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HOW INSTITUTIONS CHANGE OVER TIME

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Abstract

In this paper the author examines the forces that lead institutions to persist and change. He argues that the equilibrium institutions of society are the outcome of a political process which may be highly persistent and path dependent. This explains why patterns of underdevelopment are so persistent and policy advice is often so fruitless. Institutional change will arise if there is a real change in the political equilibrium - in the distribution of power in society, for example towards those with a vested interest in socially more desirable institutions. Change can also happen when the parameters of the system alter in a way which leads the interests of those in power to change. The author illustrates the nature of persistence and change by examples from the history of the United States, Bolivia, and Africa.

ملخص

في هذه الورقة يتناول المؤلف القوى التي تؤدي بالمؤسسات إلى الاستمرار والتغيير، فيزعم أن مؤسسات التوازن في المجتمع هي نتاج عملية سياسية تنسم بقدر كبير من الاستمرار والتعويل على المسار، ويوضح لنا هذا السبب في استمرار نماذج التخلف مع عدم جدوى النصح المتعلق بالسياسة في كثير من الأحيان. وسوف ينشأ التغيير المؤسسي إن حدث تغيير حقيقي في التوازن السياسي - وفي توزيع السلطة في المجتمع علي سبيل المثال تجاه أصحاب المصلحة الثابتة في وجود مؤسسات تخطي بالمزيد من التحبيذ الاجتماعي. ويمكن أن يحدث التغيير كذلك إذا تغيرت مؤشرات النظام على نحو يؤدي إلى تغيير مصالح من بيدهم مقاليد الأمور. ويوضح المؤلف طبيعة الاستمرار والتغيير فيسرد أمثلة من تاريخ الولايات المتحدة وبوليفيا وأفريقيا.

1. Introduction

There is now a great deal of consensus among economists that differences in comparative economic performance across countries are primarily due to differences in their institutions. Though for many years scholars such as Douglass North had argued in favor of institutional approaches to development, until very recently economists have been content to focus on factor accumulation, technical change, and policy differences without really coming to grips with the rules of the game which led different countries to have such different incentives to save and invest and choose good policies. Recent empirical work, stemming from Hall and Jones (1999) and Acemoglu, Johnson and Robinson (2001, 2002), has instead seen factor accumulation and policy as endogenous to the institutional structure of society and shown convincingly that it is variation in this structure that explains diverging patterns of income per-capita.

The acceptance of the role of comparative institutions in development leads to three important questions: First, why do institutions differ? Second, why do countries with poor institutions, which do not stimulate economic growth, not reform them? Third, despite apparently powerful tendencies for institutions to persist, why do they nevertheless sometimes change? This essay focuses on the third question, but to provide an answer to this question it is necessary to first address the others.

Answering the first question has been central to the recent empirical literature. Since to some extent institutions may be endogenous to income per-capita or other omitted variables, to identify the causal effect of institutions on economic performance it is necessary to isolate an exogenous source of variation in institutions – something which determines institutions but which is itself not a determinant of incomes. The main contribution of Acemoglu, Johnson and Robinson (2001) was to specifically address this question by exploiting a theory of the creation of institutions in European colonies. They argued that the historical disease environment faced by Europeans in the colonial world had a large impact on settlement patterns and that colonies with greater European settlement tended to have better institutions. Crucially, however, the sources of historical settler mortality for Europeans are not important for explaining income differences today; and so historical mortality can provide a source of variation in institutions, which is not a determinant of current incomes.

This empirical strategy was based on a theory about divergence of institutions within the colonial world. Without such a theory, it would have been difficult to come up with the idea of using historical settler mortality as a source of variation in institutions. But of course this is not a univariate theory of history. Historical settler mortality is *a* source of variation in institutions with a particularly attractive statistical property. There are many other sources of variation in institutions and even in the colonial sample, settler mortality explained only 25 percent of the variation in the security of property rights. Acemoglu, Johnson and Robinson (2002) explored other variables, such as the historical density of indigenous population, which also seemed to have played a significant role molding institutions (see Engerman and Sokoloff, 1997). However, such variables do not obviously play a role in explaining institutional variation outside of the sample of countries colonized by European powers (though of course the colonization of Eastern Europe by Germans in the Middle Ages or the colonization of Siberia by Russians in the nineteenth century may have unleashed similar forces).

More generally, the theory of institutional variation which emerges from this work is premised on the observation that institutions tend to be highly inertial. Once a set of institutions comes to dominate society it tends to persist for long periods of time, though the institutional path can certainly change in the context of major *critical junctures*. These could include factors external to a society such as the imposition of colonial rule, inter-state war, or globalization, but they also include changes endogenous to society such as revolution, or industrialization and the rise of the middle class.

From this perspective, to ask why a society has the institutions it does one has to look at its history to see what forces have buffeted it and the impact they have had, and how a society has or has not changed during particular critical junctures. Countries have different institutions because they have different histories. Nevertheless, there may be forces for institutional convergence; and societies which were affected by common shocks and forces may well have similar institutions, as is true in much of Latin America, for example. They may also respond in similar ways at subsequent critical junctures. For instance, the impact of globalization in Latin America in the late nineteenth century with the great economic opportunities it presented generally led to a deterioration in economic institutions such as property rights and political institutions, as it fostered the consolidation of more autocratic regimes in countries like Guatemala and Mexico. The response of most Latin American countries to this shock was filtered through the existing political equilibrium in much the same way as Postan (1944) had previously analyzed the institutional implications of commercial expansion in late medieval Europe (see also Brenner, 1976). This is to say that there is a large amount of path dependence in the institutions of a society. Nevertheless, institutions also change as we shall see.

Let me then move to the second question concerning the puzzling absence of institutional reform. The answer to this question is partially familiar to those who have read the public choice or political economy literature. This would suggest that institutional equilibria are highly inertial because of large vested interests in the institutional status quo. For a variety of reasons the intuitions of the Coase Theorem do not apply (see Acemoglu, 2003, for why) so there is no way to buy off those who would lose from reform of institutions. However, to understand the absence of reform we need to go far beyond the simple idea that interest groups may lose rents from reform. Firstly, as initially pointed out by Acemoglu and Robinson (2000), loss of political power from reform may be more important than loss of economic rents (if you don't lose your political power you can always keep extracting rents). Second, the political economy mechanisms via which bad institutions perpetuate themselves over time are considerably more complex than the image of an interest group struggling to avoid losing its rents. Said another way, we need a much better description of the mechanisms that lead to path dependence. Let me motivate this with some examples to which I shall return later.

Though there was a great deal of persistence in the institutions of Latin America there have also been quite a few revolutions. While one can argue that in many countries independence from Spain in the early nineteenth century led to few changes in who was running these societies, and there may still be some places where this is true (see Stone, 1990, on Central America), there have been many instances where ruling elites were swept away and new ones took their place. This is certainly true of the Mexican, Bolivian, Cuban, and Nicaraguan revolutions for instance. In Bolivia, it is clear that those with a vested interest in the pre-existing institutions had their political power and rents eliminated. But did institutions get better in Bolivia? To examine another example, in many Sub-Saharan African countries since independence, poor policy outcomes have been blamed on particular personalities, such as Joseph Mobutu in the Congo, Kenneth Kaunda in Zambia, Hastings Banda in Malawi, or Kwame Nkrumah in Ghana. Did getting rid of Mobutu and his coterie, the so-called *grandes legumes* ("big vegetables") improve the policies of the Congo? Did the destruction of vested interests in Bolivia lead to a dramatic new development path? The answer in both cases is no, and I will argue that this is because the political and institutional equilibrium can be path-dependent in a much deeper way that has yet been recognized.

This brings me to the third question, the heart of the paper, on institutional change. Before getting into that, in the next section I want to first drive home the theory of institutions which underpins my discussion. After that I focus squarely on notions of institutional persistence. In relating the historical mortality of Europeans in the colonial world hundreds of years ago to current institutions, Acemoglu, Johnson and Robinson (2001) made large claims about the persistence of

institutions. Before discussing change, we must understand better how to think about institutional persistence. In this section I return again to Bolivia and the Congo. Finally, having discussed a theory of institutions and why and how they persist, I move to discuss institutional change. There is nothing mysterious about institutional change: it happens when there is a sufficiently large alteration in the underlying distribution of interests or of political power in society. Nevertheless, as yet we can make few generalizations about the circumstances when this will occur. One of the main contributions of this essay is to point out that, thought of properly, the institutional equilibrium is more persistent than currently understood; and that even apparently radical transitions of power such as took place in Bolivia in 1952, and in the Congo in 1997, are still consistent with institutional persistence.

2. Elements of a Theory of Institutions

I now briefly discuss a theory of institutions (see Acemoglu, Johnson and Robinson, 2005, for an extensive discussion). Economic institutions matter for economic growth because they shape the incentives of key economic actors in society; in particular, they influence investments in physical and human capital and technology, and the organization of production. Economic institutions not only determine the aggregate economic growth potential of the economy, but also the distribution of resources in the future. In other words, they influence not only the size of aggregate income, but how income is divided among different groups and individuals in society.

Though it is somewhat controversial I shall include economic policies along with economic institutions. Like institutions, policies are chosen by those with political power and they have large impacts on the incentive structure of society, so for the purposes of the discussion it is not important to distinguish between them.

Economic institutions and policies are endogenous and are determined as collective choices of the society. Clearly, there is no guarantee that all individuals and groups will prefer the same set of economic institutions because, as noted above, different economic institutions lead to different income distributions. Consequently, there will be a conflict of interest over the choice of economic institutions. In such a situation it will be the distribution of political power in society that determines what institutions are chosen. The group with more political power will tend to secure the set of economic institutions that it prefers.

The distribution of political power in society is also endogenous, however. Following Acemoglu and Robinson (2006) I distinguish between two components of political power: *de jure* (institutional) and *de facto* political power. Here *de jure* political power refers to all types of power that originate from the political institutions in society. Political institutions determine the constraints on and the incentives of key actors in the political sphere. Examples of political institutions include the form of government, for example, democracy vs. dictatorship or autocracy, and the extent of constraints on politicians and political elites. There is more to political power than political institutions, however. A group of individuals, even if they are not allocated power by political institutions, for example as specified in the constitution, may nonetheless possess political power. Namely, they can revolt, use arms, hire mercenaries, co-opt the military, or use economically costly but largely peaceful protests in order to impose their wishes on society. I refer to this type of political power as *de facto* political power, which itself has two sources. First, it depends on the ability of the group in question to solve its collective action problem, i.e., to ensure that people act together, even when any individual may have an incentive to free ride. Second, the *de facto* power of a group depends on its economic resources, which determine both their ability to use (or misuse) existing political institutions and also their option to hire and use force against different groups.

It will be the composition of *de facto* and *de jure* power in society that determines the actual power of a group or set of interests, and this will determine which economic institutions arise. It is

obvious from this description that there are large forces here which generate persistence in the political economy equilibrium. If a certain group is empowered by the existing structure of political power then they will choose economic institutions that favor them. This will increase their wealth and be one channel through which their de facto power will persist or increase. Moreover, those who hold power today will not only be able to determine economic institutions today. They will also be able to determine political institutions in the future, which tends to cement the de jure power of such a group. Hence the distribution of political power and thus economic institutions is naturally highly persistent over time. Nevertheless, there may be intrinsic dynamics or shocks to the system that lead to redistributions of power and thus changes in economic institutions. It may also be the case that the incentives of those in power are changed, perhaps because of technical innovation or new market opportunities, and this may change economic institutions we well.

This dynamic vision emphasizes that those with power today take decisions not just to maximize their income today, but also to maintain their grip on power. These goals are often in contradiction. This can be for the simple reason that economic policies which increase the incomes of elites today may increase the incomes of opponents even more, thus influencing the future distribution of de facto power. It may also be that, as pointed out in the seminal study by Bates (1981), good economic policies are not good politics. In particular, though providing public goods may increase the incomes of the elite, staying in power may be better achieved by using redistributive instruments that can be targeted at supporters and withheld from opponents.

3. Thinking about Institutional Change and Persistence

I already began to suggest some ideas about why institutions persist. They persist when the incentives and structures of power that led to them also persist. I now want to be very clear about what it is that is persisting when we talk about institutional persistence. To see why this is an important issue let me consider some of the examples of dysfunctional institutions that have arisen in the recent literature on long-run comparative development.

Consider first colonial Latin America. Much emphasis has been placed by a number of scholars on how particular economic institutions, such as the *encomienda* and the *mita*,¹ were designed to transfer rents from Amerindians to Spaniards (Engerman and Sokoloff, 1997, Acemoglu, Johnson and Robinson, 2001). But the *encomienda* was pretty much dead as an institution by the end of the sixteenth century and the most infamous *mita*, to the silver mines in Potosí in Bolivia, was abolished in 1820 (see Dell, 2007). Indian tribute and slavery were abolished everywhere in the Americas by the 1880s. With respect to political institutions, there was also a great deal of change in specific institutions. After independence Latin American countries wrote constitutions (the Dominican Republic had fifteen different constitutions between 1844 and 1896), introduced democracy (usually reluctantly), had coups, became federal, and then sometimes became centralized again. They also changed their electoral systems from majoritarian to proportional. Moving to Africa, Uganda started out at independence as a parliamentary system, switched to presidential, back to parliamentary, and then back to presidential again.

So specific economic and political institutions change a lot. This is problematical for the main paradigm that economists have for talking about institutional persistence which is the QWERTY paradigm, due to David (1985). This paradigm, inspired by the bizarre organization of the typewriter keyboard, argues that the major puzzle is to understand how something specific, created long ago in conditions which have vanished, can still exist today. Mapped into institutions

¹ The *encomienda* was a grant of Amerindians to a Conquistador. The Indians were supposed to provide all sorts of goods, tribute, and labor services in exchange for the “protection” of the Conquistador. The *mita* was originally a system of compulsory labor services used by the state of Tiwanakusuyu (the correct name for the empire ruled by the Inca) which was heavily adapted by the Spaniards to provide labor for mines throughout the colonial empire.

this may be a useful way to talk about why countries formerly colonized by the French still use the Napoleonic Codes as the basis for their legal system. But clearly, such an approach will not be useful for talking about institutional persistence in Latin America. The last compulsory labor service which was a direct colonial legacy, *pongueaje* was abolished in the Bolivian revolution; and we will not be able to understand underdevelopment in Latin America by pointing to the persistence of specific colonial economic institutions since these long vanished.

Rather, what is required is a theory of how persistence and change can coexist. There are several ways to build such a theory because I think there is more than one mechanism by which this can happen. The first mechanism I will emphasize is what I call the *persistence of power and elites* (following Acemoglu and Robinson, 2008). In this case, though specific economic and political institutions may change, the underlying distribution of political power stays the same and the same people stay in charge. I shall illustrate this idea by examining the economic history of the U.S. South.

The crucial observation, to understand why persistence and change in economic institutions can coexist, is to note that the approach to institutions described above suggests that economic institutions are chosen for their economic benefits. For instance, in the U.S. South before the Civil War, plantation slavery was used as a way to repress labor and generate higher profits for cotton planters than they would have achieved with a free labor market. Labor repression creates poor social incentives. Yet slavery is not the only way to repress or extract rents from labor. Rents can be extracted using monopsony power or anti-vagrancy laws that impede labor mobility, and repression can be exercised by the Ku Klux Klan and the threat of lynching. In essence there are many different instruments which can be used to attain the same goals, or to put it more colloquially, 'there are many ways to skin a cat'. Specific economic institutions, the instruments, may change, but the ultimate effect on incentives and the allocation of resources may be minor. This is why Acemoglu, Johnson and Robinson (2001) focused on an institutional outcome variable: the absence of expropriation risk. There are many paths via which expropriation risk can be absent.

The second mechanism I shall consider, I refer to as the *path dependence of political equilibria*. In this situation specific institutions and the people in power change, but those newly empowered use political strategies and economic institutions which are heavily conditioned by the existing institutional status quo (Acemoglu and Robinson, 2007a). Here vested interests in the status quo may be demolished but the political equilibrium is path-dependent, and those who take over have similar incentives to those they replaced. I argue that this is one way to think about why the Bolivian revolution had little effect on institutions and growth in Bolivia.

The final mechanism I will consider is another type of path dependence of political equilibria which seems distinct enough to warrant a separate name. I call it the *persistence of bad rulers*. This is motivated by the African examples I gave in the introduction. Often poor economic policies and performance seemed to be linked with individual bad leaders but when these leaders are finally removed, new leaders turn out to be as bad as those they replaced. I shall argue this is also an example of path dependence of political equilibria which stems from the incentives citizens have to back different types of challengers when faced with a bad ruler.

Both of these mechanisms are reminiscent of the ideas of the sociologists Michels (1915), Mosca (1939) and Pareto (1969) in their work on elites. They all provided theories of how apparent social change was merely the 'circulation of elites' which could occur with few real changes in society. In a sense, the research I am describing provides microfoundations for some of their ideas.

Persistence of Power and Institutions in the U.S. South

Before the Civil War the U.S. South was run by plantation owners, and the economy was based on a system of slavery and labor-intensive cotton production. The South was relatively poor (about 70 percent of the national level of GDP per-capita). There was little manufacturing industry, low urbanization, and a far lower density of canals and railroads than in the rest of the country, particularly the North (see Bateman and Weiss, 1981, Wright, 1986, Ransom and Sutch, 2001).

The defeat of the South in the Civil War on the surface led to major alteration in economic and political institutions. Slavery was abolished and freed male slaves given the right to vote. One might have anticipated a dramatic change in the incentive environment and economic outcomes. Instead, what emerged was a labor-intensive, low-wage, low-education and repressive economy that looked remarkably like the antebellum Southern economy. Economic performance got relatively worse in the South after the Civil War with GDP per-capita declining to about 50 percent of the national average, where it stayed until the 1940s.

The reason for this is quite simple. Despite losing the Civil War, the traditional landed elites could sustain their political control of the South, particularly after Reconstruction ended in 1877 and the Union army was withdrawn. These elites were able to block economic reforms that might have undermined their power, such as the distribution of fifty acres and a mule to each freed slave, and they were able to use their local political power to disenfranchise blacks and re-exert control over the labor force. They did this through the use of Black Codes, Vagrancy Laws, Ku Klux Klan and Jim Crow (Woodward, 1955).

In the U.S. South, even though political institutions changed in such a way as to redistribute de jure political power away from the white elites, they were able to compensate for this through the use of de facto power. It is perhaps not surprising that the plantation elites had such a relative advantage over the newly freed slaves in terms of their ability to act collectively. In consequence they maintained their political control (see Wiener, 1978, for a fascinating study of this). Though political control no longer allowed slavery to be used, cotton planters could extract rents and repress the labor force in many other ways. For economic performance however, there was little difference in which sorts of method of labor repression was used. The economy did not improve because the incentive environment for the mass of the population persisted.

Path Dependence of the Political Equilibrium and the Bolivian Revolution

In 1952 a revolution, masterminded by a political party, the MNR (Movimiento Nacionalista Revolucionario), overthrew the traditional political and economic system in Bolivia (Klein, 1992, for an authoritative overview). The tin mines, formerly the property of three families, were expropriated and nationalized. All of the great haciendas were seized, the landed elites evicted, and the land distributed to the peasants. The La Rosca coalition, which had represented traditional interests in politics was displaced, universal suffrage was introduced, the military disarmed, and the much hated *pongueaje* abolished.

This case looks very different from the U.S. South. The freed southern slaves did not get their forty acres and a mule in 1865, but Bolivian peasants got their forty hectares and an alpaca in 1952! The displacement of the elite implies that the mechanism I outlined in the last sub-section cannot apply. Surely economic institutions and performance improved in Bolivia? Unfortunately they did not. By the end of the 1960s Bolivia's Polity score was back to where it had been before the revolution, as was its level of inequality (Kelley and Klein, 1981). Economic growth was more or less zero. How can we comprehend the failure of these reforms?

One way to understand this comes from Heath's (1972) study of local politics before and after the revolution in the province of Nor Yungas. Heath studied how peasants gained access to land and credit and how they interacted with the legal system. What he showed is that although the details

of these interactions changed, there were large qualitative similarities before and after the revolution. For instance, with respect to land, before the revolution peasants had to ask for access to land from local hacienda owners. In exchange for land they had to provide favors and services, including support for the political parties preferred by the landowners. After the revolution land was allocated by the local community, the *ayllus*, but like the relationship between the PRI and the *ejidos* of Mexico, the decision-making system of these organizations was heavily influenced by the MNR, which, wished to exchange access to land for political support, just as hacienda owners had done. These relationships, both before and after the revolution, were completely clientelistic exchanges of private goods for political support. What Heath documented was a remarkable persistence in political strategies between the old and new elites of Bolivia.

One can think of the persistence of such strategies in terms of the path dependence of political equilibria. The MNR developed in competition with the pre-existing elite in the 1950s and its political strategies were formed by them. Once it came to power it continued to use the same strategy as it had previously adopted, e.g. clientelism.

There is an alternative way to think about path dependence in this context, which is formalized in Acemoglu and Robinson (2007a). Bolivian political institutions in the 1940s and 1950s placed few checks and balances on the use of power, and the traditional elite were able to use this power to expropriate property rights and design economic institutions in their own interests. Those institutions were unpopular with the great mass of Bolivians, which implies that once the MNR had solved the collective action problem they could expect support for a challenge to the existing regime. But the MNR faced a trade-off. On the one hand it could garner political support by promising to change political institutions in such a way as to introduce more constraints on power and improve economic institutions, such as property rights. Such a promise would enhance its support, but would also mean that once in power it would be able to extract fewer rents for itself. In the context of the 1950s political institutions, it would have been relatively attractive for the MNR to persist with the same ones, because while this lowered their probability of removing the traditional elite, it meant the promise of large rents if they attained power. This trade-off leads to a genuine form of path dependence because it depends on the status quo. Had political institutions been better in Bolivia in the 1950s then the MNR would have been more likely to maintain them than to introduce worse ones.

The Persistence of Bad Leaders—Fighting Fire with Fire

In policy circles one often hears about the importance of good leadership. Good leadership may be particularly important in the countries of Sub-Saharan Africa where one cannot rely on political institutions to place constraints or checks and balances on the use of executive power and where the traditional characterization of politics is “personalistic.” What is striking about the history of post-independence Africa is the incredible incidence of bad leaders. It is hard to imagine that if you chose people at random from the population they would be less public spirited than Robert Mugabe in Zimbabwe, Omar al-Bashir in the Sudan, Idi Amin in Uganda, Mengistu Haile Mariam in Ethiopia, Sami Abacha in Nigeria, Macias Nguema in Equatorial Guinea, Omar Bongo in Gabon, or Jean-Bédél Bokassa in the Central African Republic. Particularly curious is the way in which the fall of a bad leader only leads to the rise of another. The coup of Amin, for instance, was initially popular given that it was at the expense of the increasingly authoritarian regime of Milton Obote. The same was true of the rise of the Derg and Mengistu in Ethiopia after they had ejected the tottering monarchy of Haile Selassie from power, and even perhaps the victory of Charles Taylor in Liberia at the expense of the regime of Samuel Doe (which itself had initially been popular for ending the hundred-year rule of the True Whig Party). Many other examples come to mind, such as the replacement of Kaunda in Zambia by Frederick Chiluba. The Congo has suffered the most amazing run of bad leaders from Leopold II, through Patrice Lumumba, Joseph Mobutu and then Laurant Kabila. Amin turned out to be worse than Obote,

Mengistu at least as bad as the Solomonic Dynasty he replaced, and Chiluba was as corrupt as Kaunda.

Just as one would have thought that replacing governing elites in Bolivia would have led to real change in institutions and policies, one might have thought that removing terrible leaders in Africa would have led to improvements. Following Acemoglu and Robinson (2007b) I now argue that in fact it is not a coincidence that the Belgian colonial state was ousted by Patrice Lumumba, who was himself ousted by Joseph Mobutu..

The idea is as follows: There are three sorts of leaders: bad ones and two sorts of good ones. Bad ones ruin the economy and can be unscrupulous in the sense that they are prepared to use violence, coercion, etc., to stay in power. Good leaders always lead to better economic outcomes, but may or may not behave unscrupulously. You can think of good ones as being public spirited in the sense that they choose institutions that promote economic development. Whether or not leaders are good can only be determined by having them in power and seeing what happens to the economy.

Consider an equilibrium where, in the past, leaders and potential leaders were able to signal that they can play unscrupulously. Thus citizens know that if a leader cannot play unscrupulously he must be good. However, to get rid of a bad and unscrupulous incumbent it may be advantageous to *fight fire with fire*, meaning you may have to back a leader who can be as unscrupulous, because such a person will have an advantage in removing the incumbent. Even though an unscrupulous challenger may have a high risk of being bad, he has a better chance of unseating the incumbent than an obviously good type who is unable to behave unscrupulously. One way of thinking about this to ask yourself the question: Do you back Nelson Mandela or Mahatma Gandhi? Gandhi was incapable of being unscrupulous and he urged a particular non-violent strategy for getting rid of the British imperial state in India. Mandela, on the other hand, was quite happy to promote armed struggle to get rid of the apartheid regime and was prepared to do what it took to achieve his political goals. In the end, Mandela turned out to be a good type who played an enormous role in promoting the stability and development of South Africa. The argument here is simply that *ex ante* it was more likely that Mandela was a bad type than it was that Gandhi was a bad type. Though Mandela may have turned out to be good, an interesting contrast is provided by the situation north of the Limpopo river. The citizens of Zimbabwe backed another unscrupulous type, Robert Mugabe, because of his advantage in getting rid of the unscrupulous incumbent regime of Ian Smith. Unfortunately, *ex post* Mugabe turned out to be a bad type with dire consequences for the economic institutions and performance of Zimbabwe.

These simple ideas provide another mechanism by which the political equilibrium may be path dependence. It may be rational for citizens to fight fire with fire, even though with some probability the challenger they back will turn out to be bad once in office.

4. How Do Institutions Change Over Time?

There seem to be strong mechanisms of persistence at work in social systems, even if change is also ubiquitous. I think this explains why patterns of underdevelopment are so persistent and policy advice/intervention is often so fruitless. But we also observe important transitions in institutions toward equilibria that lead to better economic performance and higher welfare. Institutional change will arise if there is a real change in the political equilibrium—in the distribution of power in society, for example, towards those with a vested interest in more socially desirable institutions. Change can also happen when the parameters of the system alter in a way which leads the interests of those in power to change.

To give a tangible example of the forces leading to institutional change, let me return to the U.S. South. Starting in the 1940s the income per-capita of the U.S. South began to converge very rapidly with the U.S. average. This period saw the end of the isolation of the labor market. It saw

the abolition of institutionalized racial discrimination in labor markets and social life, and the re-enfranchisement of blacks culminating in the Voting Rights Act of 1965 (see Wright, 1999, for an overview).

These changes were driven by a number of interacting forces, which both changed the ability and the incentive of Southern elites to maintain the previous system. The ability of whites to continue with the institutions which had been in effect since the late nineteenth century was severely undermined by the fact that blacks in South finally solved the collective action problem (McAdam, 1983). The civil rights movement made much of the previous system unenforceable. Black collective action was facilitated by the intervention of the federal government. At the same time, white ability and incentive to continue to repress labor grew less. Starting in the 1940s there had been a huge emigration of blacks from the South, which could no longer be controlled. At the same time technological change, particularly the mechanization of cotton picking (Heinicke, 1994) made it far less important to repress labor.

There was real change therefore in the political equilibrium in the South, which led to much better economic institutions. The old economy based on extracting rents from the blacks crumbled, along with all the negative externalities it had for other parts of the economy. No new elite arose to carry on repressing black labor using different instruments, nor did the situation turn around, with blacks extracting rents from whites. This may have been because of the technological changes taking place at the same time, but more likely it was because the South is embedded in a larger economy with well functioning institutions. This feature of the South may have considerably raised the opportunity cost of having bad economic institutions and is something which obviously differentiates it from Bolivia or the Congo.

In conclusion, then, real change in institutions can come when changes in state variables or structural parameters influence the costs and benefits of different sets of institutions, and thus cause a change of interests, or when there is a change in the distribution of political power. These changes are often endogenous to the system, though as I have mentioned, external factors like colonialism or globalization have no doubt shaped institutions. The analysis does not suggest however that different types of shocks have unambiguous implications for institutions. For example, it will be futile to show that globalization is either good or bad for institutions. That may depend on the context, the factor endowments and opportunities of the society, which incentives it changes and which groups it strengthens or weakens.

In principle, policy interventions promoted by economists and by external entities such as the World Bank can lead to sustained institutional reform by working on any of these margins. In practice however, most such attempts seem to have little impact on the institutions of society because they do little to disrupt the distribution of power, and leaders can substitute one instrument for another that has been “reformed.” We are still far from having a convincing framework that will help us understand how to change the political economy equilibrium of a society. In addition, simplistic analysis of policy reform without taking into account the incentives of the reformers is unlikely to be very productive. Though the government of the U.S. is currently very enthusiastic about promoting democratic reform, this was not the case when it was encouraging coups against democratically elected governments it did not like, in Guatemala and Iran in the 1950s or Chile in the 1970s. The recent experience with the democratic election of a Hamas government in Palestine shows that enthusiasm for democracy is conditional on who wins elections. Though institutions like the World Bank do not have such explicit political agendas, they are also complex bureaucracies whose practical objective cannot simply be assumed to be that of maximizing the welfare of citizens in poor countries.

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