

Why Nations Fail

THE ORIGINS OF POWER,
PROSPERITY, AND POVERTY

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P R E F A C E

THIS BOOK IS about the huge differences in incomes and standards of living that separate the rich countries of the world, such as the United States, Great Britain, and Germany, from the poor, such as those in sub-Saharan Africa, Central America, and South Asia.

As we write this preface, North Africa and the Middle East have been shaken by the “Arab Spring” started by the so-called Jasmine Revolution, which was initially ignited by public outrage over the self-immolation of a street vendor, Mohamed Bouazizi, on December 17, 2010. By January 14, 2011, President Zine El Abidine Ben Ali, who had ruled Tunisia since 1987, had stepped down, but far from abating, the revolutionary fervor against the rule of privileged elites in Tunisia was getting stronger and had already spread to the rest of the Middle East. Hosni Mubarak, who had ruled Egypt with a tight grip for almost thirty years, was ousted on February 11, 2011. The fates of the regimes in Bahrain, Libya, Syria, and Yemen are unknown as we complete this preface.

The roots of discontent in these countries lie in their poverty. The average Egyptian has an income level of around 12 percent of the average citizen of the United States and can expect to live ten fewer years; 20 percent of the population is in dire poverty. Though these differences are significant, they are actually quite small compared with those between the United States and the poorest countries in the world, such as North Korea, Sierra Leone, and Zimbabwe, where well over half the population lives in poverty.

Why is Egypt so much poorer than the United States? What are the

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constraints that keep Egyptians from becoming more prosperous? Is the poverty of Egypt immutable, or can it be eradicated? A natural way to start thinking about this is to look at what the Egyptians themselves are saying about the problems they face and why they rose up against the Mubarak regime. Noha Hamed, twenty-four, a worker at an advertising agency in Cairo, made her views clear as she demonstrated in Tahrir Square: "We are suffering from corruption, oppression and bad education. We are living amid a corrupt system which has to change." Another in the square, Mosaab El Shami, twenty, a pharmacy student, concurred: "I hope that by the end of this year we will have an elected government and that universal freedoms are applied and that we put an end to the corruption that has taken over this country." The protestors in Tahrir Square spoke with one voice about the corruption of the government, its inability to deliver public services, and the lack of equality of opportunity in their country. They particularly complained about repression and the absence of political rights. As Mohamed ElBaradei, former director of the International Atomic Energy Agency, wrote on Twitter on January 13, 2011, "Tunisia: repression + absence of social justice + denial of channels for peaceful change = a ticking bomb." Egyptians and Tunisians both saw their economic problems as being fundamentally caused by their lack of political rights. When the protestors started to formulate their demands more systematically, the first twelve immediate demands posted by Wael Khalil, the software engineer and blogger who emerged as one of the leaders of the Egyptian protest movement, were all focused on political change. Issues such as raising the minimum wage appeared only among the transitional demands that were to be implemented later.

To Egyptians, the things that have held them back include an ineffective and corrupt state and a society where they cannot use their talent, ambition, ingenuity, and what education they can get. But they also recognize that the roots of these problems are political. All the economic impediments they face stem from the way political power in Egypt is exercised and monopolized by a narrow elite. This, they understand, is the first thing that has to change.

Yet, in believing this, the protestors of Tahrir Square have sharply

diverged from the conventional wisdom on this topic. When they reason about why a country such as Egypt is poor, most academics and commentators emphasize completely different factors. Some stress that Egypt's poverty is determined primarily by its geography, by the fact that the country is mostly a desert and lacks adequate rainfall, and that its soils and climate do not allow productive agriculture. Others instead point to cultural attributes of Egyptians that are supposedly inimical to economic development and prosperity. Egyptians, they argue, lack the same sort of work ethic and cultural traits that have allowed others to prosper, and instead have accepted Islamic beliefs that are inconsistent with economic success. A third approach, the one dominant among economists and policy pundits, is based on the notion that the rulers of Egypt simply don't know what is needed to make their country prosperous, and have followed incorrect policies and strategies in the past. If these rulers would only get the right advice from the right advisers, the thinking goes, prosperity would follow. To these academics and pundits, the fact that Egypt has been ruled by narrow elites feathering their nests at the expense of society seems irrelevant to understanding the country's economic problems.

In this book we'll argue that the Egyptians in Tahrir Square, not most academics and commentators, have the right idea. In fact, Egypt is poor precisely because it has been ruled by a narrow elite that have organized society for their own benefit at the expense of the vast mass of people. Political power has been narrowly concentrated, and has been used to create great wealth for those who possess it, such as the \$70 billion fortune apparently accumulated by ex-president Mubarak. The losers have been the Egyptian people, as they only too well understand.

We'll show that this interpretation of Egyptian poverty, the people's interpretation, turns out to provide a general explanation for why poor countries are poor. Whether it is North Korea, Sierra Leone, or Zimbabwe, we'll show that poor countries are poor for the same reason that Egypt is poor. Countries such as Great Britain and the United States became rich because their citizens overthrew the elites who controlled power and created a society where political rights were much more broadly distributed, where the government was

accountable and responsive to citizens, and where the great mass of people could take advantage of economic opportunities. We'll show that to understand why there is such inequality in the world today we have to delve into the past and study the historical dynamics of societies. We'll see that the reason that Britain is richer than Egypt is because in 1688, Britain (or England, to be exact) had a revolution that transformed the politics and thus the economics of the nation. People fought for and won more political rights, and they used them to expand their economic opportunities. The result was a fundamentally different political and economic trajectory, culminating in the Industrial Revolution.

The Industrial Revolution and the technologies it unleashed didn't spread to Egypt, as that country was under the control of the Ottoman Empire, which treated Egypt in rather the same way as the Mubarak family later did. Ottoman rule in Egypt was overthrown by Napoleon Bonaparte in 1798, but the country then fell under the control of British colonialism, which had as little interest as the Ottomans in promoting Egypt's prosperity. Though the Egyptians shook off the Ottoman and British empires and, in 1952, overthrew their monarchy, these were not revolutions like that of 1688 in England, and rather than fundamentally transforming politics in Egypt, they brought to power another elite as disinterested in achieving prosperity for ordinary Egyptians as the Ottoman and British had been. In consequence, the basic structure of society did not change, and Egypt stayed poor.

In this book we'll study how these patterns reproduce themselves over time and why sometimes they are altered, as they were in England in 1688 and in France with the revolution of 1789. This will help us to understand if the situation in Egypt has changed today and whether the revolution that overthrew Mubarak will lead to a new set of institutions capable of bringing prosperity to ordinary Egyptians. Egypt has had revolutions in the past that did not change things, because those who mounted the revolutions simply took over the reins from those they'd deposed and re-created a similar system. It is indeed difficult for ordinary citizens to acquire real political power and change the way their society works. But it is possible, and we'll see how this happened in England, France, and the United States, and

also in Japan, Botswana, and Brazil. Fundamentally it is a political transformation of this sort that is required for a poor society to become rich. There is evidence that this may be happening in Egypt. Reda Metwaly, another protestor in Tahrir Square, argued, “Now you see Muslims and Christians together, now you see old and young together, all wanting the same thing.” We’ll see that such a broad movement in society was a key part of what happened in these other political transformations. If we understand when and why such transitions occur, we will be in a better position to evaluate when we expect such movements to fail as they have often done in the past and when we may hope that they will succeed and improve the lives of millions.

1.

SO CLOSE AND YET SO DIFFERENT

THE ECONOMICS OF THE RIO GRANDE

THE CITY OF NOGALES is cut in half by a fence. If you stand by it and look north, you'll see Nogales, Arizona, located in Santa Cruz County. The income of the average household there is about \$30,000 a year. Most teenagers are in school, and the majority of the adults are high school graduates. Despite all the arguments people make about how deficient the U.S. health care system is, the population is relatively healthy, with high life expectancy by global standards. Many of the residents are above age sixty-five and have access to Medicare. It's just one of the many services the government provides that most take for granted, such as electricity, telephones, a sewage system, public health, a road network linking them to other cities in the area and to the rest of the United States, and, last but not least, law and order. The people of Nogales, Arizona, can go about their daily activities without fear for life or safety and not constantly afraid of theft, expropriation, or other things that might jeopardize their investments in their businesses and houses. Equally important, the residents of Nogales, Arizona, take it for granted that, with all its inefficiency and occasional corruption, the government is their agent. They can vote to replace their mayor, congressmen, and senators; they vote in the presidential elections that determine who will lead their country. Democracy is second nature to them.

Life south of the fence, just a few feet away, is rather different. While the residents of Nogales, Sonora, live in a relatively prosperous part of Mexico, the income of the average household there is about one-third that in Nogales, Arizona. Most adults in Nogales, Sonora, do

not have a high school degree, and many teenagers are not in school. Mothers have to worry about high rates of infant mortality. Poor public health conditions mean it's no surprise that the residents of Nogales, Sonora, do not live as long as their northern neighbors. They also don't have access to many public amenities. Roads are in bad condition south of the fence. Law and order is in worse condition. Crime is high, and opening a business is a risky activity. Not only do you risk robbery, but getting all the permissions and greasing all the palms just to open is no easy endeavor. Residents of Nogales, Sonora, live with politicians' corruption and ineptitude every day.

In contrast to their northern neighbors, democracy is a very recent experience for them. Until the political reforms of 2000, Nogales, Sonora, just like the rest of Mexico, was under the corrupt control of the Institutional Revolutionary Party, or Partido Revolucionario Institucional (PRI).

How could the two halves of what is essentially the same city be so different? There is no difference in geography, climate, or the types of diseases prevalent in the area, since germs do not face any restrictions crossing back and forth between the United States and Mexico. Of course, health conditions are very different, but this has nothing to do with the disease environment; it is because the people south of the border live with inferior sanitary conditions and lack decent health care.

But perhaps the residents are very different. Could it be that the residents of Nogales, Arizona, are grandchildren of migrants from Europe, while those in the south are descendants of Aztecs? Not so. The backgrounds of people on both sides of the border are quite similar. After Mexico became independent from Spain in 1821, the area around "Los dos Nogales" was part of the Mexican state of Vieja California and remained so even after the Mexican-American War of 1846–1848. Indeed, it was only after the Gadsden Purchase of 1853 that the U.S. border was extended into this area. It was Lieutenant N. Michler who, while surveying the border, noted the presence of the "pretty little valley of Los Nogales." Here, on either side of the border, the two cities rose up. The inhabitants of Nogales, Arizona, and No-

gales, Sonora, share ancestors, enjoy the same food and the same music, and, we would hazard to say, have the same “culture.”

Of course, there is a very simple and obvious explanation for the differences between the two halves of Nogales that you’ve probably long since guessed: the very border that defines the two halves. Nogales, Arizona, is in the United States. Its inhabitants have access to the economic institutions of the United States, which enable them to choose their occupations freely, acquire schooling and skills, and encourage their employers to invest in the best technology, which leads to higher wages for them. They also have access to political institutions that allow them to take part in the democratic process, to elect their representatives, and replace them if they misbehave. In consequence, politicians provide the basic services (ranging from public health to roads to law and order) that the citizens demand. Those of Nogales, Sonora, are not so lucky. They live in a different world shaped by different institutions. These different institutions create very disparate incentives for the inhabitants of the two Nogaleses and for the entrepreneurs and businesses willing to invest there. These incentives created by the different institutions of the Nogaleses and the countries in which they are situated are the main reason for the differences in economic prosperity on the two sides of the border.

Why are the institutions of the United States so much more conducive to economic success than those of Mexico or, for that matter, the rest of Latin America? The answer to this question lies in the way the different societies formed during the early colonial period. An institutional divergence took place then, with implications lasting into the present day. To understand this divergence we must begin right at the foundation of the colonies in North and Latin America.

THE FOUNDING OF BUENOS AIRES

Early in 1516 the Spanish navigator Juan Díaz de Solís sailed into a wide estuary on the Eastern Seaboard of South America. Wading ashore, de Solís claimed the land for Spain, naming the river the Río

de la Plata, “River of Silver,” since the local people possessed silver. The indigenous peoples on either side of the estuary—the Charrúas in what is now Uruguay, and the Querandí on the plains that were to be known as the Pampas in modern Argentina—regarded the newcomers with hostility. These locals were hunter-gatherers who lived in small groups without strong centralized political authorities. Indeed it was such a band of Charrúas who clubbed de Solís to death as he explored the new domains he had attempted to occupy for Spain.

In 1534 the Spanish, still optimistic, sent out a first mission of settlers from Spain under the leadership of Pedro de Mendoza. They founded a town on the site of Buenos Aires in the same year. It should have been an ideal place for Europeans. Buenos Aires, literally meaning “good airs,” had a hospitable, temperate climate. Yet the first stay of the Spaniards there was short lived. They were not after good airs, but resources to extract and labor to coerce. The Charrúas and the Querandí were not obliging, however. They refused to provide food to the Spaniards, and refused to work when caught. They attacked the new settlement with their bows and arrows. The Spaniards grew hungry, since they had not anticipated having to provide food for themselves. Buenos Aires was not what they had dreamed of. The local people could not be forced into providing labor. The area had no silver or gold to exploit, and the silver that de Solís found had actually come all the way from the Inca state in the Andes, far to the west.

The Spaniards, while trying to survive, started sending out expeditions to find a new place that would offer greater riches and populations easier to coerce. In 1537 one of these expeditions, under the leadership of Juan de Ayolas, penetrated up the Paraná River, searching for a route to the Incas. On its way, it made contact with the Guaraní, a sedentary people with an agricultural economy based on maize and cassava. De Ayolas immediately realized that the Guaraní were a completely different proposition from the Charrúas and the Querandí. After a brief conflict, the Spanish overcame Guaraní resistance and founded a town, Nuestra Señora de Santa María de la Asunción, which remains the capital of Paraguay today. The conquistadors married the Guaraní princesses and quickly set themselves up as a

new aristocracy. They adapted the existing systems of forced labor and tribute of the Guaraní, with themselves at the helm. This was the kind of colony they wanted to set up, and within four years Buenos Aires was abandoned as all the Spaniards who'd settled there moved to the new town.

Buenos Aires, the "Paris of South America," a city of wide European-style boulevards based on the great agricultural wealth of the Pampas, was not resettled until 1580. The abandonment of Buenos Aires and the conquest of the Guaraní reveals the logic of European colonization of the Americas. Early Spanish and, as we will see, English colonists were not interested in tilling the soil themselves; they wanted others to do it for them, and they wanted riches, gold and silver, to plunder.

FROM CAJAMARCA . . .

The expeditions of de Solís, de Mendoza, and de Ayolas came in the wake of more famous ones that followed Christopher Columbus's sighting of one of the islands of the Bahamas on October 12, 1492. Spanish expansion and colonization of the Americas began in earnest with the invasion of Mexico by Hernán Cortés in 1519, the expedition of Francisco Pizarro to Peru a decade and a half later, and the expedition of Pedro de Mendoza to the Río de la Plata just two years after that. Over the next century, Spain conquered and colonized most of central, western, and southern South America, while Portugal claimed Brazil to the east.

The Spanish strategy of colonization was highly effective. First perfected by Cortés in Mexico, it was based on the observation that the best way for the Spanish to subdue opposition was to capture the indigenous leader. This strategy enabled the Spanish to claim the accumulated wealth of the leader and coerce the indigenous peoples to give tribute and food. The next step was setting themselves up as the new elite of the indigenous society and taking control of the existing methods of taxation, tribute, and, particularly, forced labor.

When Cortés and his men arrived at the great Aztec capital of Tenochtitlan on November 8, 1519, they were welcomed by