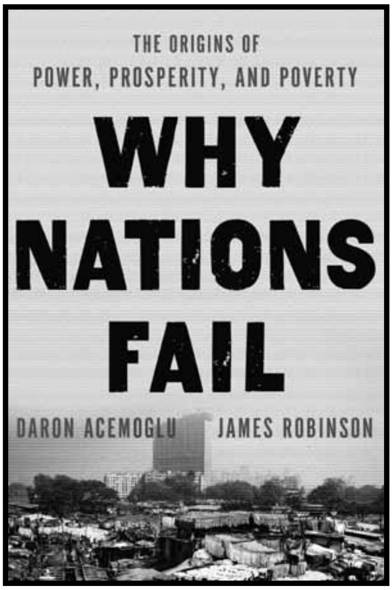
Why Nations Fail

BY DARON ACEMOGLU
AND JAMES A. ROBINSON

Nobel laureates (George Akerlof, Ken Arrow, Gary Becker, Peter Diamond, Robert Solow) have been lining up to blurb *Why Nations Fail* – and for good reason. This new book by Daron Acemoglu (MIT economist) and James A. Robinson (Harvard political scientist) is an audacious attempt to explain why the economic and political fortunes of similarly endowed countries diverge so dramatically. It integrates the best of economics, history and political theory to build a simple yet powerful model, a one-size-fits-most explanation for success and failure on a grand scale. And did I mention that *Why…* is anecdote rich and easily accessible to non-specialists? Here, we offer a first taste free; you'll be back for more.



— *Peter Passell*

In the summer of 1945, as the Second World War was drawing to a close, the Japanese colony in Korea began to collapse. Within a month of Japan's unconditional surrender in August, Korea was divided at the 38th parallel into two spheres of influence. The South was administered by the United States. The North, by Russia.

The uneasy peace of the cold war was shattered in June 1950 when the North Korean army invaded the South. Though initially the North Koreans made large inroads, capturing the capital city, Seoul, by the autumn they were in full retreat. It was then that Hwang Pyong-Won and his brother were separated. Hwang Pyong-Won managed to hide and avoid being drafted into the North Korean army. He stayed in the South and worked as a pharmacist. His brother, a doctor working in Seoul treating wounded soldiers from the South Korean army, was taken north as the North Korean army retreated. Dragged apart in 1950, the Hwang brothers met again in 2000 in Seoul for the first time in 50 years, after the two governments finally agreed to initiate a limited program of family reunification.

As a doctor, Hwang Pyong-Won's brother had ended up working for the air force, a good job in a military dictatorship. But even those with privileges in North Korea don't do that well. When the brothers met, Hwang Pyong-Won asked about how life was north of the 38th parallel. He had a car, but his brother didn't. "Do you have a telephone?" he asked his brother. "No," said his brother. "My daughter, who works at the Foreign Ministry, has a phone, but if you don't know the code you can't call."

Hwang Pyong-Won recalled how all the people from the North at the reunion were asking for money, so he offered some to his brother. But his brother said, "If I go back with money the government will say, 'Give that money to us,' so keep it."

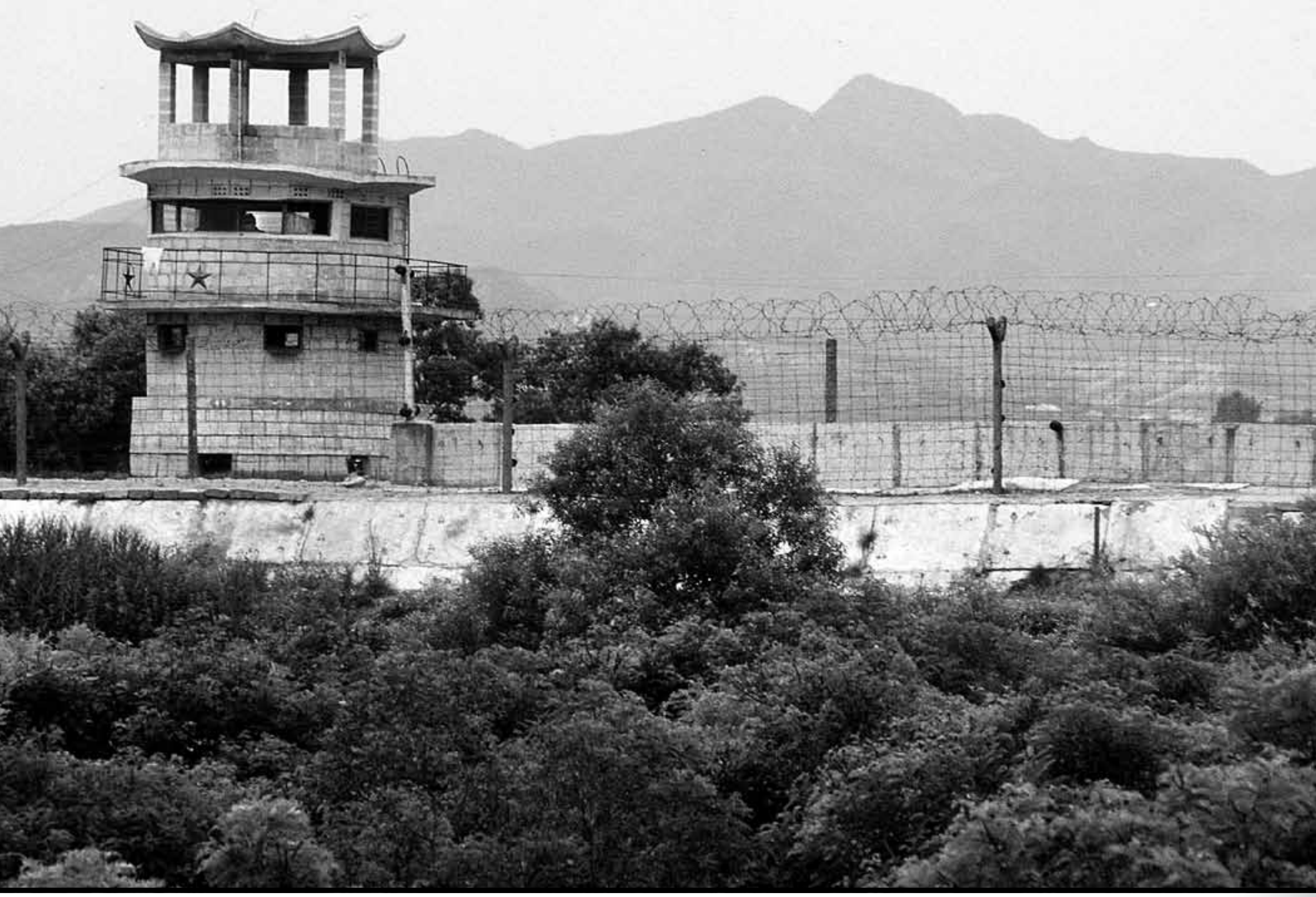
Hwang Pyong-Won noticed his brother's coat was threadbare: "Take off that coat and leave it, and when you go back wear this one," he suggested. "I can't do that," his brother replied. "This is just borrowed from the government to come here." Hwang Pyong-Won recalled how, when they parted, his brother was ill at ease and always nervous as though someone were listening.

He was poorer than Hwang Pyong-Won imagined. His brother said he lived well, but Hwang Pyong-Won thought he looked awful and was thin as a rake.

The people of South Korea have living standards similar to those of Portugal and Spain. To the north, in the so-called Democratic People's Republic of Korea, living standards are akin to those of a sub-Saharan African country, about one-tenth of average living standards in South Korea. The health of North Koreans is in an even worse state; average North Koreans can expect to live 10 years less than their cousins south of the 38th parallel.

These striking differences are not ancient. In fact, they did not exist prior to the end of the Second World War. But after 1945, the different governments in the north and the south adopted very different ways of organizing their economies.

South Korea was led, and its early economic and political institutions were shaped, by the Harvard- and Princeton-educated,



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staunchly anti-communist Syngman Rhee, with significant support from the United States. Rhee was elected president in 1948. Forged in the midst of the Korean War and against the threat of communism spreading south of the 38th parallel, South Korea was no democracy.

Both Rhee and his equally famous successor, General Park Chung-Hee, secured their places in history as authoritarian presidents. But both governed a market economy where private property was recognized. And after 1961, Park effectively threw the weight of the state behind rapid economic growth, channeling credit and subsidies to firms that were successful.

The situation north of the 38th parallel was different. Kim Il-Sung, a leader of anti-Japanese communist partisans during the Second World War, established himself as dictator by 1947 and, with the help of the Soviet Union, introduced a rigid form of central planning as part of the so-called *Juche* system. Private property was outlawed, and markets were banned. Freedoms were curtailed not only in the marketplace, but in every sphere of North Koreans' lives – except for those who happened to be part of the very small ruling elite around Kim Il-Sung and, later, his son and successor Kim Jong-Il.

It should not surprise us that the economic fortunes of South and North Korea diverged sharply. Kim Il-Sung's command economy soon proved to be a disaster. Detailed statistics are not released by North Korea, which is a secretive state to say the least. Nonetheless,

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available evidence confirms what we know from the all-too-often recurring famines: not only did industrial production fail to take off, but North Korea, in fact, experienced a collapse in agricultural productivity.

Lack of private property meant that few people had incentives to invest or to exert effort to increase or even maintain productivity. The stifling, repressive regime was inimical to innovation and the adoption of new technologies. But Kim Il-Sung, Kim Jong-Il and their cronies had no intention of reforming the system, or introducing private property, markets or private contracts, or changing economic and political institutions. North Korea continues to stagnate economically.

Meanwhile, in the south, economic institutions encouraged investment and trade. South Korean politicians invested in education, achieving high rates of literacy and schooling. South Korean companies were quick to take advantage of the relatively educated population, as well as policies encouraging investment and industrialization, exports, and the transfer of technology. South Korea quickly became one of East Asia's "miracle economies," one of the most rapidly growing in the world.

By the late 1990s, in just about half a century, South Korean growth and North Korean stagnation led to a ten-fold gap between the two halves of this once-united country – imagine what a difference a couple of centuries could make. The economic disaster of North Korea, when placed against the South Korean economic success, is striking: neither culture nor geography nor ignorance can explain the divergent paths of North and South Korea. We have to look to institutions for an answer.

EXTRACTIVE AND INCLUSIVE ECONOMIC INSTITUTIONS

Countries differ in their economic success because of their different institutions – the rules influencing how the economy works, and the incentives that motivate people. Imagine teenagers in North and South Korea, and what they expect from life. Those in the North grow up in poverty, without entrepreneurial initiative, creativity or adequate education to prepare them for skilled work. Much of the education they do receive is pure propaganda, meant to shore up the legitimacy of the regime; there are few books, let alone computers. After finishing school, everyone has to go into the army for ten years.

These teenagers know that they will not be able to own property, start a business or become more prosperous even if many people engage illegally in private economic activities to make a living. They also know that they will not have legal access to markets where they can use their skills or their earnings to purchase the goods they desire. They are even unsure about what human rights they will enjoy.

Those in the south obtain a good education, and face incentives that encourage them to exert effort and excel in their chosen vocation. South Korea is a market economy, built on private property. South Korean teenagers know that, if successful as entrepreneurs or workers, they can one day enjoy the fruits of their investments and efforts; they can improve their living standard, buying cars, houses and health care.

In the south the state supports economic activity. So it is possible for entrepreneurs to borrow money from banks and financial markets, for foreign companies to enter into partnerships with South Korean firms, for individuals to obtain mortgages to buy houses. In the south, by and large, you are free to open any business you like. In the north, you are not. In the south, you can hire workers, sell your products or services and spend your money in the marketplace in whichever way you want. In the north, there are only black markets.

These different rules are the institutions under which North and South Koreans live. Inclusive economic institutions, such as those in South Korea or in the United States, are the ones that encourage participation by the great mass of people in economic activities that make best use of their talents and skills and that enable individuals to make their own choices. To be inclusive, economic institutions must feature secure private property, an unbiased system of law, and public services that provide a level playing field in which people can exchange and contract. They must also permit the entry of new businesses and allow people to choose their careers.

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The contrast between South and North Korea (and, as outlined in another chapter, between the United States and Latin America) illustrates a general principle. Inclusive economic institutions foster economic activity, productivity growth and prosperity. Secure private property rights are central, since only those with such rights will be willing to invest and increase productivity. A businessman who expects his output to be stolen, expropriated or entirely taxed away will have little incentive to work, let alone an incentive to undertake investment and innovation.

But such rights must exist for the majority of people in society. In 1680 the English government conducted a census of the population of its West Indian colony of Barbados. The census revealed that, of the total population on the island of around 60,000, almost 39,000 were African slaves who were the property of the remaining one-third of the population. Indeed, they were mostly the property of the largest 175 sugar planters, who also owned most of the land.

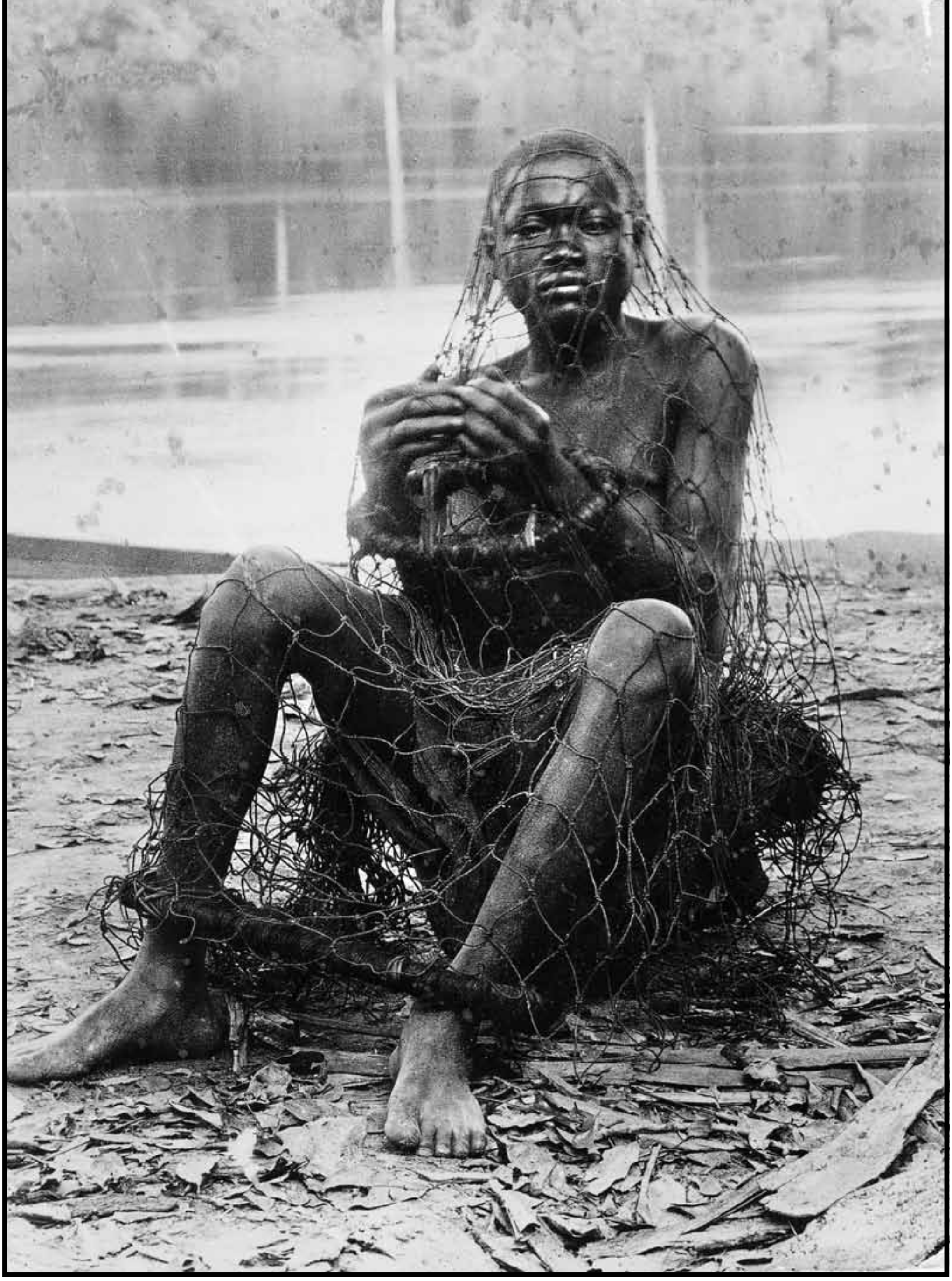
Markets in slaves were, in fact, a part of the economic institutions systematically coercing the majority of the population and robbing them of the right to choose their occupations and how they should utilize their talents.

These large planters had secure, enforceable property rights over their land and even over their slaves. If one planter wanted to sell slaves to another, he could do so and expect a court to enforce the sale or any other contract he wrote. Why? Of the 40 judges and justices of the peace on the island, 29 of them were large planters. Also, the eight most senior military officials were all large planters.

Despite well-defined, secure property rights and contracts for the island's elite, Barbados did not have inclusive economic institutions, since two-thirds of the population were slaves with no access to education or economic opportunities, and no incentives to use their talents or skills. Inclusive economic institutions require secure property rights and economic opportunities, not just for the elite, but for a broad cross-section of society. Secure property rights, the law, public services and the freedom to contract and exchange all rely on the state, the institution with the coercive capacity to impose order, to prevent theft and fraud, and to enforce private contracts.

To function well, society also needs other public services: roads and a transport network so that goods can be moved, a public infrastructure so that economic activity can flourish, and some type of basic regulation to prevent fraud and malfeasance. Though many of these public services can be provided by markets and private citizens, the degree of coordination necessary to do so on a large scale often eludes all but a central authority. The state is thus inexorably intertwined with economic institutions as the enforcer of law and order, private property and contracts, and often as a key provider of public services. Inclusive economic institutions need and use the state.

The economic institutions of North Korea or of colonial Latin America do not have these properties. Private property is nonexistent in North Korea. In colonial Latin America there was private property for Spaniards, but the property of the indigenous peoples was highly insecure. In neither society were



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the great majority of people able to make independent economic decisions; they were subject to mass coercion.

In neither society was the power of the state used to provide critical public services that promoted prosperity. In North Korea, the state built an education system to inculcate propaganda, but was unable to prevent famine. In colonial Latin America, the state focused on coercing indigenous peoples. In neither society was there a level playing field or an unbiased legal system. In North Korea, the legal system is an arm of the ruling Communist Party, and in Latin America it was a tool of discrimination against general population. We call such institutions, which have opposite properties to those we call inclusive, "extractive" economic institutions – extractive because such institutions are designed to extract income and wealth from one portion of society to benefit a different portion.

ENGINES OF PROSPERITY

Inclusive economic institutions create inclusive markets, which not only give people freedom to pursue the vocations in life that best suit their talents but also provide a level playing field that gives them the opportunity to do so. Those who have good ideas will be able to start businesses, workers will choose activities in which their productivity is greatest, and less efficient firms can be replaced by more efficient ones. Contrast how people choose their occupations under inclusive markets with colonial Peru and Bolivia, where many were forced to work in silver and mercury mines, regardless of their skills or wishes. Inclusive markets are not just free markets.

Barbados in the 17th century also had markets. But in the same way that it lacked property rights for all but the narrow planter elite, its markets were far from inclusive; markets in slaves were, in fact, a part of the economic institutions systematically coercing the majority of the population and robbing them of the right to choose their occupations and how they should utilize their talents.

Inclusive economic institutions also pave the way for two other engines of prosperity: technology and education. Sustained economic growth is almost always accompanied by technological improvements that enable people (labor), land and existing capital (buildings, existing machines and so on) to become more productive. Think of our great-great-grandparents who, just over a century ago, did not have access to planes or automobiles or most of the advanced health care we now take for granted – not to mention indoor plumbing, air-conditioning, shopping malls, radio or motion pictures, let alone information technology, robotics or computer-controlled machinery. And going back a few more generations, technological know-how and living standards were even more backward – so much so that we would find it hard to imagine how most people struggled through life.

All economic institutions are created by society. Politics is the process by which a society chooses the rules that will govern it. When there is conflict over institutions, what happens depends on which people or groups win out in the game of politics.

These improvements follow from science and from the efforts of entrepreneurs such as Thomas Edison, who applied science to create profitable businesses. This process of innovation is made possible by economic institutions that encourage private property, uphold contracts, create a level playing field, and encourage the creation of new businesses that can bring new technologies to life. It should therefore be no surprise that it was the United States, not Mexico or Peru, that produced Thomas Edison, and that it was South Korea, not North Korea, that today produces technologically innovative companies such as Samsung and Hyundai.

Intimately linked to technology are the skills of the work force acquired in schools, at home and on the job. We are so much more productive than a century ago – not just because of better technology embodied in machines but because of the greater know-how that workers possess. All the technology in the world would be of little use without workers who knew how to use it.

But there is more to skills than just the ability to run machines. The education of the work force generates the scientific knowledge upon which progress is built. Many of the innovators of the Industrial Revolution and afterward, like Thomas Edison, were not highly educated, but these innovations were much simpler than technologies being produced now. Today, technological change requires education both for the innovator and the worker. And here we see the importance of economic institutions that create a level playing field.

The United States could produce (or attract from foreign lands) the likes of Bill Gates, Steve Jobs, Sergey Brin, Larry Page and Jeff Bezos, and the hundreds of scientists who made fundamental discoveries in information technology, nuclear power, biotech and other fields upon which these entrepreneurs built their businesses. The supply of talent was there to be harnessed because most teenagers in the United States have access to as much schooling as they wish. Now imagine a different society – for example the Congo or Haiti, where a large fraction of the population has no means of attending school, or where, if they manage to go to school, the quality of teaching is lamentable, where teachers do not show up for work, and even if they do, there may be no books.

The low education level of poor countries is a product of economic institutions that fail to create incentives for parents to send their children to school, and by political institutions that fail to induce the government to build and support schools that meet the needs of parents and children. These nations pay a high price for the inadequate education of their population and the lack of inclusive markets. They fail to mobilize their nascent talent. They have many potential Bill Gateses and perhaps an Albert Einstein or two who are now working as poor, uneducated farmers, coerced to do what they don't want to do or drafted into the army because they never had the opportunity to realize their life vocations.

The ability of economic institutions to harness the potential of inclusive markets, encourage technological innovation, invest in people and mobilize the talents of a large number of individuals is critical for economic growth. Explaining why so many economic institutions fail to meet these simple objectives is the central challenge of this book.

EXTRACTIVE AND INCLUSIVE POLITICAL INSTITUTIONS

All economic institutions are created by society. Those of North Korea, for example, were forced on its citizens by the communists who took over the country in the 1940s, while those of colonial Latin America were imposed by the Spanish conquistadors. South Korea ended up with very different economic institutions than North Korea because different people with different interests and objectives made the decisions about how to structure society. In other words, South Korea had different politics.

Politics is the process by which a society chooses the rules that govern it. Politics surrounds institutions for the simple reason that, while inclusive institutions may be good for the economic prosperity of a nation, some people or groups, such as the elite of the Communist Party of North Korea or the sugar planters of colonial Barbados, will be much better off with institutions that are extractive in nature.

When there is conflict over institutions, the resolution depends on which people or groups win out in the game of politics – who can get more support, obtain additional resources and form more effective alliances. In short, who wins depends on the distribution of political power in society.

The political institutions of a society are a key determinant of the outcome of this game. They are the rules that govern incentives in politics. They determine how the government is chosen and which part of the government has the right to do what. Political institutions determine who has power in society and to what ends that power will be used.

If the distribution of power is narrow and unconstrained, then the political institutions are absolutist, as exemplified by the monarchies reigning throughout the world during much of history. Under absolutist political institutions, such as those in North Korea and colonial Latin America, the individuals who wield this power are able to set up economic institutions to enrich themselves and to augment their power at the expense of society. In contrast, political institutions that distribute power broadly and subject it to constraints are pluralist in nature. Instead of being vested in a single individual or a narrow group, political power rests with a broad coalition or a plurality of groups.

There is obviously a close connection between pluralism and inclusive economic institutions. But the key to understanding why South Korea and the United States have inclusive economic institutions is not just their pluralist political institutions but also their sufficiently centralized and powerful states.

A telling contrast is with the East African nation of Somalia. Political power in Somalia has long been widely distributed – almost pluralistic. Indeed there is no real authority that can control or sanction what anyone does. Society is divided into deeply antagonistic clans that lack the clout to dominate one another. The power of one clan is constrained only by the guns of another. This distribution of power leads not to inclusive institutions but to chaos. And at the root of it is the Somali state's lack of central authority to enforce even minimal law and order, to support economic activity, trade or even to provide basic security to its citizens.

Max Weber [the late 19th-century sociologist] provided a widely accepted definition of the state, identifying it with the "monopoly of legitimate violence" in society. Without such a monopoly and the degree of centralization that it entails, the state cannot play its role as enforcer of law and order, let alone provide public services and regulate economic activity. When the state fails to achieve some degree of central authority, society sooner or later descends into chaos – as did Somalia.

We will refer to political institutions that are sufficiently centralized and pluralist as "inclusive" political institutions. When either of these conditions fails, we will refer to the institutions as extractive.

There is strong synergy between economic and political institutions. Extractive political institutions concentrate power in the hands of a narrow elite and place few constraints on the exercise of power. Economic institutions are then often structured by the elite to extract resources from the rest of the society. Extractive economic institutions thus naturally accompany extractive political institutions. In fact, they inherently depend on extractive political institutions for their survival.

By vesting power broadly, inclusive institutions tend to uproot economic institutions that expropriate the resources of the many, to erect entry barriers and to suppress the functioning of markets so that only a few benefit. In Barbados, for example, the plantation system based on the exploitation of slaves could not have survived without political institutions that excluded the slaves from the political process. The economic system impoverishing millions for the benefit of a tiny elite in North Korea would also be unthinkable without the total political domination of the communist party.

In Barbados and Latin America, the colonists were able to use their political power to impose economic institutions that made them huge fortunes at the expense of the rest of the population.

This synergy between extractive economic and political institutions creates a strong feedback loop: political institutions enable the elites controlling power to choose economic institutions with few constraints or opposing forces. They also enable the elites to structure political institutions and their evolution. Extractive economic institutions, in turn, enrich the same elites, and their economic wealth and power help to consolidate their political dominance.

In Barbados and Latin America, for example, the colonists were able to use their political power to impose economic institutions that made them huge fortunes at the expense of the rest of the population. The resources these economic institutions generated enabled these elites to build armies and police forces to defend their absolute monopolies over power. The implication, of course, is that extractive political and economic institutions support each other and tend to persist.

There is, in fact, more to the synergy between extractive economic and political institutions. When existing elites are challenged under extractive political institutions and the newcomers break through, the newcomers are likewise subject to few constraints. They thus have incentives to maintain these political institutions and create a similar set of economic institutions, as Porfirio Díaz and the elite surrounding him did at the end of the 19th century in Mexico.

Inclusive economic institutions, in turn, are forged on foundations laid by inclusive political institutions, which broadly distribute power and constrain its arbitrary exercise. These political institutions also make it harder for others to usurp power and to undermine the foundations of inclusive institutions. Those controlling political power cannot easily use it to set up extractive economic institutions for their own benefit. Inclusive economic institutions, in turn, create a more equitable distribution of resources, facilitating the persistence of inclusive political institutions.

It was not a coincidence that, once the Virginia Company [chartered in the early 17th century by King James I to settle a wedge of what is now the mid-Atlantic region] gave land and freedom from draconian contracts to the colonists it had previously tried to coerce, the General Assembly allowed the colonists to govern themselves. Economic rights without political rights would not have been trusted by the colonists, who had experienced the persistent efforts of the Virginia Company to coerce them. Neither would these economies have been stable and durable.

In fact, combinations of extractive and inclusive institutions are generally unstable. Extractive economic institutions under inclusive political institutions are unlikely to survive for long, as our discussion of Barbados suggests.

Similarly, inclusive economic institutions will neither support nor be supported by extractive political ones. Either they will be transformed into extractive economic institutions to the benefit of the narrow interests that hold power, or the economic dynamism they create will destabilize the extractive political institutions, opening the way for the emergence of inclusive political institutions. Inclusive economic institutions also tend to reduce the benefits the elites can enjoy by ruling over extractive political institutions since those institutions face competition in the marketplace and are constrained by the rights of the rest of society.

WHY NOT ALWAYS CHOOSE PROSPERITY?

Political and economic institutions, which are ultimately the choice of society, can be inclusive and encourage economic growth. Or they can be extractive and become impediments to economic growth. Nations fail when they have extractive economic institutions, supported by extractive political institutions that impede economic growth. This means that the choice of institutions – that is, the politics of institutions – is central to our quest for understanding the reasons for the success and failure of nations. We have to understand why the politics of some societies leads to inclusive institutions that foster economic growth, while the politics of the vast majority of societies throughout history has led to extractive institutions that hamper economic growth.

It might seem obvious that everyone should have an interest in creating the type of economic institutions that will bring prosperity. Wouldn't every citizen, every politician – even predatory dictators – want to make the country as wealthy as possible?

Consider the Kingdom of Kongo [the precolonial state in west central Africa]. Though this kingdom collapsed in the 17th century, it provided the name for the modern country that became independent from Belgian rule in 1960. As an independent polity, Congo experienced almost unbroken economic decline and mounting poverty under the rule of Joseph Mobutu between 1965 and 1997.

This decline continued after Mobutu was overthrown by Laurent Kabila. Mobutu created a highly extractive set of economic institutions. The citizens were impoverished, but Mobutu and the elite surrounding him, known as Les Grosses Legumes (the Big Vegetables), became fabulously wealthy. Mobutu built himself a palace at his birthplace, Gbadolite, in the north of the country, with an airport large enough to land a supersonic Concorde jet, a plane he frequently rented from Air France for travel to Europe. In Europe he bought castles and owned large tracts of the Belgian capital of Brussels.

Wouldn't it have been better for Mobutu to set up economic institutions that increased the wealth of the Congolese rather than deepening their poverty? If Mobutu had managed to increase the prosperity of his nation, would he not have been able to appropriate even more money, buy a Concorde instead of renting one, have more castles and mansions, possibly a bigger, more powerful army?

Unfortunately for the citizens of many countries in the world, the answer is no. Economic institutions that create incentives for economic progress may simultaneously redistribute income and power in such a way that a predatory dictator and others with political power may end up worse off.

The fundamental problem is that there will necessarily be conflict over economic institutions. Different institutions have different consequences for the prosperity of a nation, how that prosperity is distributed and who has power.

The fundamental problem is that there will necessarily be conflict over economic institutions. Different institutions have different consequences for the prosperity of a nation, how that prosperity is distributed and who has power. The economic growth that can be induced by institutions creates both winners and losers.

This was clear during the Industrial Revolution in England, which laid the foundations for the prosperity we enjoy in rich countries of the world today. It centered on a series of pathbreaking technological changes in steam power, transportation and textile production. Even though mechanization led to enormous increases in total incomes and ultimately became the foundation of modern industrial society, it was bitterly opposed by many. Not because of ignorance or shortsightedness – quite the contrary. Such opposition to economic growth has its own, unfortunately coherent, logic.

Economic growth and technological change are accompanied by what the great economist Joseph Schumpeter called creative destruction. They replace the old with the new. New sectors attract resources from old ones. New firms take business away from established ones. New technologies make existing skills and machines obsolete. Economic growth, and the inclusive institutions upon which it is based, create losers as well as winners in the political arena and in the economic marketplace. Fear of creative destruction is often at the root of the opposition to inclusive economic and political institutions.

European history provides a vivid example of the consequences of creative destruction. On the eve of the Industrial Revolution in the 18th century, the governments of most European countries were controlled by aristocracies and traditional elites, whose major source of income was land or trading privileges they enjoyed thanks to monopolies and entry barriers enforced by monarchs. Urbanization and industrialization took resources away from the land, reduced rents and increased the wages that landowners had to pay their workers. These elites also experienced the emergence of merchants who eroded their trading privileges. All in all, they were the clear economic losers from industrialization.

Urbanization and the emergence of a socially conscious middle and working classes also challenged the political monopoly of landed aristocracies. So with the spread of the Industrial Revolution the aristocracies weren't just the economic losers; they also risked losing their hold on political power. With their economic and political power under threat, these elites often formed a formidable opposition to industrialization.

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The aristocracy was not the only loser from industrialization. Artisans whose manual skills were made obsolete by mechanization likewise opposed the spread of industry. Many organized against it, rioting and destroying the machines they saw as responsible for the decline of their livelihood. They were the Luddites, a word that has become synonymous with resistance to technological change.

John Kay, the English inventor of the "flying shuttle" in 1733, one of the first significant improvements in the mechanization of weaving, had his house burned down by Luddites in 1753. James Hargreaves, inventor of the "spinning jenny," a complementary revolutionary improvement in spinning, got similar treatment.

In practice, the artisans were much less effective than the landowners and elites in opposing industrialization. The Luddites did not possess the political power – the ability to effect political outcomes against the wishes of other groups – of the landed aristocracy. In England, industrialization marched on despite the Luddites' opposition because aristocratic opposition was muted. In the Austro-Hungarian and the Russian empires, where the absolutist monarchs and aristocrats had far more to lose, industrialization was more effectively blocked. As a consequence, the economies of Austria-Hungary and Russia stalled. They fell behind other European nations, where economic growth took off during the 19th century.

The success and failure of specific groups notwithstanding, one lesson is clear: powerful groups often stand against economic progress and against the engines of prosperity. Economic growth is not just a consequence of more and better machines, and more and better educated workers, but a transformative, destabilizing process associated with widespread creative destruction. Growth is thus sustained only if it is not blocked by the economic losers.

Conflict over scarce resources, income and power translates into conflict over the rules of the game – the economic institutions – that drive economic activity and determine who benefits from it. When there is a conflict, the wishes of all parties cannot be simultaneously met. Some will be defeated and frustrated, while others will succeed in securing outcomes they like.

Who wins has fundamental implications for a nation's economic trajectory. If the groups standing against growth are the winners, they can block change, and the economy will stagnate.

The logic of why the powerful would not necessarily want to create the institutions that promote economic success extends easily to the choice of political institutions. In an absolutist regime, some elites can wield power to set up the economic institutions they prefer. Would they be interested in changing political institutions to make them more pluralist? In general no, since this would make it more difficult – maybe impossible – for them to structure economic institutions to further their own interests.

Here again we see a ready source of conflict. The people who suffer from the extractive economic institutions cannot expect absolutist rulers to change political institutions voluntarily and to redistribute power. The only way to alter these political institutions is to force the elite to create more pluralistic institutions.

In the same way that there is no inherent reason for political institutions to evolve toward pluralism, there is no natural tendency toward political centralization. There would certainly be incentives to create more centralized state institutions in any society, particularly in those with no such centralization whatsoever. For example, in Somalia, if one clan created a centralized state capable of imposing order on the country, this could lead to economic benefits and make the clan richer.

What stops this? The main barrier to political centralization is again the fear of change: any clan attempting to centralize power in the state will also be centralizing power in its hands, and this is likely to meet the ire of those who would lose in this process. Lack of political centralization means not only leads to lack of law and order, but also an abundance of actors with sufficient powers to disrupt things. And the fear of their opposition will deter many would-be centralizers.

Political centralization is likely only when one group is sufficiently powerful to build a state over the opposition of other groups. In Somalia, power is evenly balanced, and no one clan can impose its will on any other. Therefore, the lack of political centralization persists.