
International Studies & AAE 374
Growth and Development of Nations

Lecture 24
3 December 2009

I. Institutions Overview

Commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payments of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government.

Adam Smith, *Wealth of Nations*

A. Opening Discussion Questions

1. When did Adam Smith write the *Wealth of Nations*?
2. What was happening in England at the time?
3. What does this quote have to do with “institutions”?

B. What do we mean by “institutions”?

1. Definition from Wikipedia:

Institutions are [structures](#) and [mechanisms](#) of [social order](#) and [cooperation](#) governing the [behavior](#) of two or more [individuals](#). Institutions are identified with a [social purpose](#) and permanence, transcending individual [human](#) lives and intentions, and with the making and enforcing of rules governing cooperative human behavior. The term, institution, is commonly applied to customs and behavior patterns important to a [society](#), as well as to particular formal organizations of [government](#) and [public service](#). As structures and mechanisms of social order among humans, institutions are one of the principal objects of study in the [social sciences](#), including [sociology](#), [political science](#) and [economics](#). Institutions are a central concern for [law](#), the formal regime for political rule-making and enforcement. The creation and evolution of institutions is a primary topic for [history](#).

2. Sokoloff and Engerman discuss:

- Security of property rights
- Prevalence of corruption
- Structures of the financial sector
- Investment in public infrastructure (roads, schools) and social capital
- Inclination toward working hard or to be entrepreneurial

- Democratic decision-making (broad or narrow franchise)
3. Rodrik et al discuss:
 - Role of property rights, rule of law
 - As an instrument “European Settler mortality” (more on that Wednesday) or Fraction of developing country (former colonies) speaking European language, fraction speaking English.
 4. Other dimensions of institutions?
 - Freedom of association (unions, cooperatives, religion)
 - Freedom of speech (including media)?
 - Guaranteed human rights
- C. Why do you think institutions matter to growth?
1. Savings and investment of physical capital?
 2. Investment in human capital?
 3. Technological innovation?
 4. Technological change
- D. Are Institutions the deeper driver of growth?
1. Douglas North (Nobel Prize Winner) argued so but with narrow vision of institutions.
 2. WI school of institutional economics (John R. Commons, Kenneth Parsons ([http://www.secfac.wisc.edu/senate/1999/1101/1460\(mem_res\).pdf](http://www.secfac.wisc.edu/senate/1999/1101/1460(mem_res).pdf)), Dan Bromley, Michael Carter)
 3. Lots of attention now in economics

II. *Inequality and Institutions Linkage - Engerman and Sokoloff*

A. Basic Argument

WHAT IS IT?

1. Differential paths of development in the societies of the New World (N and S America), especially since the 19th century is rooted in:
 - factor endowments (soils, minerals, crop characteristics, settlement patterns),
 - inequality (how rights to those land mineral endowments were distributed), and
 - institutions that formed out of those activities and ownership patterns, and
 - the patterns of industrialization. (see p. 42-44, and 95).
2. Specifically, the domination of Europeans in the New World at the beginning of the 16th century combined with profit maximizing incentives used to structure organization of production faced different circumstances (i.e., factor endowments) in different colonies.
 - Some areas most profitable option was crops with economies of scale (cotton and sugar), while in others mining was best option.
 - A 3rd category of colonies was best suited to grow crops that required smallholder production, such as grain.

- Places with scale economies (sugar, tobacco, and cotton plantations) or economic rents (mining), Europeans set up very unequal systems, with economic and political power concentrated in the hands of a few white slave owners. Think here of the Caribbean or indigenous peoples working in mines of Bolivia and Peru.
- In places without scale economies, grain was best farmed by smallholders and land was abundant, so the methods of production and social system were egalitarian.

3. Economic equality or inequality and institutions that formed along with those features were mutually reinforcing, and they led to divergent paths of institutional and economic development.

- Institutions, such as public education, democratic decision-making, and ... went along with equality, and elitist institutions went with the inequality elsewhere.
- In 19th century, industrialization arose in the places with greater economic and political equality, while it did not in the others.
- Up until this time, there were not discernible differences between the levels of GDP/capita in the region. With industrialization in US and Canada comes divergence with the rest of the hemisphere.
- These historical paths of institutional and economic development help to explain current differences between U.S, Canada, Australia, and most of Latin America.

B. More detail on Factor Endowments and the Colonial Economy

1. New World colonies were critical to European powers efforts to improve their national position. Major strategy for European countries in the 16th and 17th centuries was claiming and exploiting colonies to their advantage (note the dependency idea here).
2. 3 basic types of colonies that emerged in the New World.
 - a.) Colonies with climates and soils that were well suited for the production of sugar and other highly valued crops (tobacco, cotton) characterized by extensive scale economies associated with the use of slaves. Most of the sugar colonies were in the Caribbean (Barbados, Cuba, D.R.) but also in South America, mainly NE Brazil. Specialized in the production of these crops, and came to be dominated by large slave plantations with slaves of African descent. Led to societies with very unequal distributions of wealth and human capital, and even among the free population there was much greater inequality than on the North American mainland (north).
 - b.) Spanish colonies, such as Mexico, Peru, Bolivia, which were characterized by a substantial native population that survived contact with the European colonizers and by the distribution among a privileged few to enormous

blocs of land, mineral resources, and controlled labor. Took advantage of existing tribute systems to establish large-scale estates and mines. For different reasons than sugar colonies, this group also ended up with very unequal distributions of wealth and very different political rights. Silver and gold were the main initial exports, but this system endured as the economies in many parts came to be dominated by agriculture.



c.) North American mainland, Northern U.S. and Canada. Endowments here included neither an available labor force (Native Americans had moved west at first), nor a climate and soils with a comparative advantage in the production of crops characterized by economies of scale. Growth and development was thus based on laborers of European descent who had similar, relatively high levels of human capital. Family farm agriculture was predominant, and no efforts to establish large estate dominated systems worked. Sees the Southern US as an intermediate case between Northern US and a.) above.

d.) Few “inbetweeners” colonies included Argentina, Uruguay, SE Brazil. E&S discuss Argentina case.

3. Empirical Evidence:

a. Labor supply: Major problem was labor supply available to take advantage of the abundant natural resources available in the New World. This constraint led Spanish to focus their efforts in regions with largest concentrations of native populations (Mexico, Guatemala, Peru, Bolivia).

Look at the extensive and unprecedented flow of migrants, especially African slaves (testimony to the predominance of economic motives). Slaves were used in colonies of all the major European powers (only the Spanish and British drew < 2/3 of their pre-1760 immigrants from Africa. Nearly 90% in Dutch and French, and 70% in Portuguese colonies were slaves.

- b. Labor flows prior to 1760 were dominated by migration (especially of slaves) to colonies that specialized in sugar, tobacco, coffee, and other staple crops (not grains).

4. Flow of migrants into the region underwent several major changes.

- a. Growing share of slave labor
- b. Share of migrants to Spanish colonies declined – tightening of restrictions.
- c. Growing share of European immigrants prior to 1760 in colonies that specialized in sugar, tobacco, and cotton. More attractive to Europeans than Northern US and Canada because of high returns to be earned there.

C. The Role of Institutions in the Persistence of Inequality

Basic Argument: Initial conditions were reinforced by the institutions that supported them. Societies with extreme inequality led by elites inclined to establish political systems and institutions which protected their power. The opposite proves to be true in societies that began with greater equality in wealth and human capital.

Empirical Evidence:

- 1. Tight migration policies of Spain vs Loose ones of British. After independence in 1820s, LA countries loosened up European immigration policies, but perhaps too little too late as industrialization in N America made that area more attractive (Argentina would be an exception here).
- 2. Land policy: U.S. land policy made land widely available (1762 Homestead Act was the culmination of a broad access land policy. Canada pursued similar policies. Similar Argentinean and Brazilian policies in late 19th century were insufficient to overcome two centuries of restrictive land policies. Mexico, by contrast, pursued policies of moving land held by Native Americans into the hands of non-Native Americans.
- 3. Franchise to vote limited to males throughout but much broader in US and Canada than elsewhere (Table 2). Did away much sooner with wealth and literacy requirements.
- 4. Other main avenue for search regarding feedback between inequality or equality and institutional outcomes is in the area of schooling (Table 3). Again, US and Canada lead the way. Common school movement in US from the early 1800s. Nearly every northern state in the US enacted laws between 1825 and 1850 that strongly encouraged or required localities to establish free schools open to all children and supported by general taxes. Very high literacy rates from early 19th century on vs low literacy rates

- well into the 20th century in the rest of the Americas. Even the most progressive LA countries were a century behind the US and Canada.
5. Bank and capital formation

D. The Extent of Inequality and the Timing of Industrialization

Basic Argument: Big Push vs Decentralized technological progress and synergies. They argue for the latter that the patterns of growth and industrialization in the US in the late 19th century reflect a broad pattern of incremental improvements in technological productivity that were made possible by the broad access to opportunity in a more equal society.

III. Implications of their Argument for Understanding Ag & Nat Resources and Latin American Economic Development

- A. Inequality in land distribution or control over resources fundamental to understanding institutional shortcomings, later industrialization, and slow growth including unequal human capital and inequality outcomes.
- B. Historical roots of Latin American social and economic challenges run very deep and are rooted in the distributional and institutional patterns established from colonial times till the 20th century.
- C. Charts below provide some evidence on these issues.

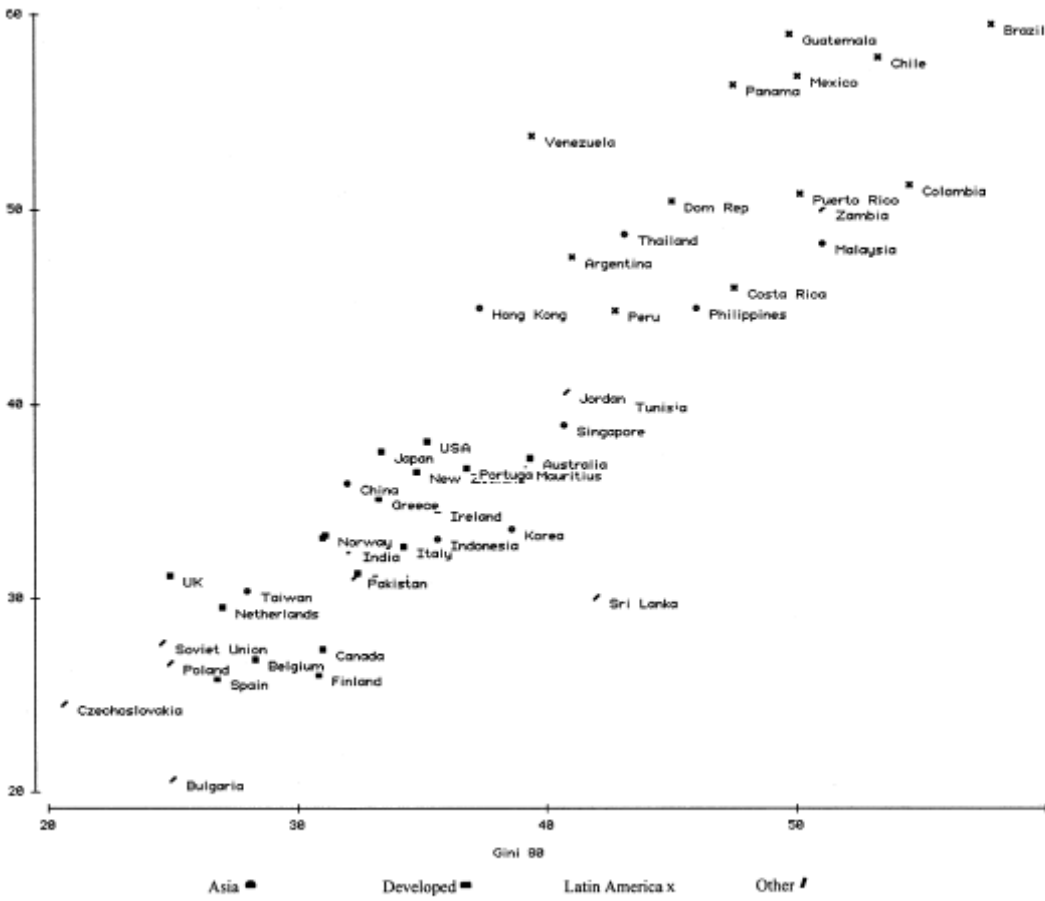
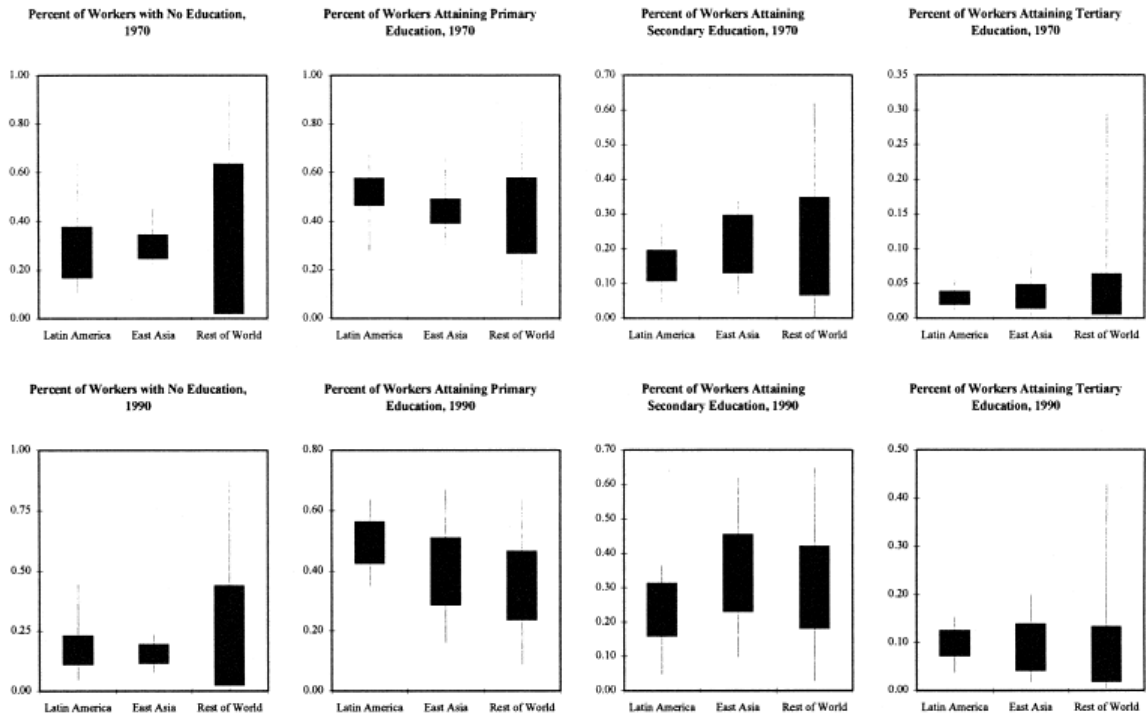


Fig. 1. Gini coefficients, 1990 vs. 1980 (Deininger and Squire, 1996).



Each boxplot extends from the minimum to the maximum observation. The shaded rectangle on each plot highlights the interquartile range (i.e. 25th through 75th percentile).

Fig. 2. Boxplots of world capital, cropland and forestland endowments, 1970–1990 (Maskus, 1991).

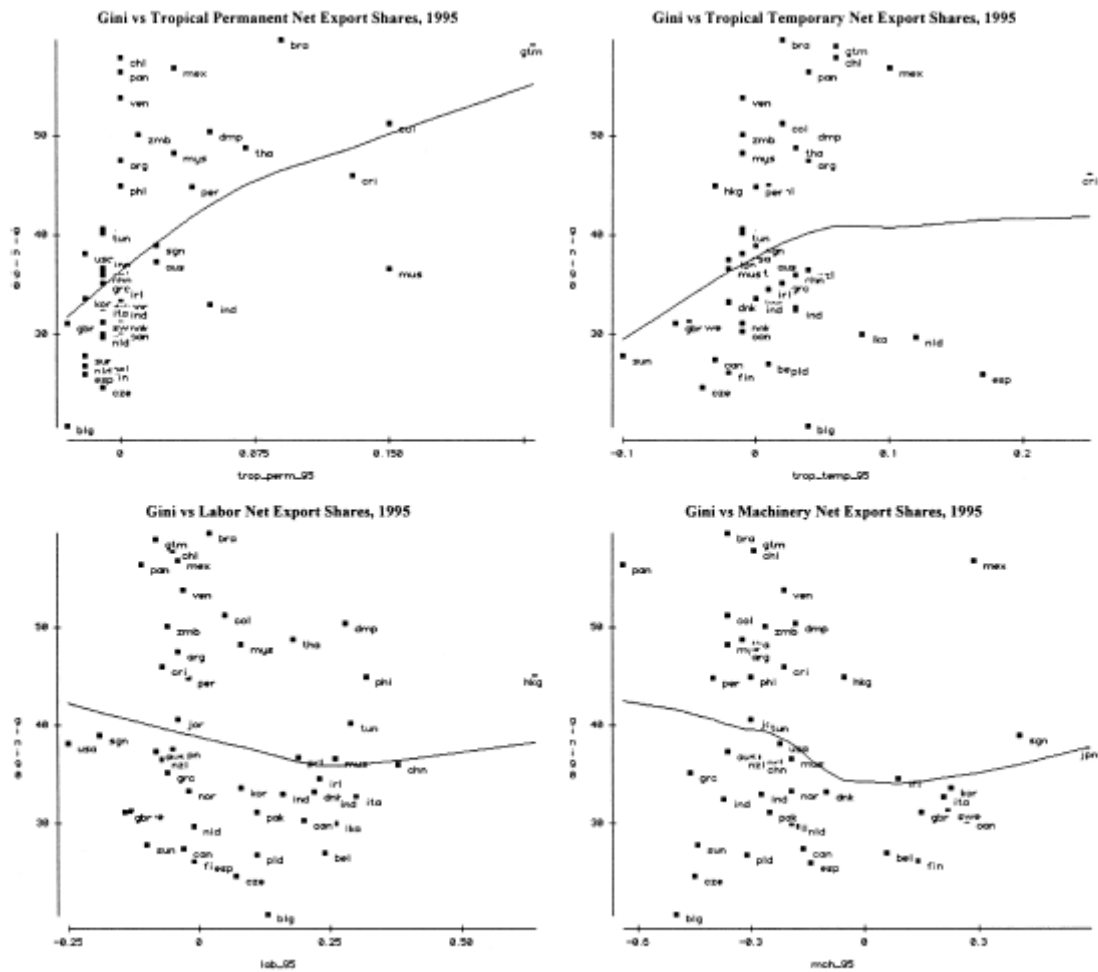


Fig. 5. 1990 Gini's vs. select 1995 net export shares (each plot is fitted with a non-parametric Lowess smoother).

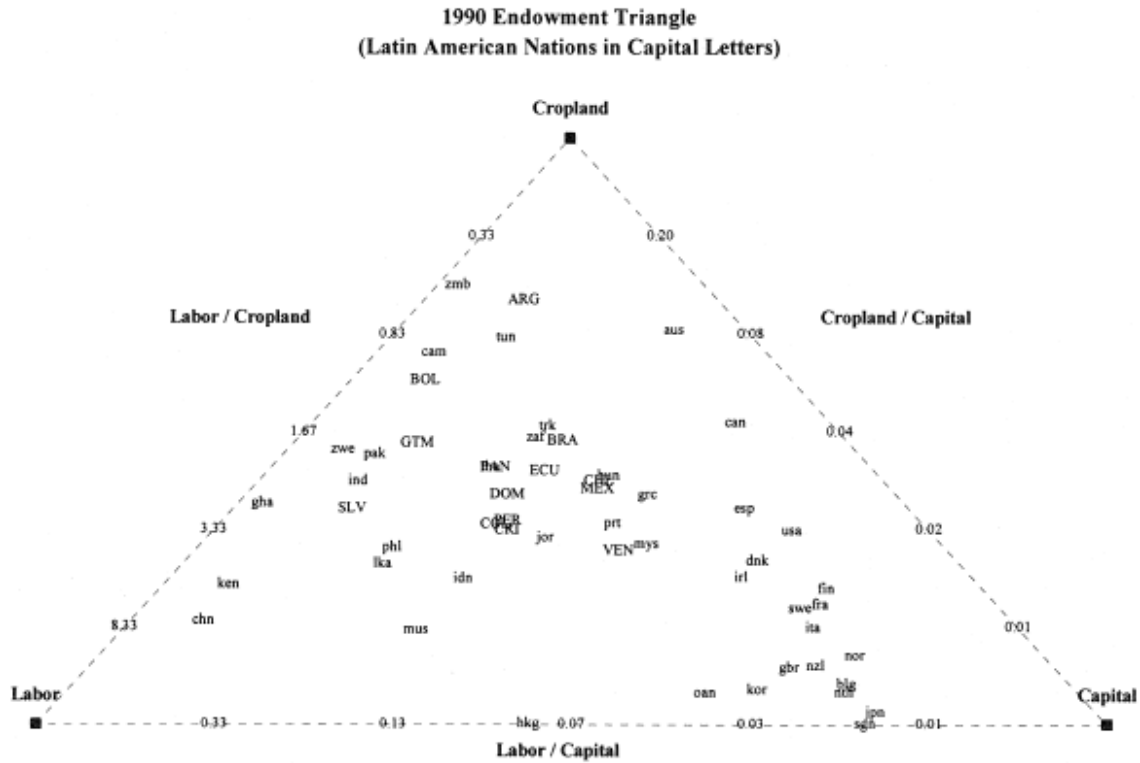


Fig. 6. 1990 Endowment triangle (Latin America in capital letters).

Further Discussion Questions:

1. S&E make an argument for persistent and long-term effects of inequality in institutions. Can you give some current examples from countries that you have studied or spent time in?
2. S&E make an argument that endowments help to shape institutions and in the longer run comparative advantage. Can you reflect on some examples?

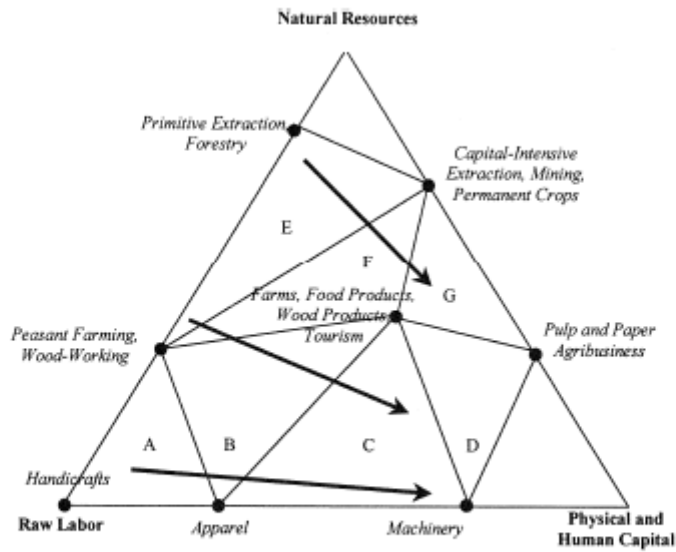


Fig. 8. Natural resource development paths.