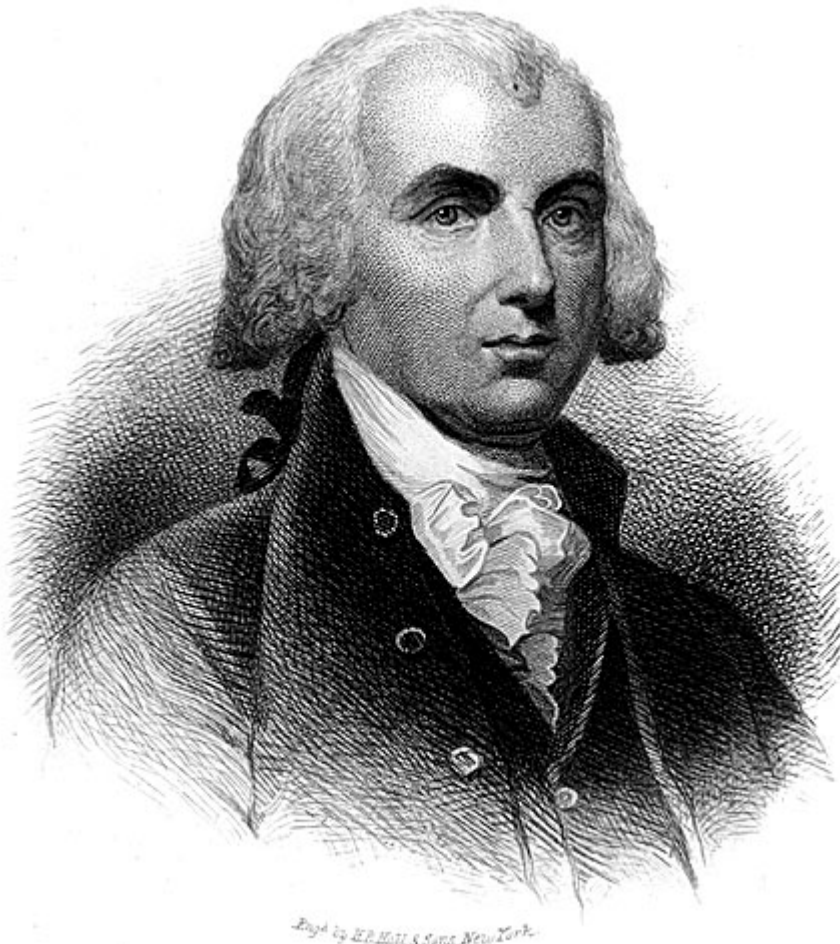
Common general definitions

- “[Shared] rules that structure social interactions”
— J. Knight (1992), *Institutions and Social Conflict*
- “A set of rules, compliance procedures, and moral and ethnical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals.”
— D. North (1981), *Structure and Change in Economic History*

Why “constraints”?



"Ambition must be made
to counteract ambition."



“In order to lay a due foundation for that separate and distinct exercise of the different powers of government... it is evident that each department should have a will of its own; and consequently should be so constituted that the members of each should have as little agency as possible in the appointment of the members of the others.”

– James Madison, *Federalist Paper no. 51*

The underlying theory



Constraining “economic institutions”

- Property rights (over use, control and transfer)
- Systems of contract enforcement, rule of law

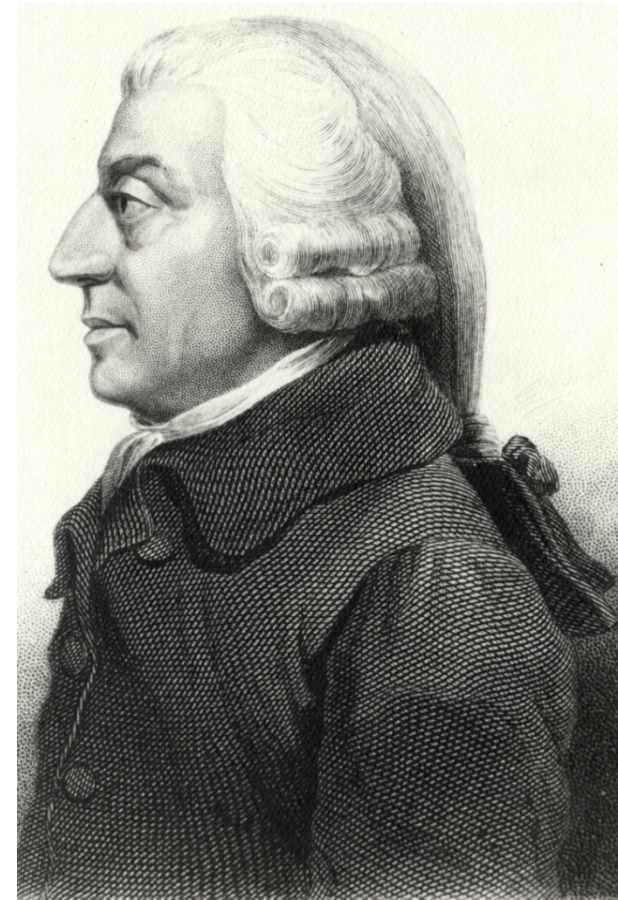
Constraining “political institutions”

- Limits on government (constitution, electoral rules, checks and balances)
- Regulates political power and “who decides”

“A man must be perfectly crazy who, where there is tolerable security, does not employ all the stock which he commands, whether be his own or borrowed of other people...

In those unfortunate countries, indeed, where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their stock, in order to have it always at hand to carry with them to some place of safety...”

— Adam Smith, *Wealth of Nations* II.1



Basic idea: Expected returns

- Division of labor, specialization, trade, accumulation, an innovation are forward-looking behaviors
- Diminish with “transaction costs”:
 - Likelihood of expropriation
 - Likelihood of contract failure
 - Absence of credit and risk markets
 - Likelihood of lengthy disputes and conflict
 - Uncertainty over all of the above





This is a fairly versatile concept of institutions



A large literature then argues about:

1. Where and how do these institutions originate?
2. How important are they to growth? Are they primary?

But first, let's explore the
definition a little further

Are unwritten rules and norms
“institutions”?

Do social norms and sanctions
constrain actors?

Example: Dispute resolution

The inevitable consequence of incomplete contracts

We tend to think about formal institutions as clarifying rights and settling disagreements

- Civil and criminal courts
- Legal rules and laws
- Police
- Property titling agencies
- “Parchment institutions”



In most societies, for most of history, informal institutions have prevented and settled the majority of disputes



- General norms, practices and rules followed by a community
 - Knight (1992), North (1994), Bardhan (2004), Greif (2006)
- Work to avoid disputes in the first place
 - Incentives to cooperate
 - Encourage communication
 - Discourage violence
- Facilitate bargaining when there is a dispute
 - Negotiation
 - Mediation through elders, civil society members, neighbors

What about coordination?

- Human interaction and markets often need to coordinate behavior
 - Measurement systems
 - Technological standards
 - Management of common pool resources
 - Hunting territory
 - Joint investments
- Are these necessarily “constraining”? Are they only solved by enforcement?
- Can be coordinated through norms (Ellickson 1991)

What about imperfect information?

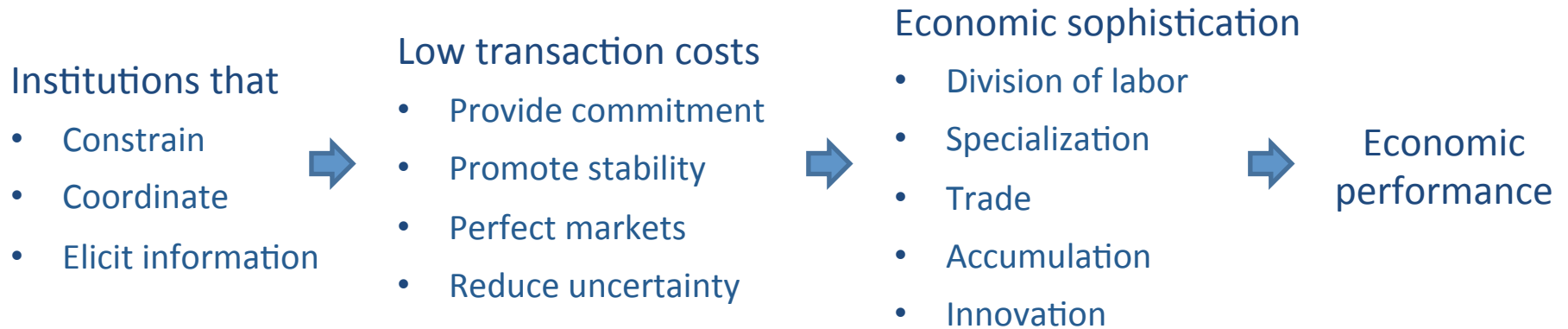
Do transaction costs only arise from the absence of constraints?

- Information asymmetries
 - Slow the process of bargaining and negotiation
 - Inhibit credit and risk markets
 - Crucial to dispute resolution and property rights
- Institutions can reduce transaction costs
 - Speed bargaining (e.g. norms, practices, mediators)
 - Reduce market imperfections
- Nothing necessarily “constraining” about such institutions
- We will encounter again when we cover conflict and war

Possible to have a slightly broader definition of institutions

- Other “institutions” may be relevant for economic performance other than purely constraining ones
 - Reducing imperfect information
 - Coordinating in the presence of multiple equilibria
- These institutions include the formal and informal

A more complete theory?



Is “the state” an institution?



“The state is a human community that successfully claims a monopoly on the legitimate use of physical force within a given territory.”

- Max Weber

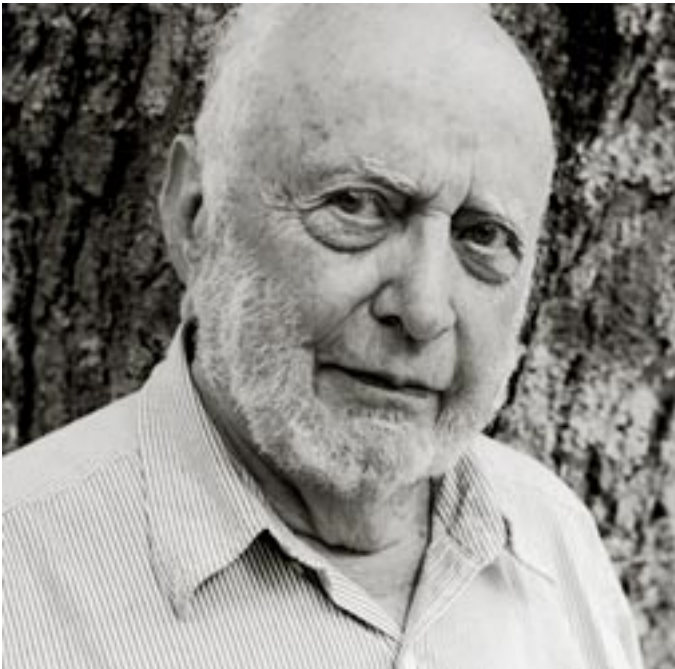
Basic states typically do things to reduce transaction costs

- Provides basic security
- Provide public goods, such as roads
- Its capacity determines the quality of security administration of justice
 - State capacity = the ability of the state to implement its own decisions and goals
- Hence is the bureaucracy an institution? The capacity to tax? The quality of the monopoly of violence?

The state as an organization

“Institutions are the rules of the game and organizations are the players.”

— Douglass North (1994)



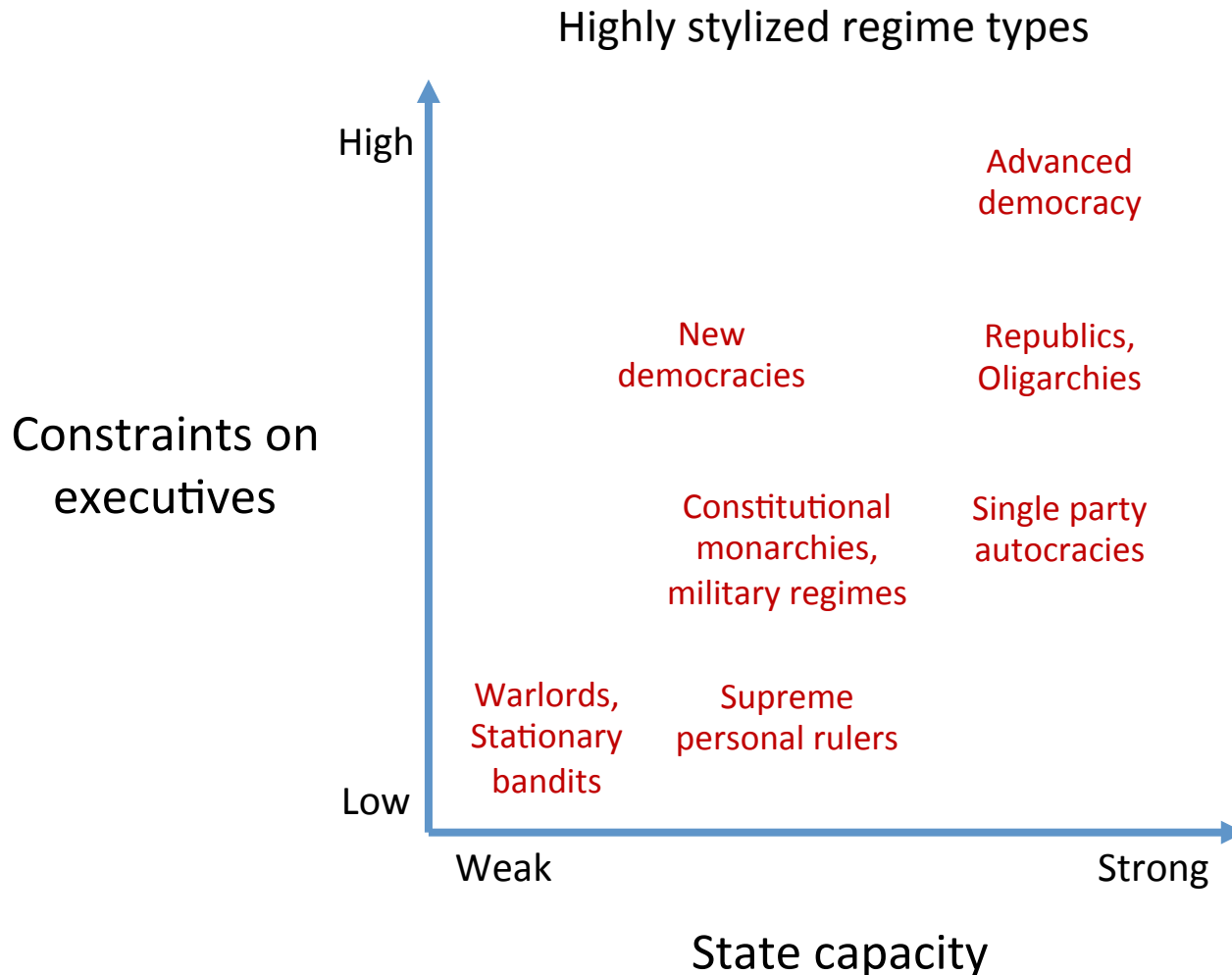
Is the state the solution to the commitment and enforcement problem?

- Up to a point, yes
 - The state as “stationary bandit”:
Prevents anarchy
 - Provides a measure of security, property rights, and law (public goods)
 - Few large populations find other, non-coercive solutions
- But not entirely
 - Beyond this basic level of public good provision, stationary bandits need not be constrained



Useful to imagine state capacity as a separate dimension

Though there is undoubtedly a correlation



2. But just how important are institutions?

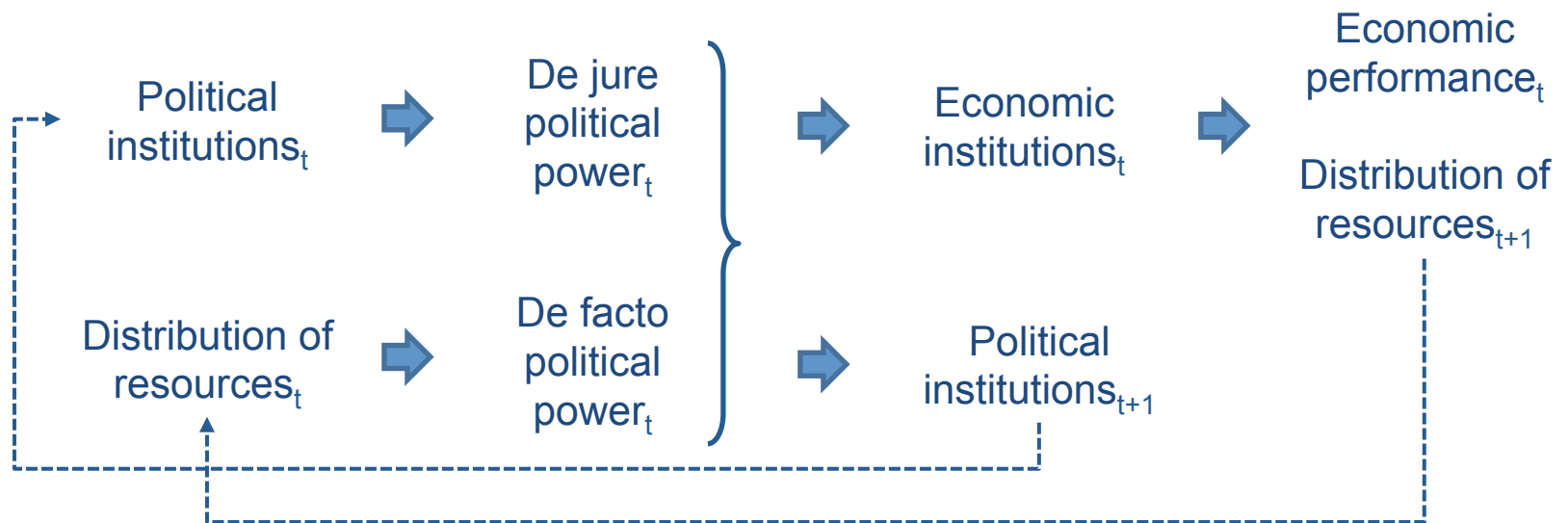
A little?

A lot?

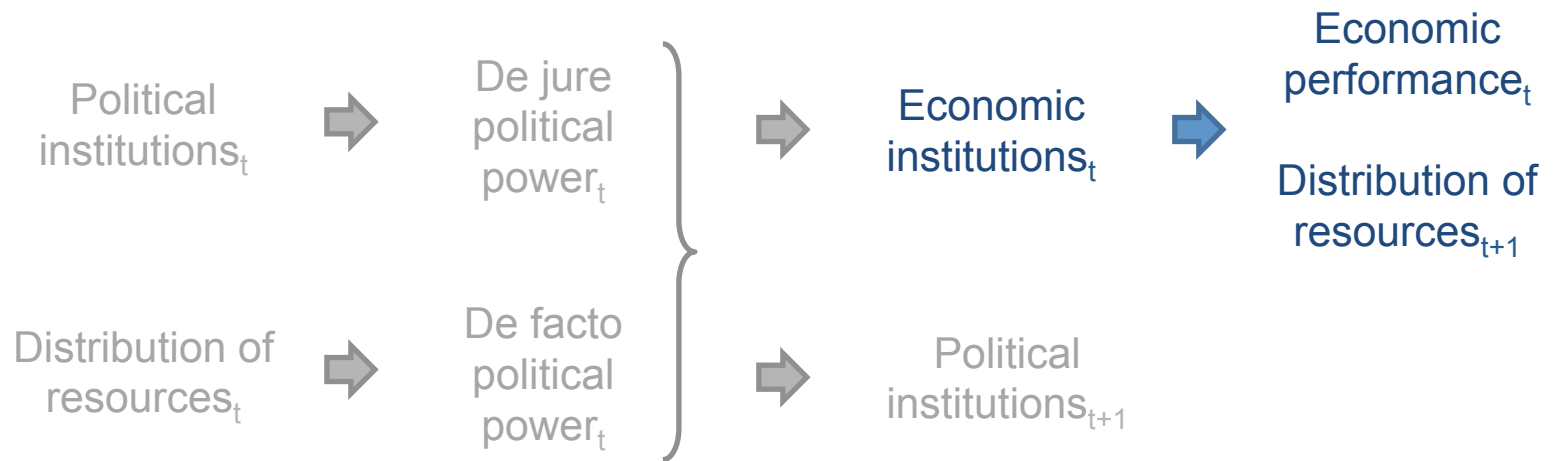
Or are they everything?

Acemoglu and Robinson's argument

A dynamic system, where institutions are endogenous

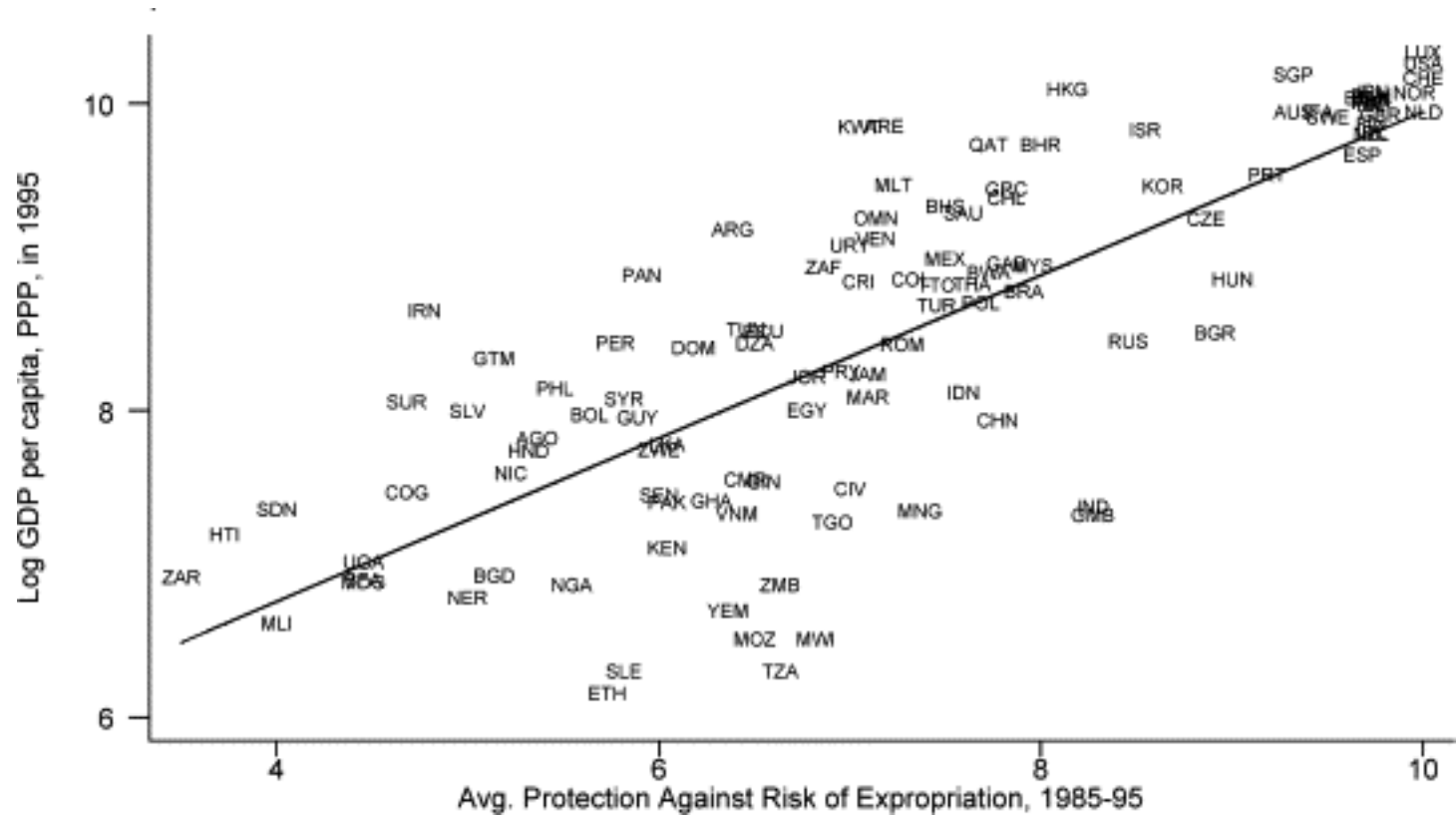


Emphasizes the same transactions cost theory we have just discussed



What is the evidence? Just how strong?

Expropriation risk and income in 1995

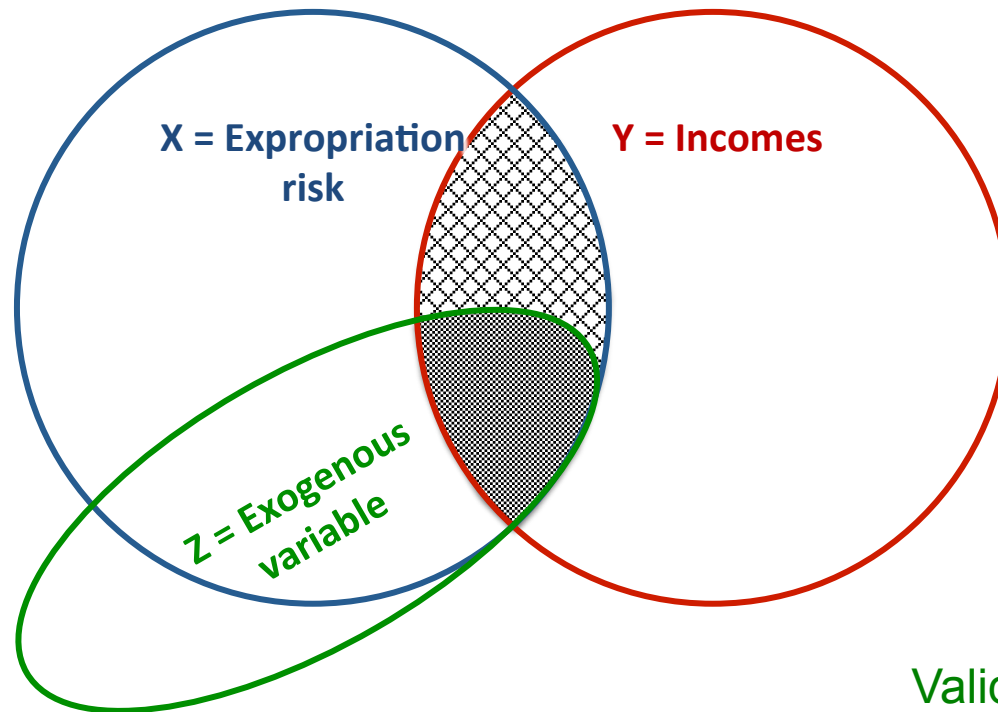


Some problems with the correlation

AJR 2005, Pande & Udry 2005, Glaeser et al 2004

- The expropriation risk data
 - An outcome not a cause
 - Underlying construction is opaque
 - Volatile (but institutions should be durable?)
 - Uncorrelated with measures of constitutional constraints
- Causation & “endogeneity” bias
 - Reverse causation: Wealthy countries invest in property rights
 - Omitted variable bias:
 - Other institutional features (less serious)
 - Other fundamentals (geography, human capital, culture, etc.)

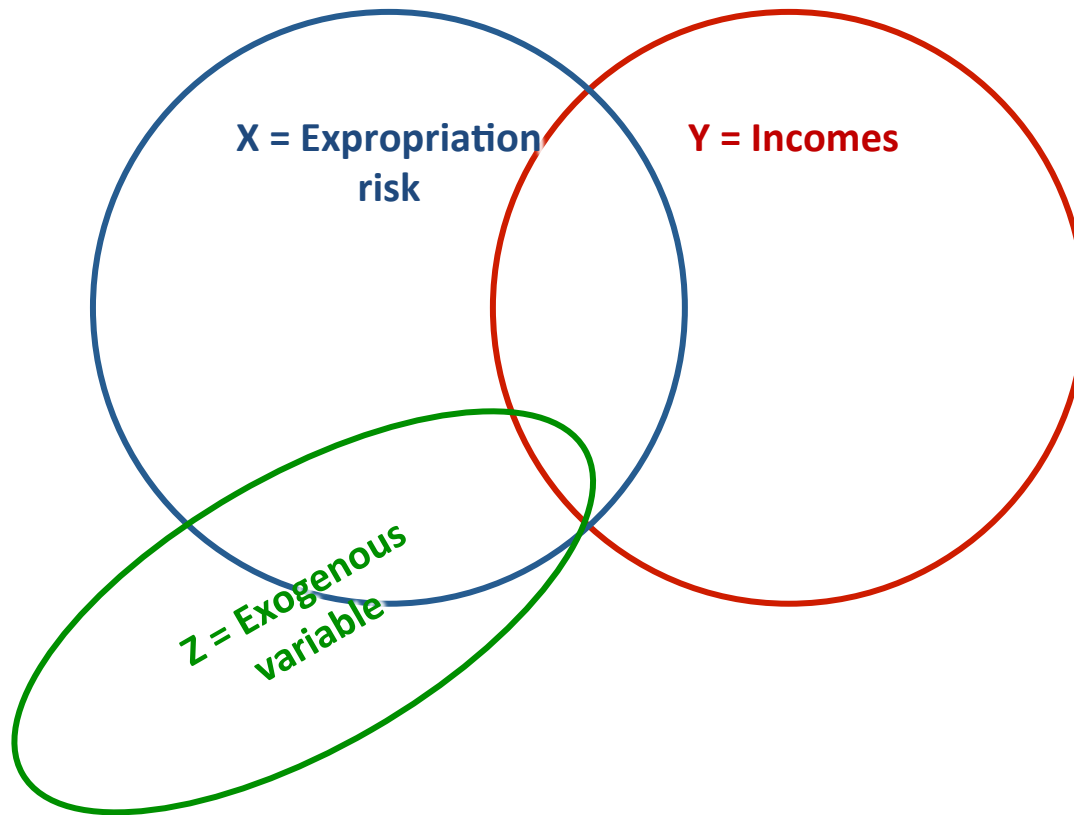
One solution when you can't run an experiment: Find “instruments”



Valid instruments (Z):

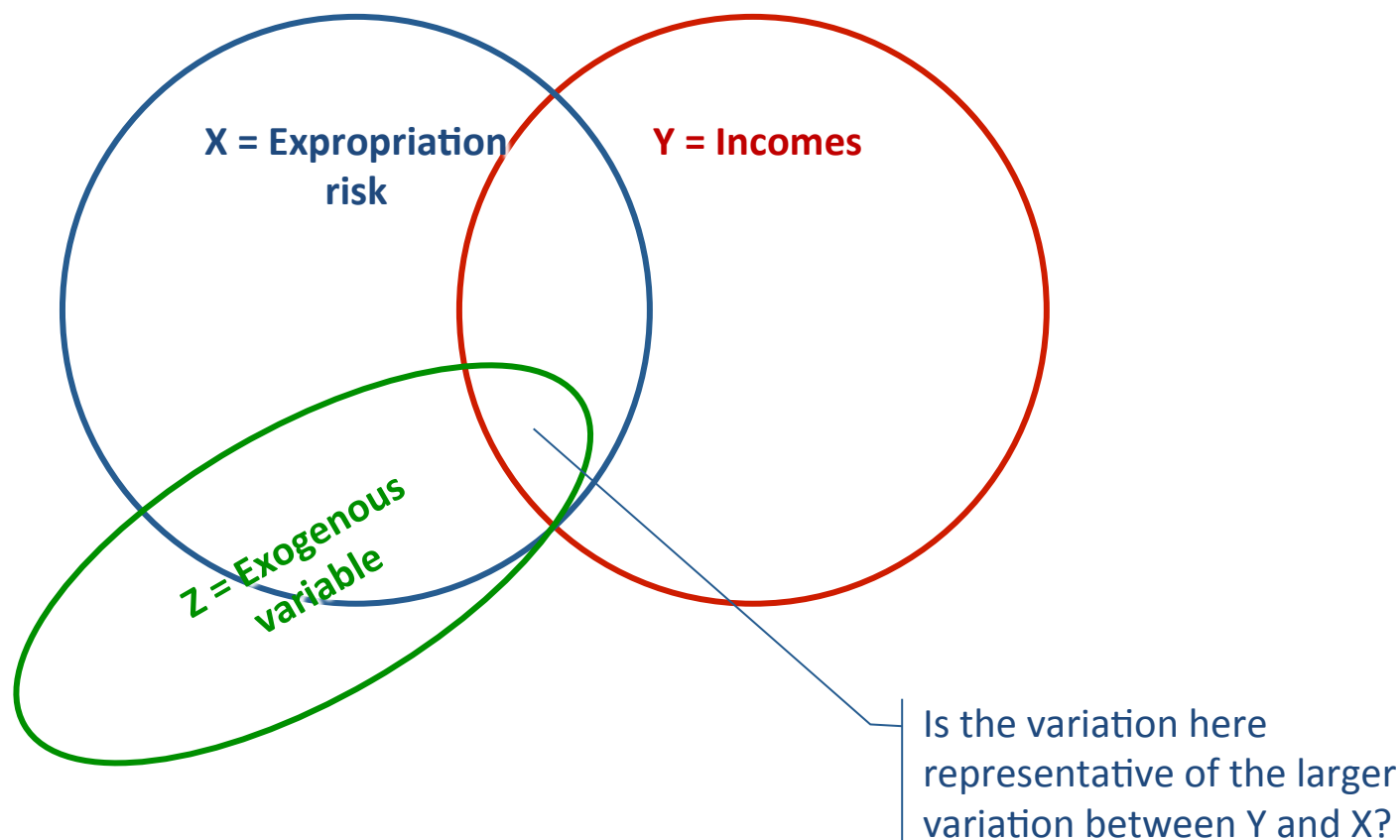
1. Are exogenous/external
2. Have a “strong” effect on X
3. Only affects Y through X
 - The “exclusion restriction”

But good instruments are hard to find
e.g. They may be “weak”



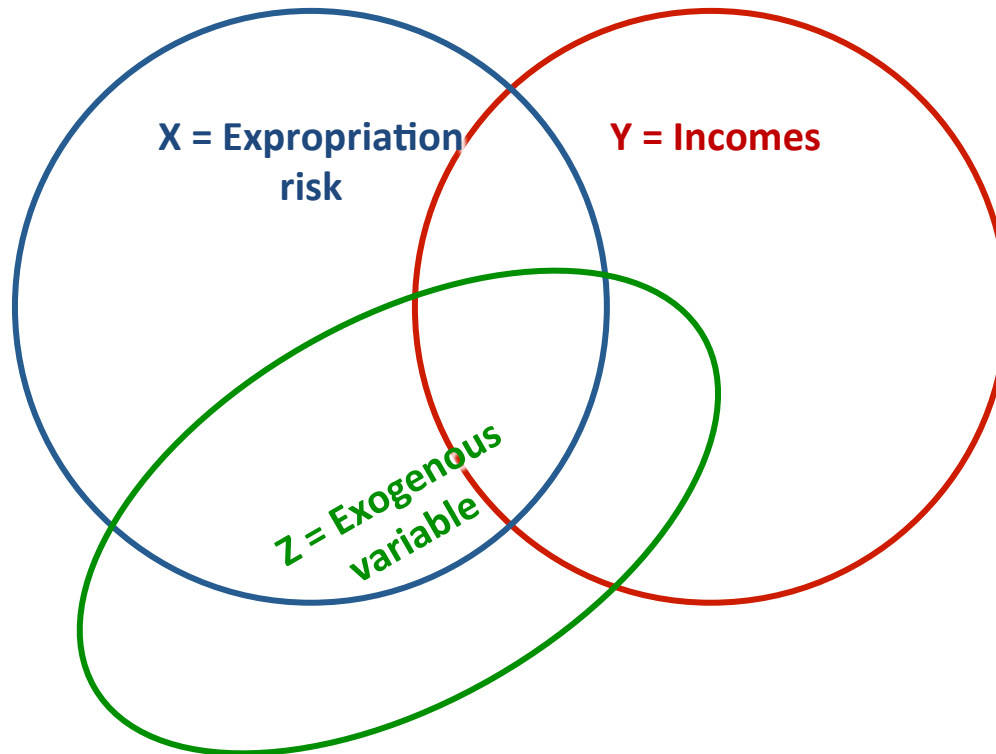
The may not be representative

The LATE: Local average treatment effect



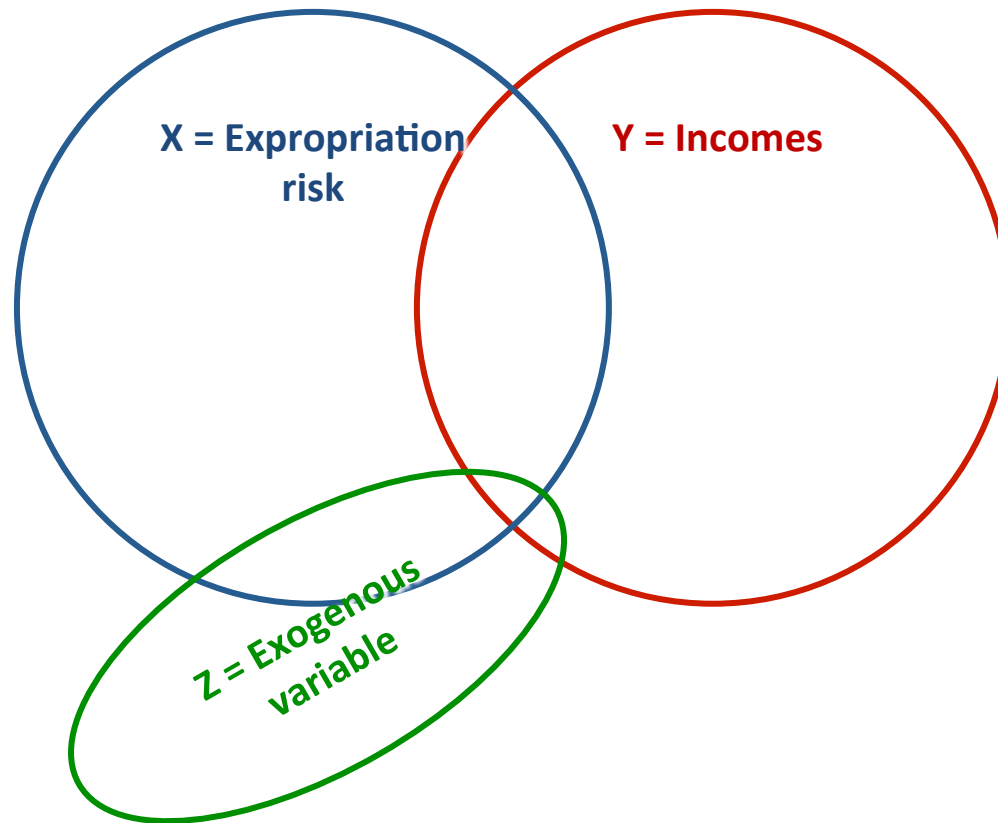
They may not be “excludable”

No longer solve the causal problem (and could make it worse)



They may be weak and not excludable

Endogeneity bias explodes, not lessens



AJR (2001) suggest an instrument: Disease environment drives institutions through settlement patterns

- Starting in 17thc, Europeans emigrated to certain areas.
- Settlement colonies survived and prospered only where the disease environment was favorable.
 - Temperate zones
 - Highlands
 - Semi-tropics



Boer traders accompanying the Klapprott family on their safari to the Uasin Gishu.

Distribution of actual and potential malaria transmission stability

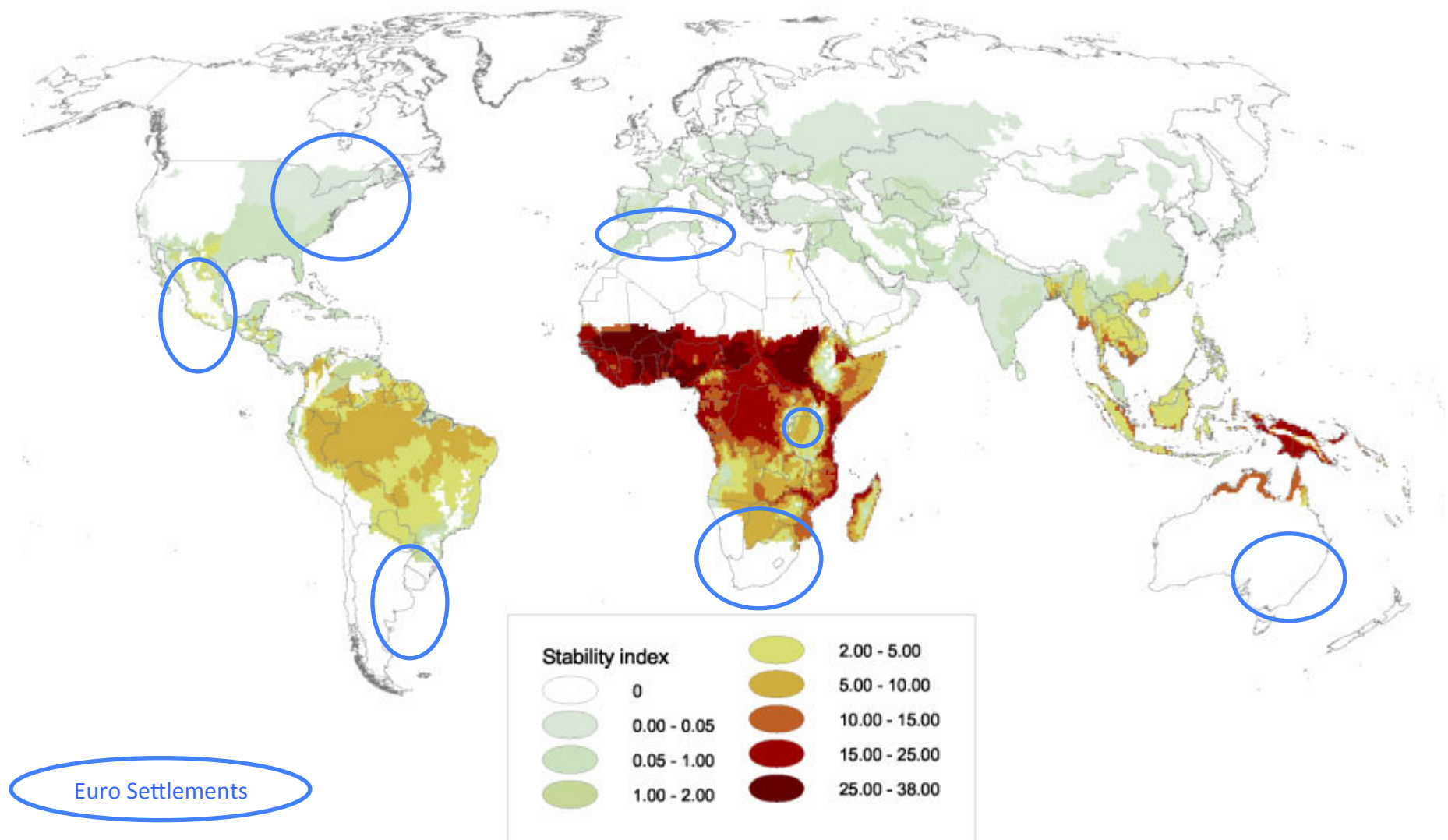
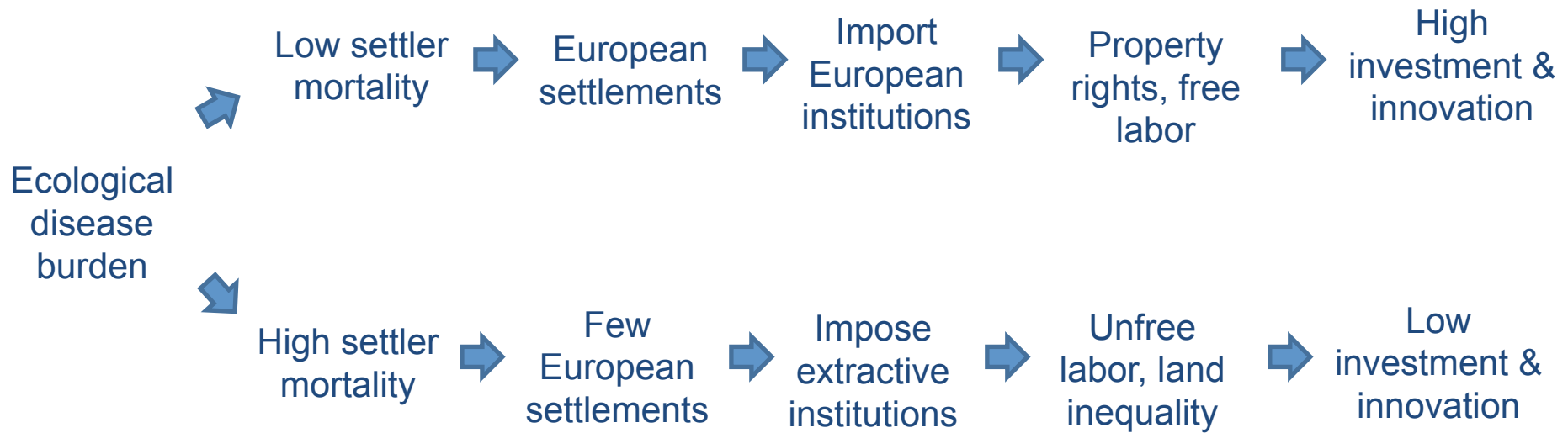


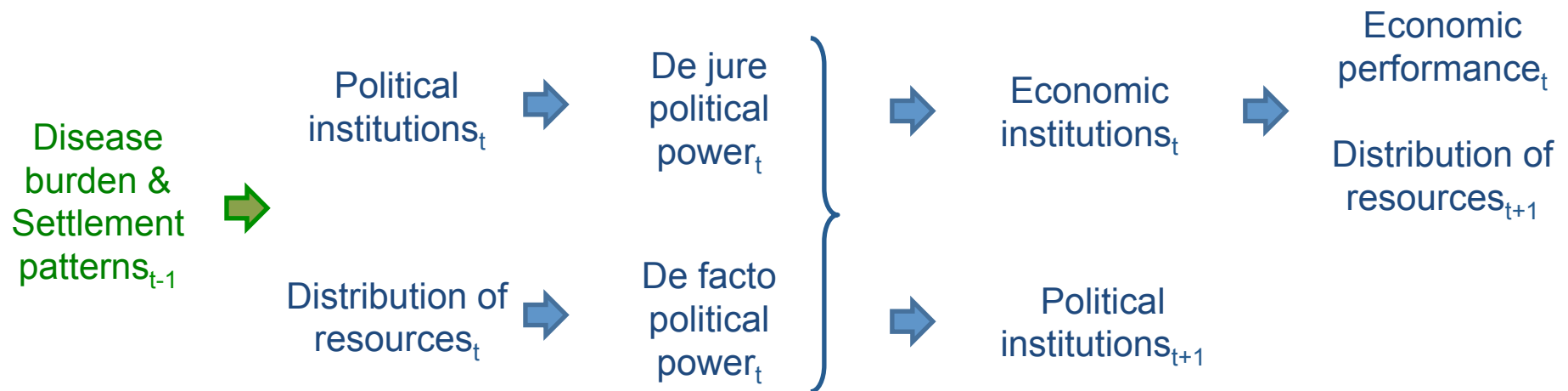
Figure 1 from Anthony Kiszewski, Andrew Mellinger, Andrew Spielman, Pia Malaney, Sonia Erlich Sachs, and Jeffrey Sachs. **A Global Index Representing The Stability of Malaria Transmission.** *Am J Trop Med Hyg* 2004 70:486-498.

Disease, settler mortality, settlement, and institutions

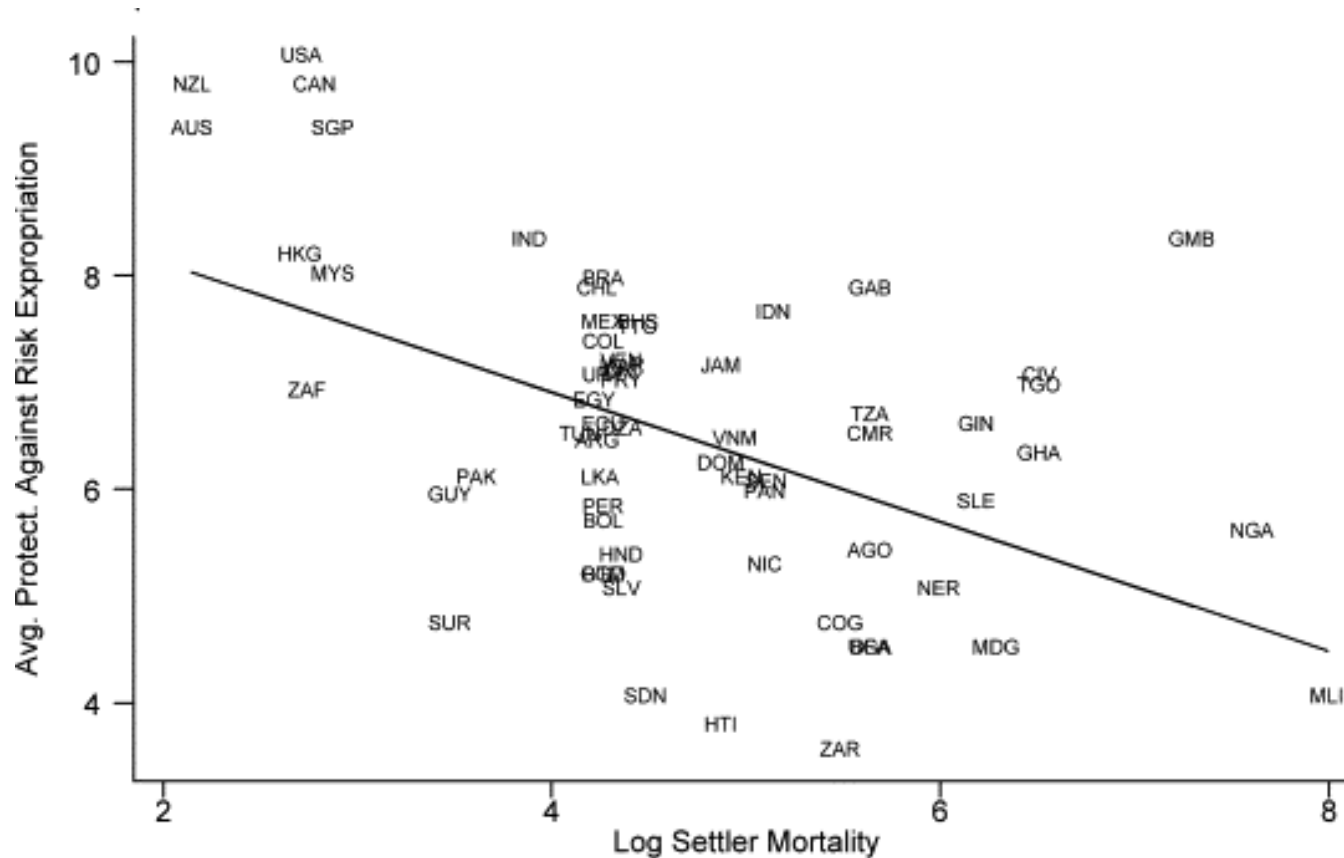
(Acemoglu, Johnson and Robinson)



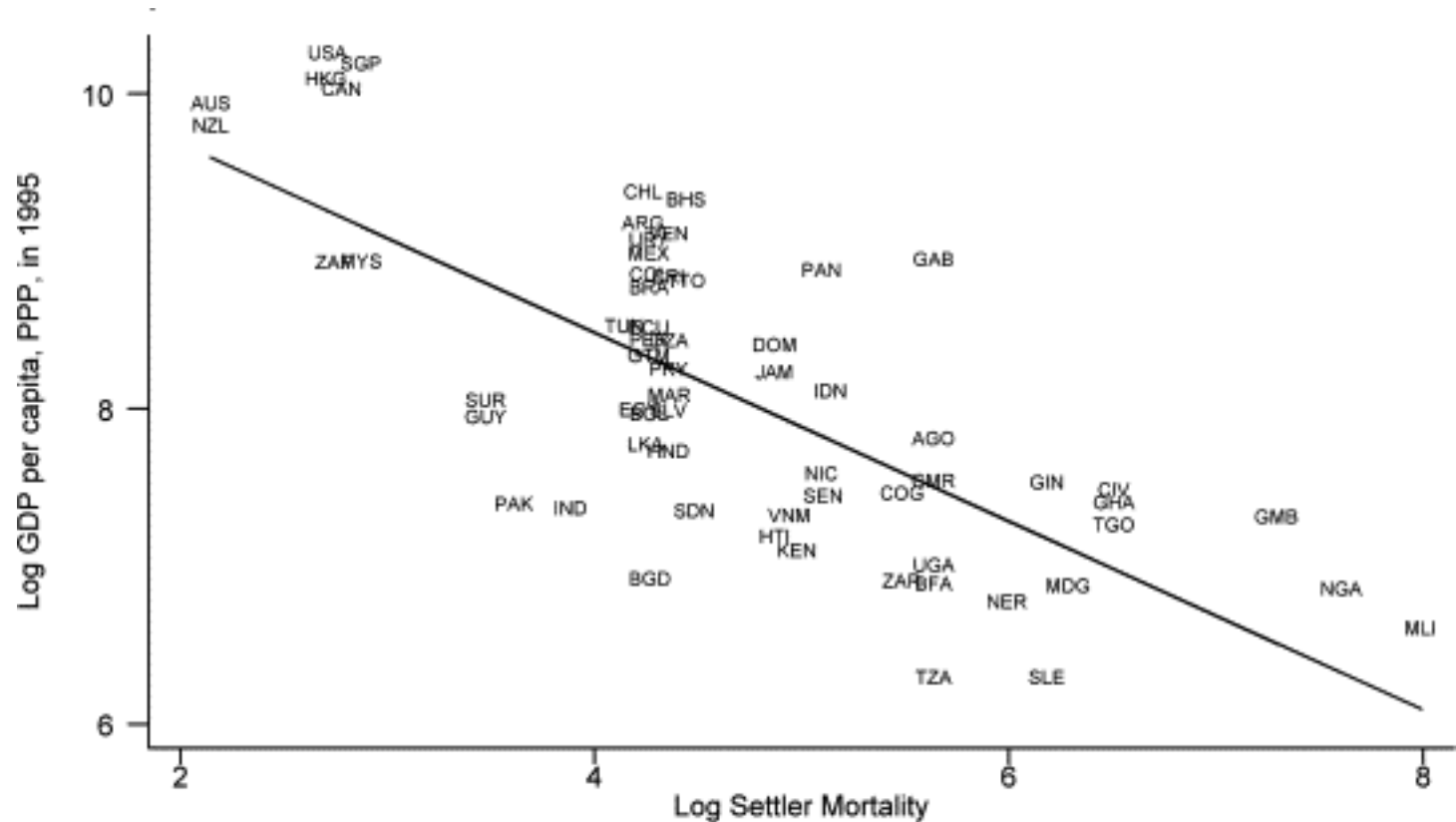
The disease burden is an exogenous shock to their endogenous system



They collect data on mortality rates of soldiers, sailors, bishops
Strongly related to current expropriation risk



And strongly related to current income



So strong that AJR claim economic institutions can account for nearly all of the income differences between high- and low- expropriation countries (e.g. Nigeria and Chile)

Are crucial assumptions met?

- Fairly persuasive evidence
- But is the instrument strong? (Albouy 2012)
 - More than half the countries have data extrapolated from other countries
 - And some of the data come from soldiers campaigning
 - Correcting for these reduces the strength of the relationship
- And the exclusion restriction?
 - Historical European mortality must have no direct effect on income
 - But what about the role of the current disease environment?
 - Settler mortality must only work through institutional channels
 - What about human capital? Culture?
 - What about technology (e.g. agricultural) or organizations (e.g. the state)

European settlement could have affected investments in human capital independent of institutional quality (Glaeser et al 2004)

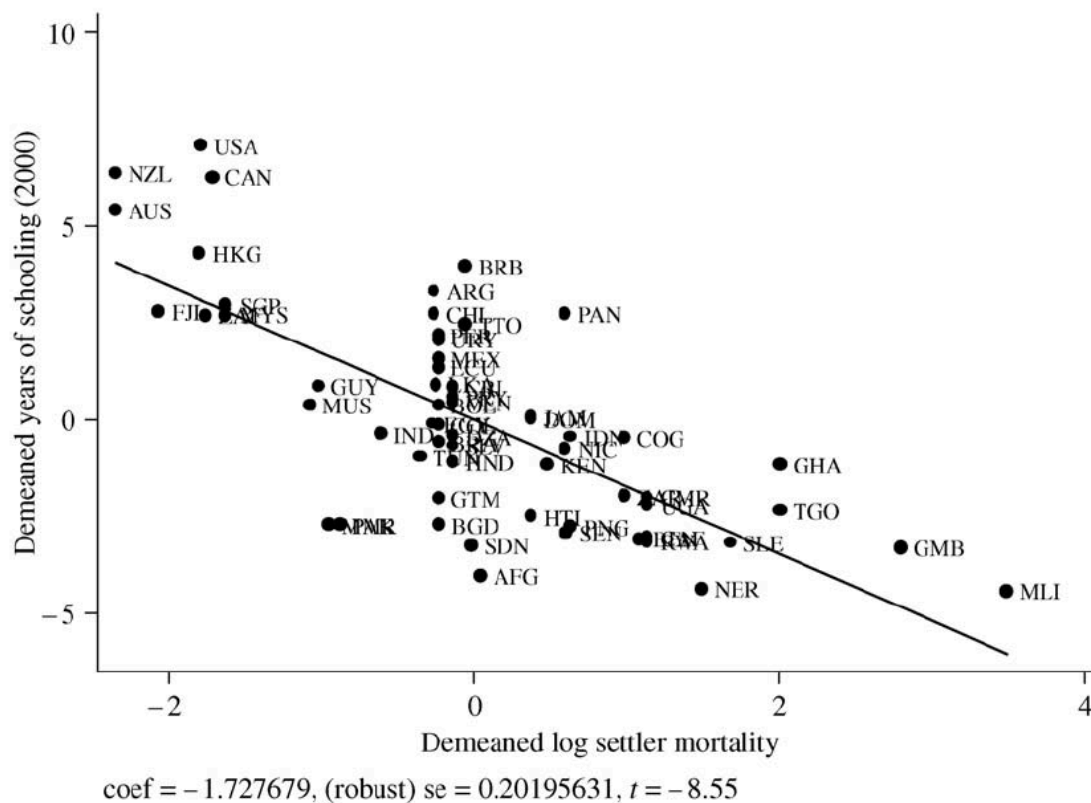


Figure 4. Years of schooling (2000) and log settler mortality.

European settlers may have even brought with them human capital rather than just institutions (Glaeser et al 2004)

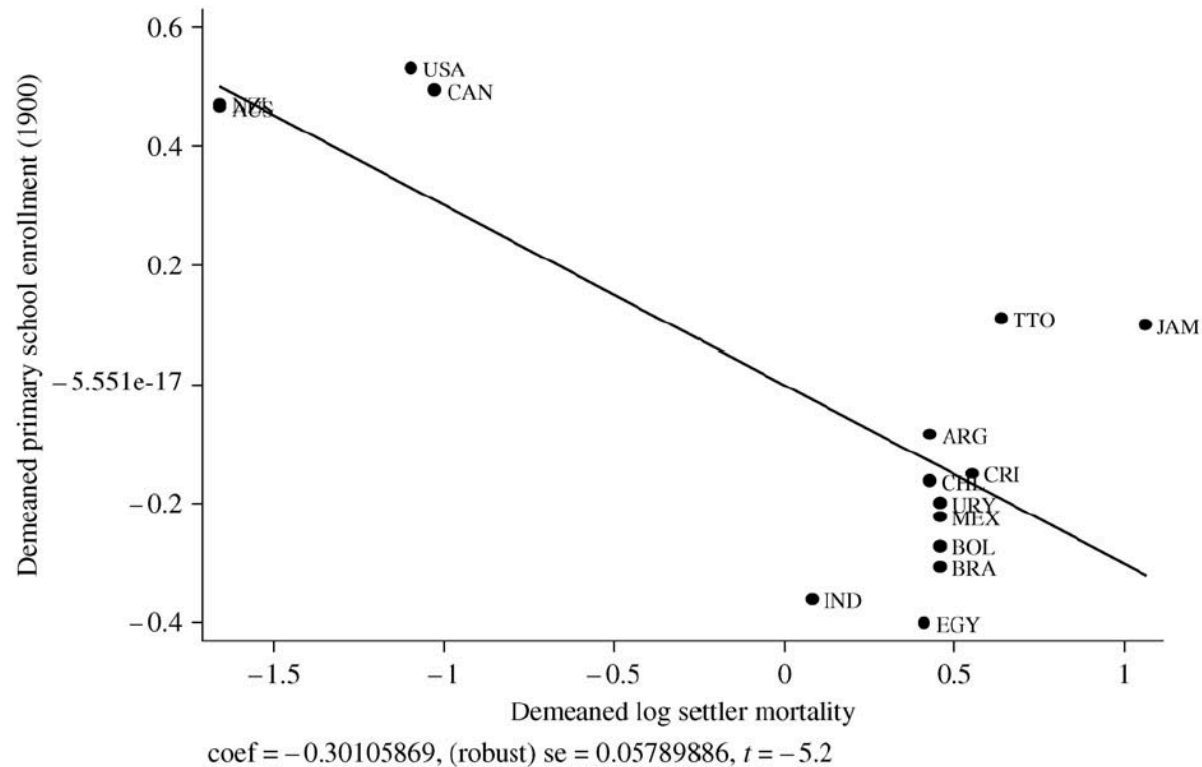
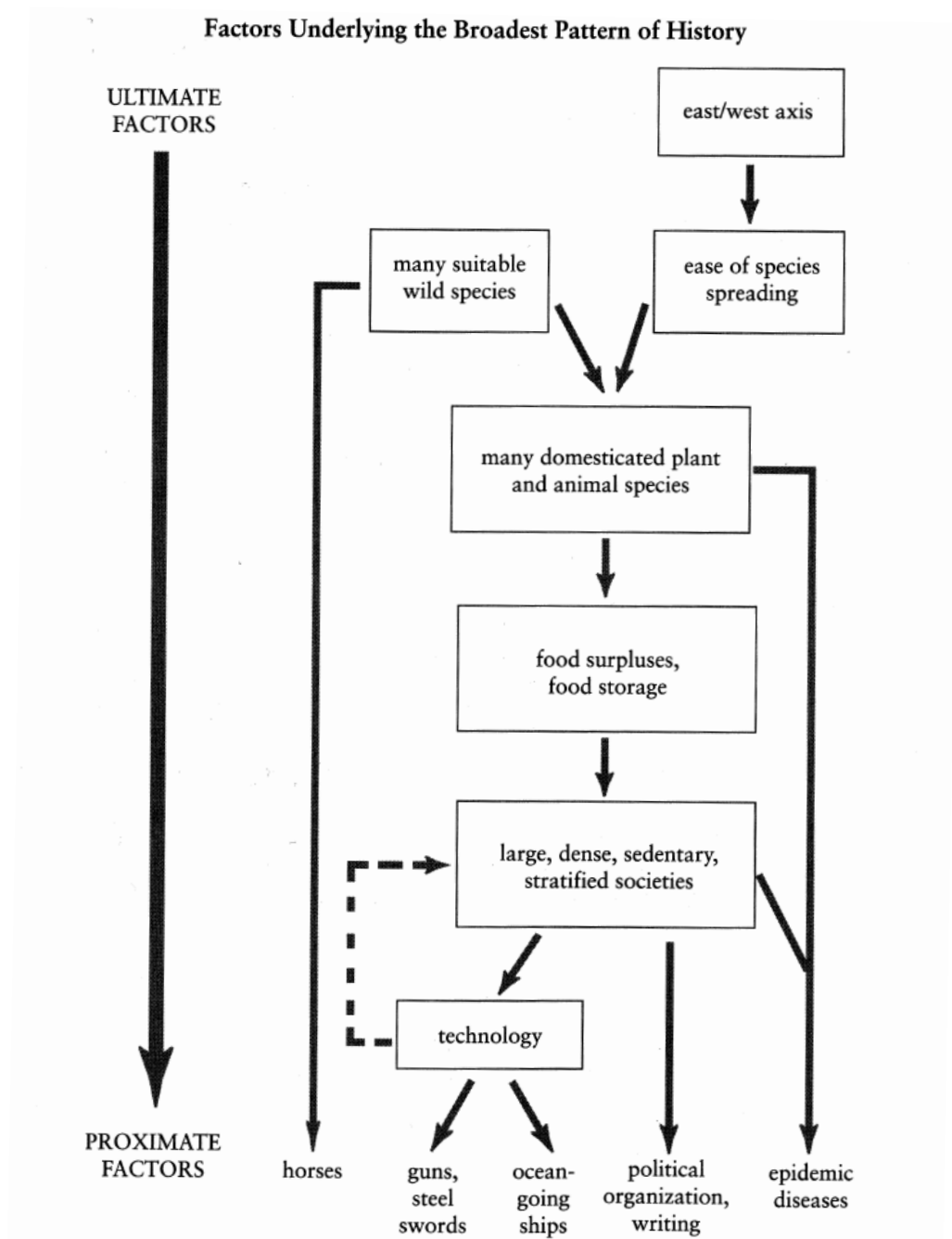


Figure 7. Primary school enrollment (1900) and log settler mortality.

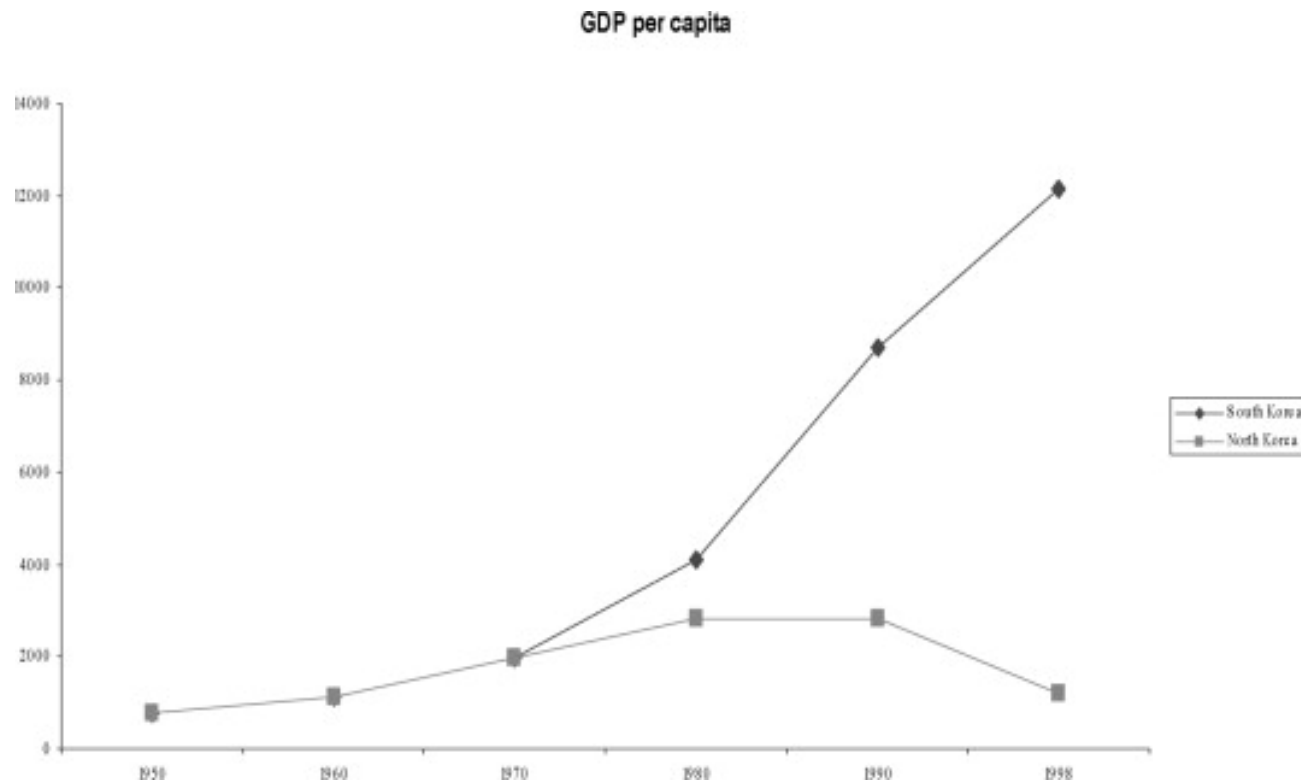
What critique might we draw from Diamond?

- Yes, conquerors were more likely to set up unfree institutions in less settled colonies
- But settlers also brought
 - Technologies
 - States and political organization
 - Not the same as our definition of institutions



The “divergent Korea” example

Shared history, geography, culture, but diverged on institutional paths



Glaeser et al (2004) skeptical

A major measure of constraints follows (or at least does not precede) most of the South Korean growth

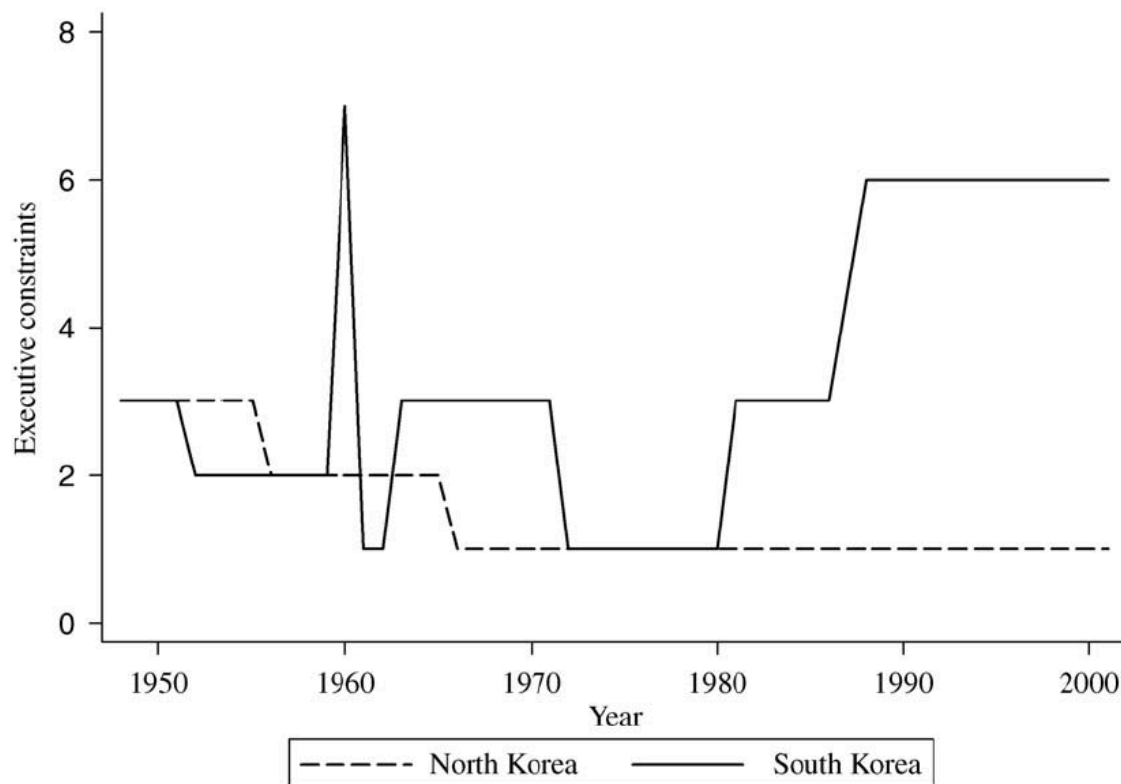
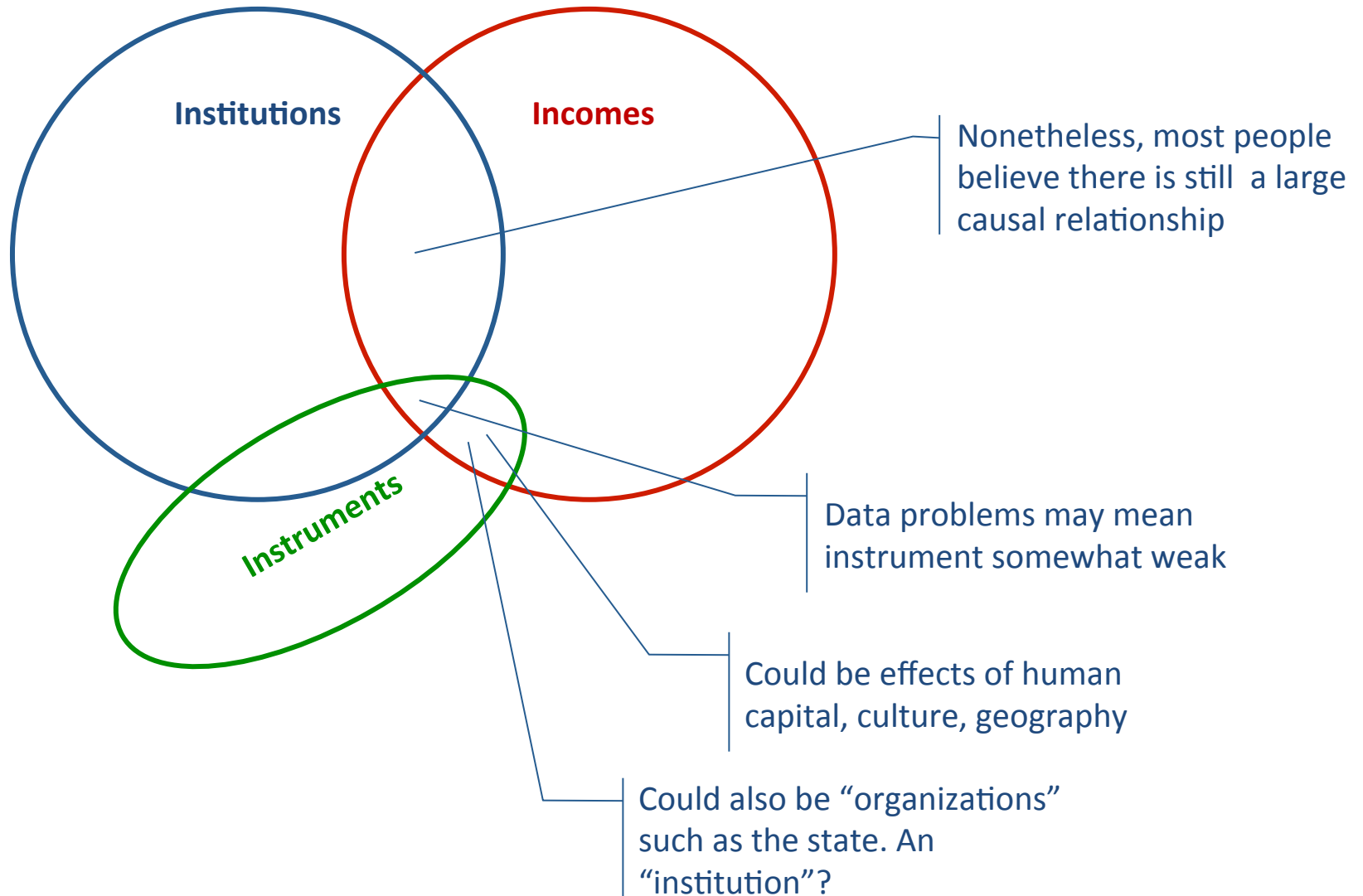


Figure 1. Executive constraints 1948–2001 North versus South Korea.

Summary of criticisms

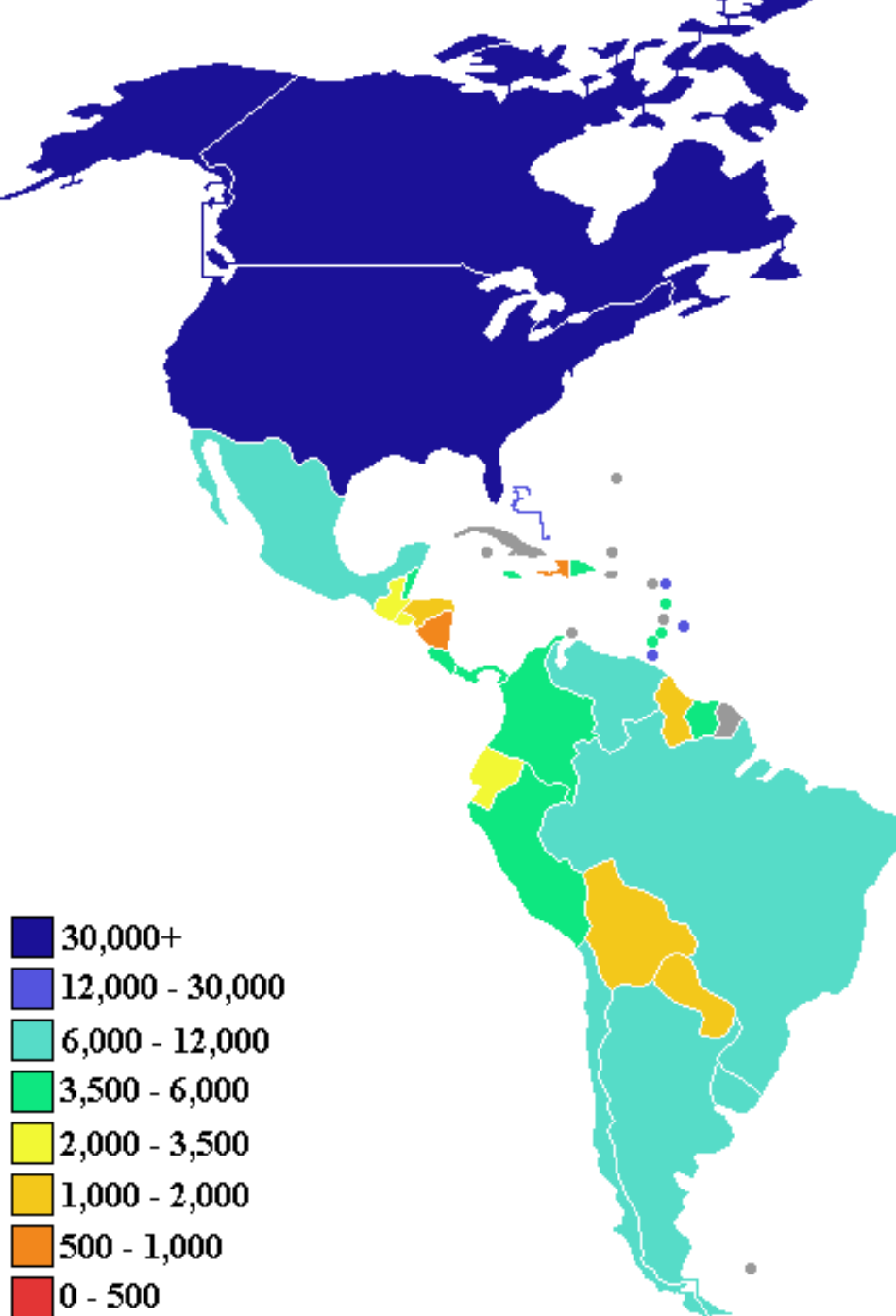


Another approach: Comparative historical/political analysis

Establishes why institutions are important, as well as where they come from

Engerman & Sokoloff:

Factor
endowments,
institutions,
inequality and
development



Look at variation within American colonies

Three broad classes of colony, based on “endowments”

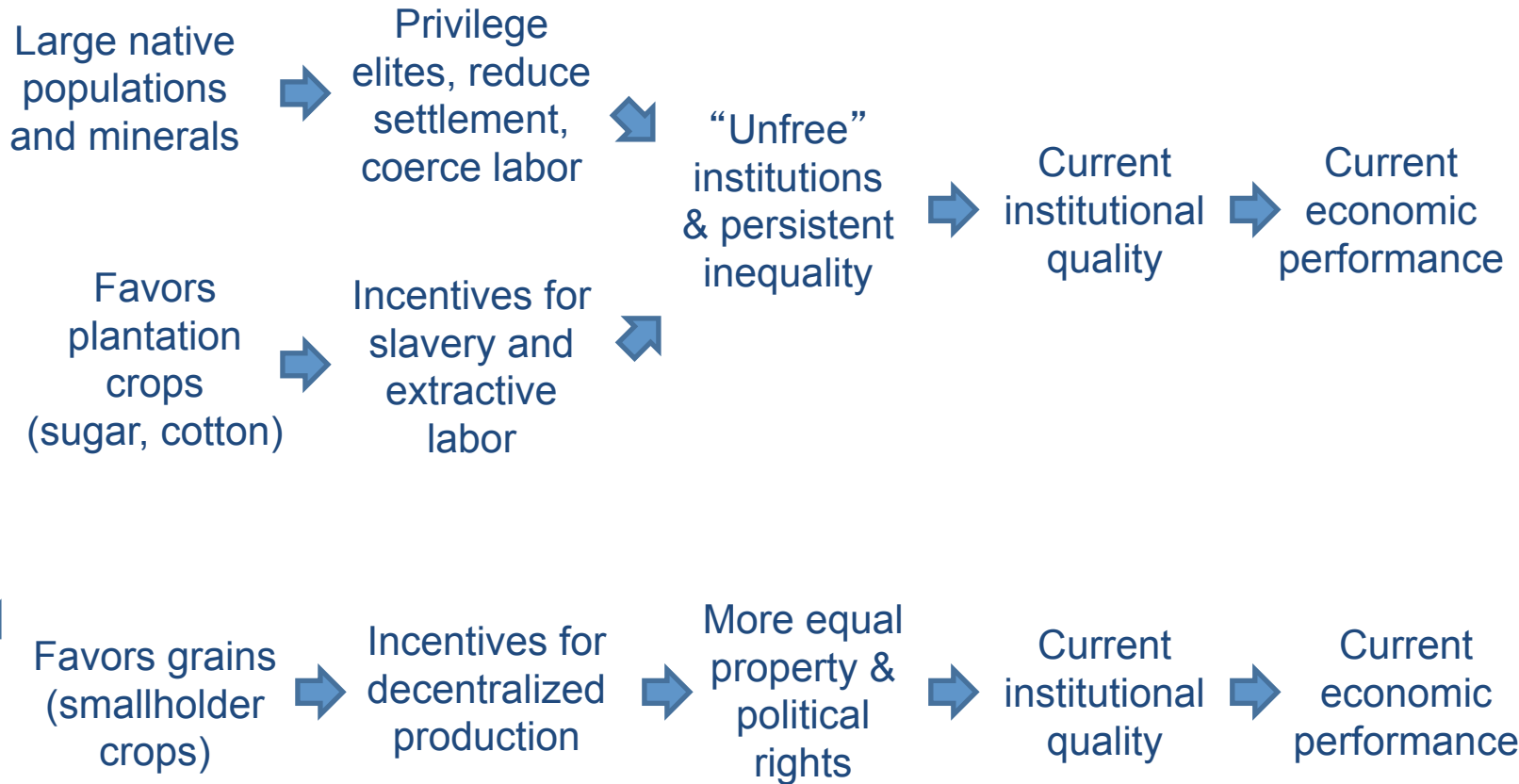
1. Soils and climate favor plantation crops such as sugar, and with it slavery
2. Minerals and large native populations favor extractive and coercive policies
3. Temperate climate and soils (and less dense native populations) favor smallholder agriculture





Geography → Institutions

(by another path: endowments)



Fundamentally, this is an argument about class relations

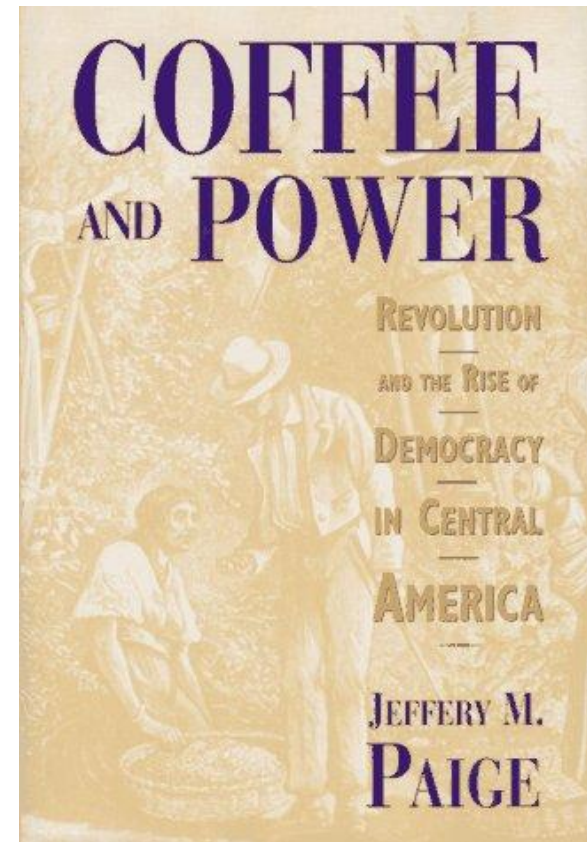
- E&S charts how different endowments shaped the initial balance of power between landholding elites, working class, and the merchant and trade class (bourgeoisie)
 - Controlling inflows of laborers and traders
 - Individual rights (over labor) of natives
 - Land policy and concentration
 - Voting rights
 - Extension of education and financial access

The variation within Latin America is instructive

The case of coffee – viable at smallholder and plantation scale



How dynastic coffee elites shaped political institutions and ideology 1850-1893



Endowments, class relations, and political systems

(Gross oversimplification)

		Initial land concentration	
		High	Low
Large native populations	High	Agrarian landed elite v. serfs	N/A
	Low	Agrarian landed elite v. Some traders & Wage labor proletariat	Elite traders/ processors v. Smallholders & proletariat

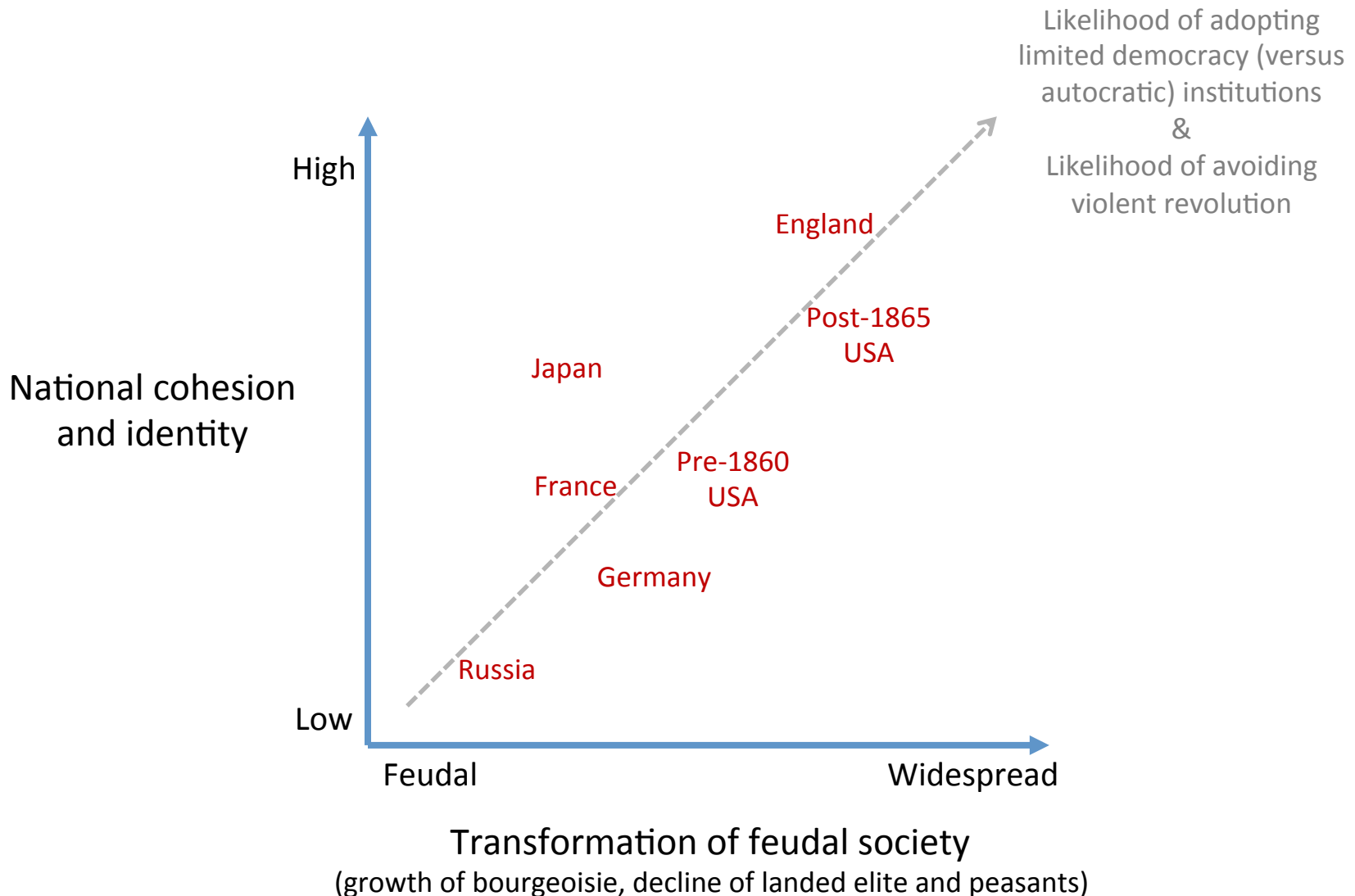
Influence over 20th century political systems and social conflict

		Initial land concentration	
		High	Low
Large native populations	High	Guatemala: Repressive authoritarian regime	N/A
	Low	El Salvador & Nicaragua: Semi-autocratic	Costa Rica: Advanced democracy

Close parallels to Ishiyama's overview of paths to democracy & dictatorship in Europe, US and Japan

- Traces the roots of constraining institutions to the social order and class relations
- “Traditional order”
 - Agrarian landed elite dominate peasants and serfs
- “Modern order”
 - Growing influence of rural capitalists (commercial agrarians) and urban capitalists (the trading and merchant bourgeoisie)

Ishiyama: The origins of democracy and dictatorship in the 19th and 20th centuries can be traced to social relations at the time of the industrial revolution



Note that the argument is rooted in endowments and trade

- England
 - **Land-intensive wool trade** → enclosure of commons → Rural commercial nobility and urban merchants/proletariat
- France
 - **Labor-intensive wine and produce** → Landed gentry retain peasant labor → Less urban
- USA
 - **Southern cotton** → slavery/serfdom over urban bourgeoisie & proletariat
 - **Northern grains and trade routes** → Rural and urban bourgeoisie
- Germany
 - **Western minerals** → commerce and urbanization
 - **Southern/Eastern labor-intensive agrarian focus** → Maintenance of feudalism
- Russia
 - **Vastness of empire** → No national unity or identity

The case of England, 1000-1700

700 years of gradual change

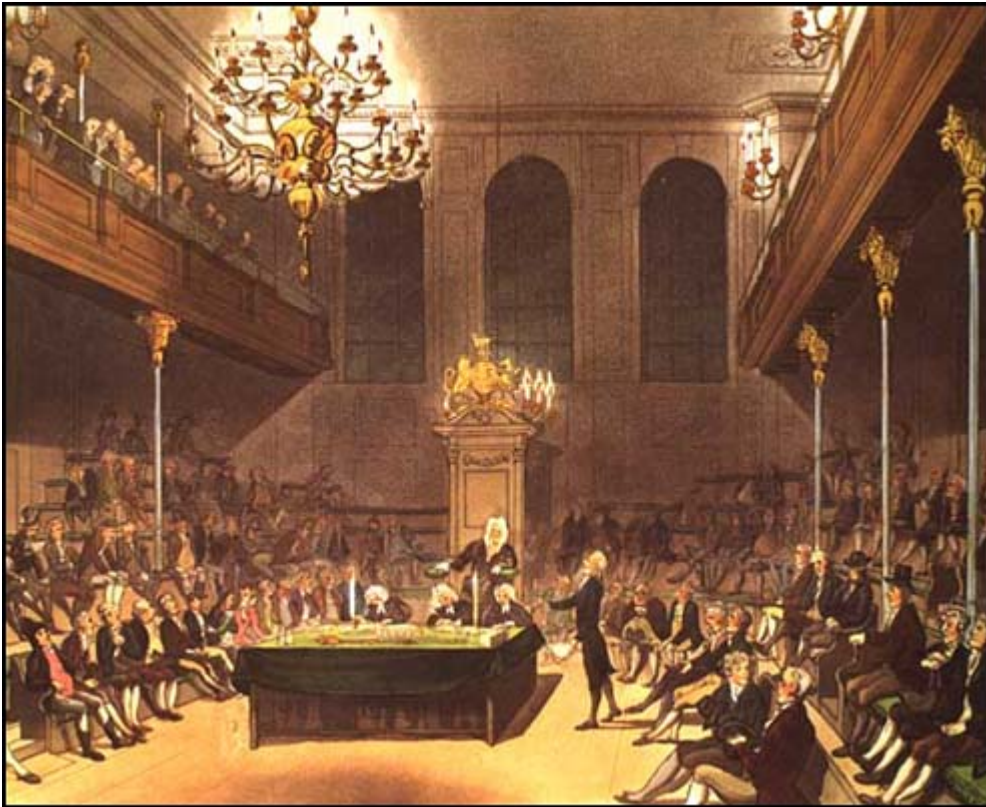
Movements to resist centralization & distribute power

- 12th C: First limits on monarchical power
 - Magna Carta, 1215: Limits placed on monarch by barony
 - 1265: First elected Parliament
- 14th C: Parliament of nobility as consultative body
- 17th C: Civil wars fought to reign in monarchical power
 - 1688: Parliament invites a new monarch to take the throne, constrained by a Constitution
- 18th-20th C: Gradual extension of the franchise

Movements to centralize and strengthen state

- 11th C: Conquered and united by Danes and Normans
- 12th C: Created royal courts, raised national taxes
- 14th C: 100 years war expands royal power
- 15th C: Henry VII demilitarizes aristocracy
- 16th C: Nascent bureaucracy under Cromwell & Henry VIII
- 17th-18th C: Periodic increases in centralization of power under King

Glorious Revolution of 1688

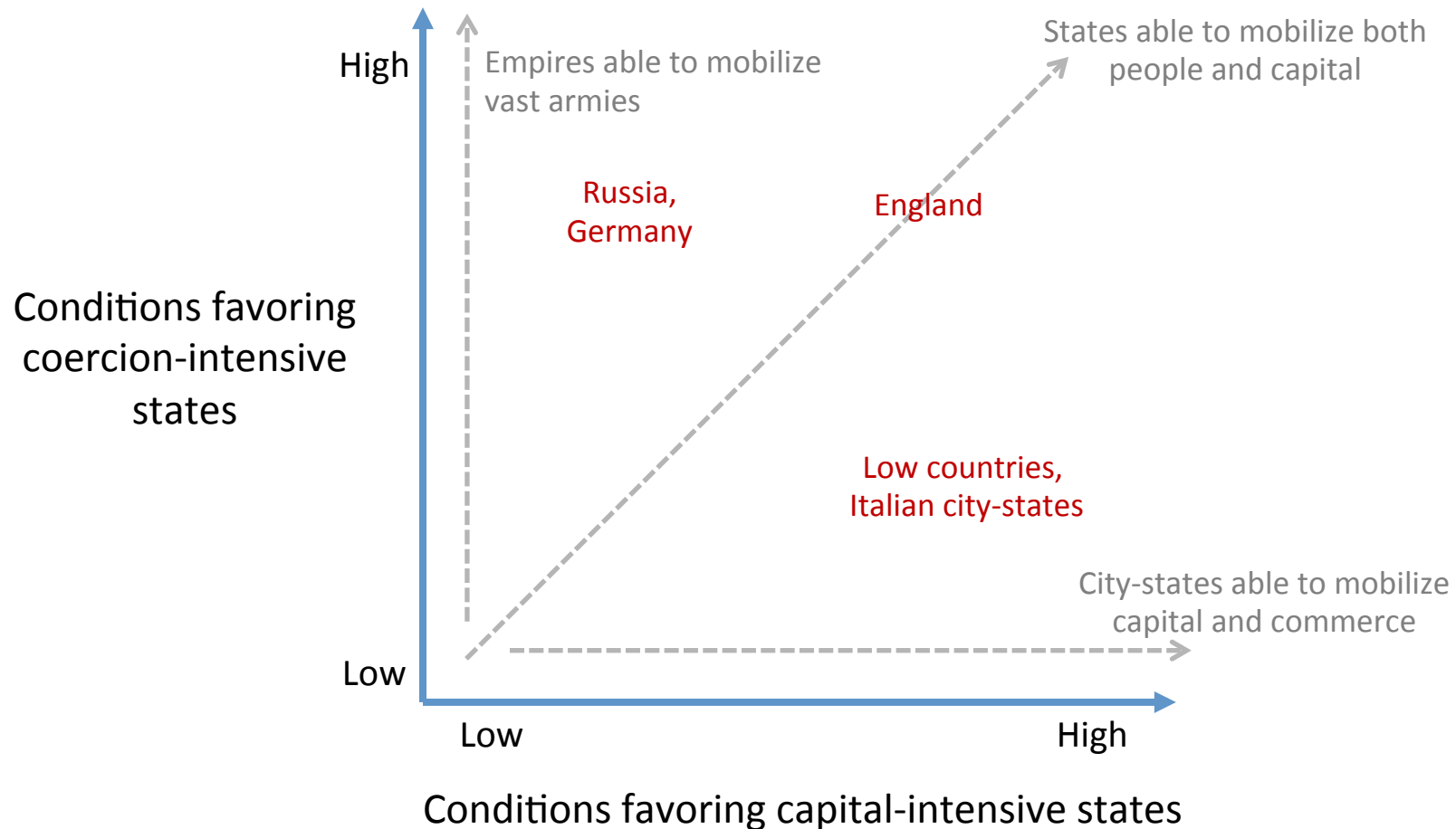


- Establishment of Parliamentary supremacy
 - Through adoption of English Bill of Rights
- Parliament deposes old monarch and invites a new monarch to the throne, on their terms

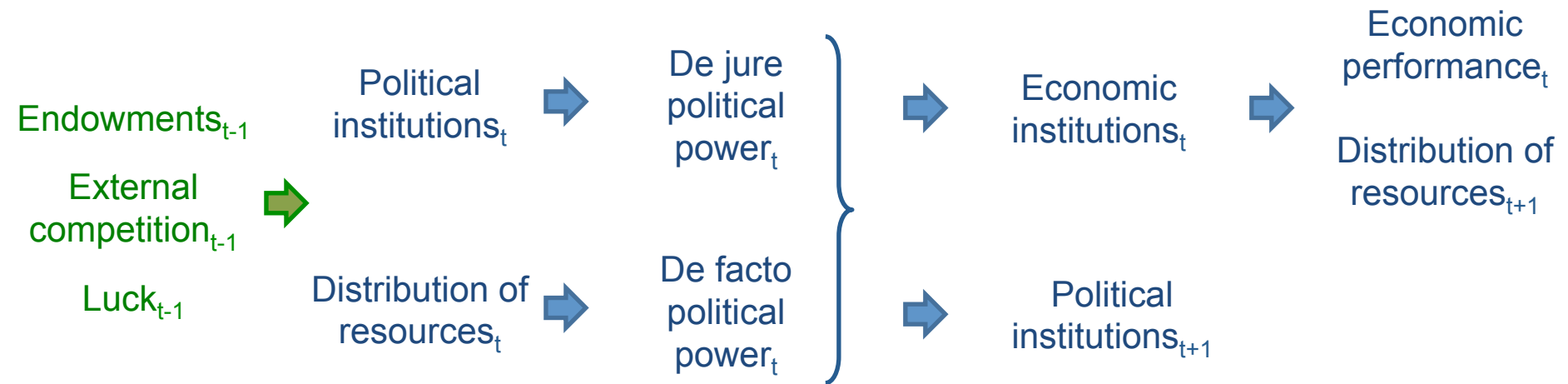
A struggle between capital and coercion?

- The attempts by nobility to build coercive, central states and extract surplus from peasants and merchants
- Attempts by lesser nobility and commercial classes to resist this extraction

Tilly: This social struggle also influenced what types of states would dominate militarily with the industrial revolution



Could think of all of these explanations fitting into:
(1) impact of exogenous conditions, and
(2) evolution of the endogenous system



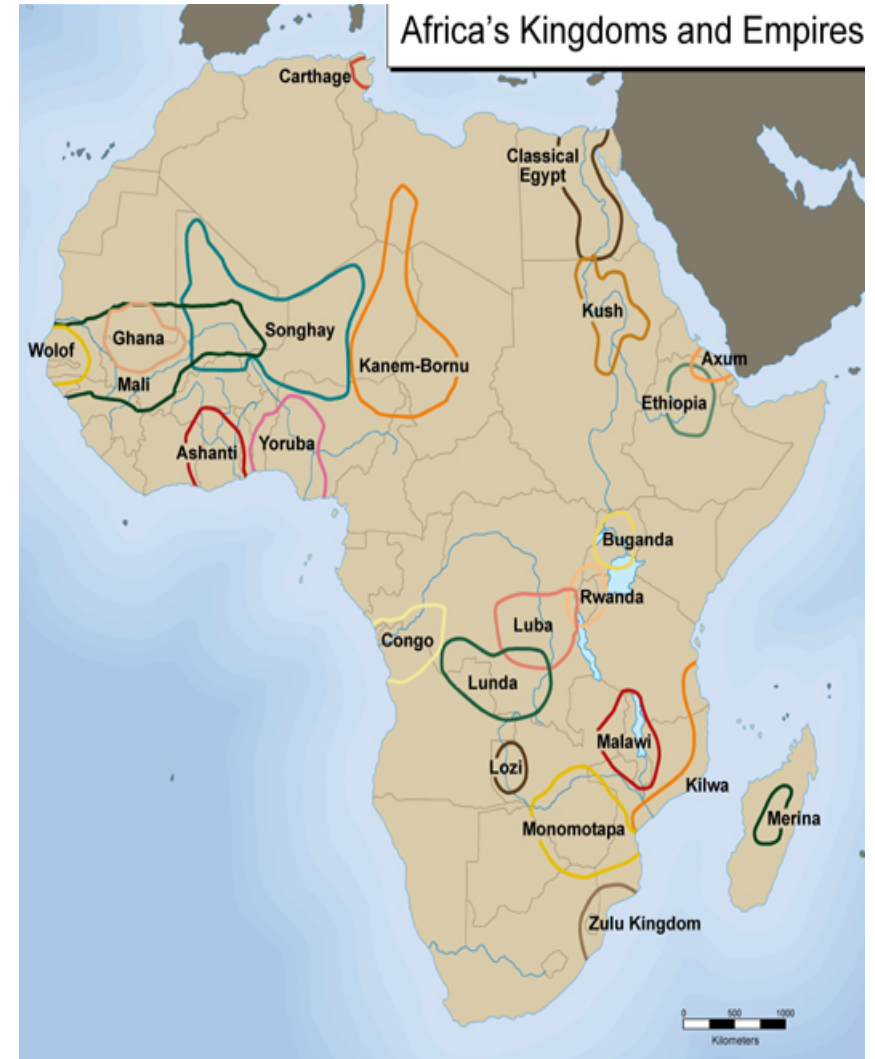
As we will see later in the course, they differ in how and why these systems and institutions evolve

Can we extend these lessons to African institutions and development?

- By the 18th and 19th century
 - These were largely agrarian societies thrust into the modern global capitalist system
 - Weak notational identities and political disunity
 - By and large endowments did not create a rural or urban commercial class
 - Limited or no bourgeoisie
- One might draw parallels to coercive states
 - Limited accountability and few constraining institutions on elites
 - Systems built to extract surplus from the peasantry

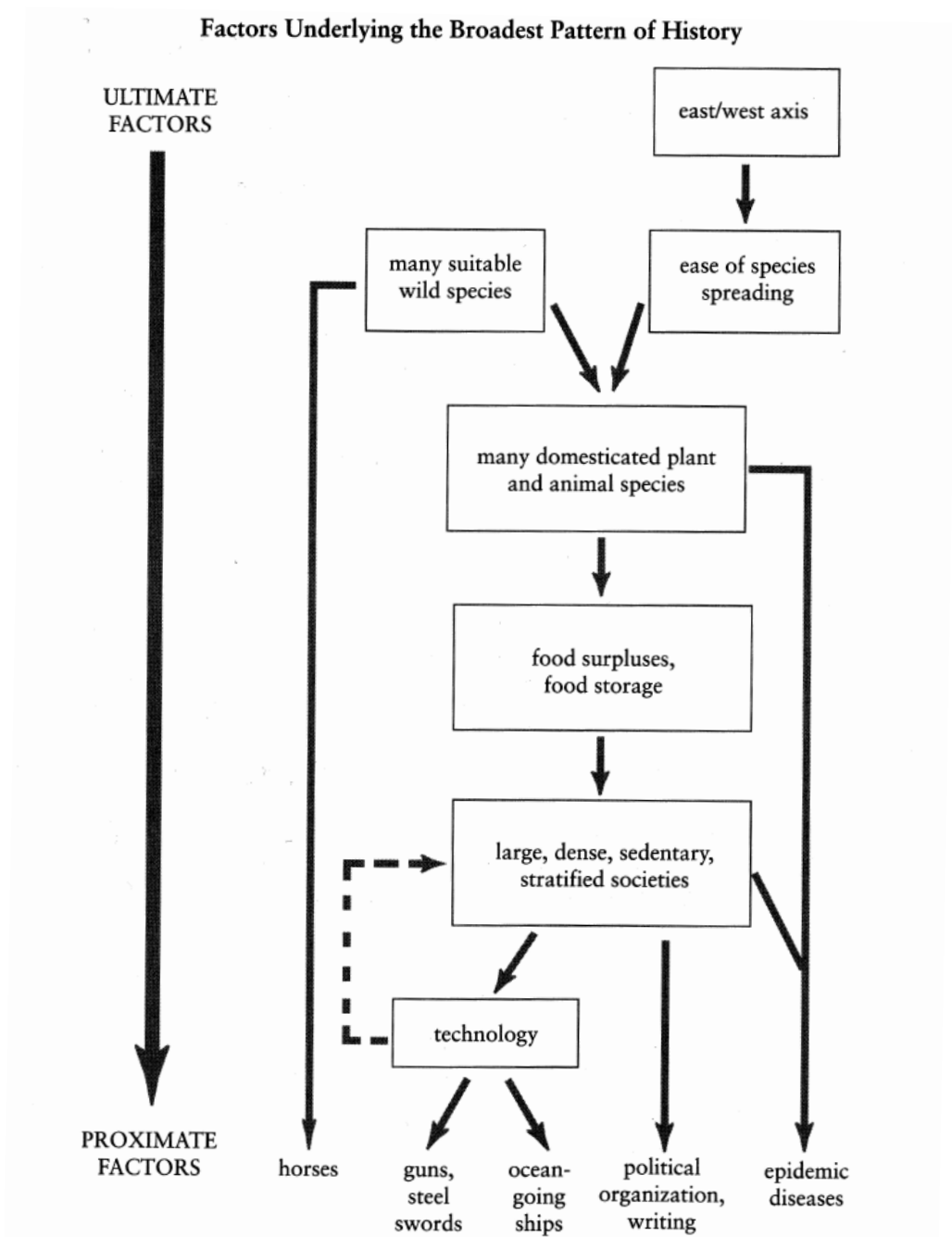
The big difference: Statehood and state capacity

- These models assume a degree of state concentration and capacity
 - Early England had a denser, more urban and more centralized polity than most of Africa
 - Polities were dense and competing
- Thus the models focus on institutional choices and regime types within relatively established states
 - The states that never came to be are ignored



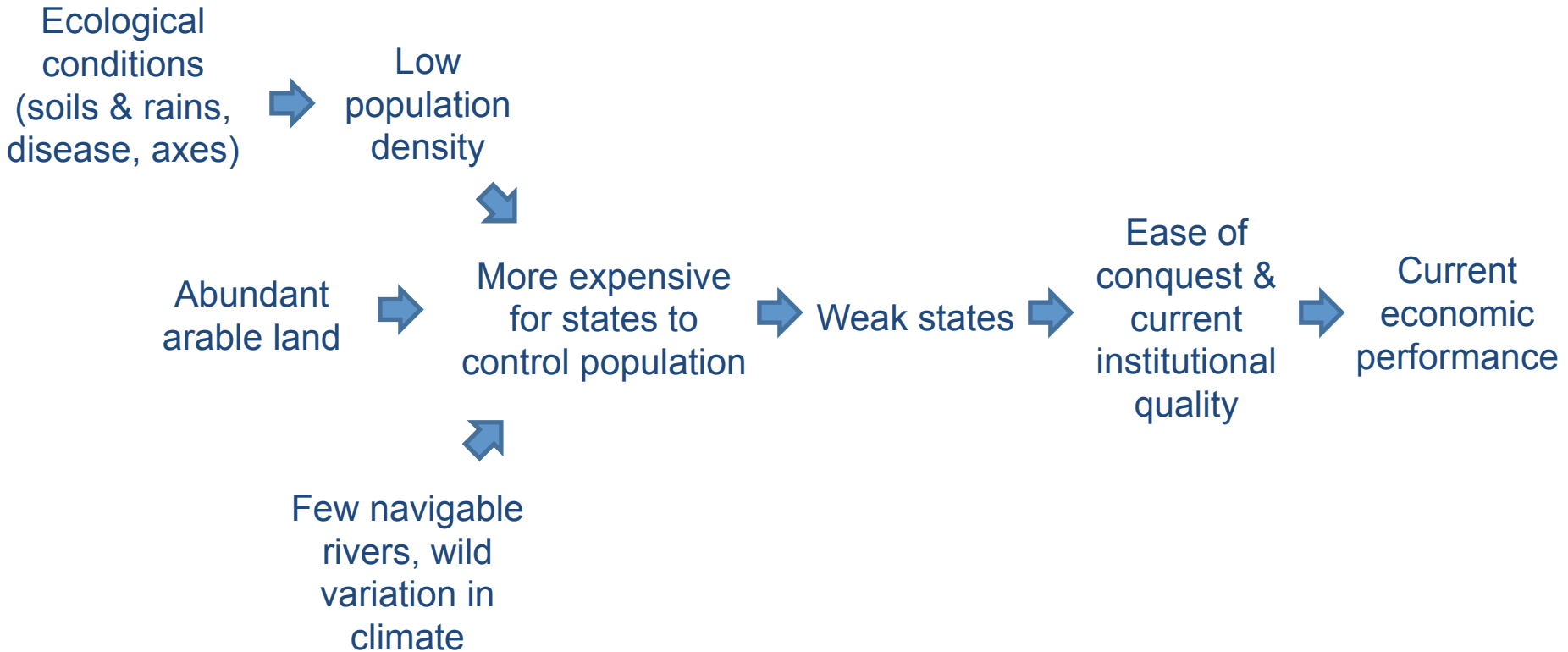
What critique might we draw from Diamond?

- Fundamentally, the Herbst and Diamond arguments are about social organization and relative state strength
- It is a model that aims to explain income differences in 1000 or 1600, but not 2000



Herbst:

Focused on explaining relative absence of states and state competition



This gives us more work to do

Where do weak and string states
come from?

These will be two closely related themes in the remainder of the course

State capacity

- What is it?
- How much does it matter?
- What processes generate it?
- What can societies do to foster it?
- Is there any role for foreign intervention?

Institution and regime choice

- What is it?
- How much does it matter?
- What processes generate it?
- What can societies do to foster it?
- Is there any role for foreign intervention?