



# Lecture Notes: Touring the Continents: Western Europe, Latin America, & North America

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## I. Failing to Clear a Very High Bar

### A. The Thirty Glorious Years

The Thirty Glorious Years that had followed World War II were so good for the global economy that they made it impossible for any reversion to anything more like normal post-1870 growth to seem satisfactory.

Now it is time to start our tour of the continents.

Let's start with the North Atlantic plus the western shore of the South Atlantic—with Western Europe, South America, and North America. They make up three discrete regions. Or, perhaps, four discrete regions, if you

want to break off the southern cone of South America from the rest of Latin America

Two of these regions do very well indeed, All of western Europe converges to the world's productivity frontier. North America surpasses what had been thought to be the world's technological and industrial pace cars, Britain and Germany, to become “the furnace where the future is forged” from around 1870 to 2016.

Latin America by contrast, does not do well. It has favorable resource to population ratios. yet it fails to converge to the world's productivity frontier.

Why doesn't it? Well, we say “extractive institutions”. But that is just a label. How were they created? How maintained? Why the very long shadow of history? Plus there is the puzzle of the southern cone of South America. It too has failed to converge to the global North norm. Yet many explanations that work for “tropical” economies’ relative poverty today do not work for the southern cone—do not explain its failure to catch up and converge.

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From 1800 to 1914, within western and central Europe, our spread of per capita income levels is constant. We have a spread of 2.5-1 in 1800. We have a spread of incomes of 2.5-1 in 1914. There are no signs of catchup and convergence within western and central Europe. But also there are no signs of divergence. That nonexistence of divergence makes western Europe an extraordinary region in the context of the years 1800-1914. Most everywhere—in othe regions and over the globe as a whole—there is substantial divergence.

Western Europe is the exception. It is as if divergences in political institutions maintained themselves, and so impelled constant relative income levels.

Look at the four countries plotted here: the United Kingdom, Spain, Sweden, and Hungary. The U.K., Spain, and Hungary grow in parallel. Sweden transitions—from closer to Spain in 1800 to closer to Britain in 1914. Sweden manages to transition itself from being a relatively poor Western European country to being a relatively rich one. As it transitions, it becomes much more democratic and open.

It does converge to the world industrial leader norm. Cause or effect of democraticization, mass education, and more secure property rights? Almost surely both. How much cause and how much effect? That is a deep question that I do not think we have a terribly good answer to. But we can at least look at the tea leaves.

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Western Europe from 1914 to 2020 sees a different pattern: catchup and convergence. The income spread drops from 2.5-1 to 1.5-1. Those countries that do badly during part of the period—Hungary behind the Iron Curtain from 1945-1990, Spain under fascist rule 1936-1975—catchup substantially once their peculiar institutions are dissolved and they reapproach the western European norm.

What is that western European norm? Since the founding of NATO and the implementation of U.S post-WWII aid in the form of the Marshall Plan with its associated conditionality demands that countries establish market-friendly mixed economies, the norm has been social democracy: political democracy, a mixed economy, indicative planning, mass education, and other forms of social insurance. There has been very strong convergence in

institutions. And there has been very strong economic convergence as well.

We describe this as converge to “developmental institutions”. But that's just a label describing the existence of a thing. It is not a description of the thing—not a description that is of much use in assisting other countries to insert the key in the lock and so open the door.

Moreover, the penalties of having had “extractive” institutions in the past still seem to matter. Hungary is now a dictatorship. It will be interesting to see what happens next. It will be sad as well. Hungary is now a dictatorship because it was unfortunate enough to have 45 years of extractive institutions from 1945 to 1990 under communism. Even a generation later, the impact is still there.

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We have seen this earlier. We have seen the importance of regime type in Europe, even in the agrarian and in feudal eras. Recall that we read an article by me and my freshman roommate Andrei Schleifer in which we concluded that institutions mattered bigtime, at least in Europe:

>The total population living in western European cities of 30,000 or more in 1650 was 4.7 million. Had each of the nine regions experienced an additional century and a half of absolutist rule before 1650, this urban population would have been reduced by two million...

>Conversely, had all of western Europe been free of absolutist rule over 1050–1650, then the regression in line 1 of table 3 predicts that Europe in 1650 would have had a total urban population of nearly 8 million...

How did Western Europe establish democracy and avoid both central planning and aristocratic rent thinking? That is a long historical story which we will now tell a little bit of.

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The most striking thing about Western Europe is how its institutions revolve in virtuous circles. Up until after World War I, they go always forward, never backward.

It appears to be what was needed for prosperity was secure property rights and a level playing field, with political power constrained and distributed. Then there would be far fewer rents from holding power. Then there would be fewer power struggles and greater stability. Then there would be more energy devoted to entrepreneurship and enterprise. Then there would be a lot less energy on the parts of entrepreneurs and enterprisers devoted to trying to protect their political flanks from rent seeking and expropriation

As history advances in time, and western Europe develops, we see the political base of the population getting wider and wider. The population becomes more educated. As more people acquire the potential for political agency, we see franchise extension: more people both allowed to vote and who grab the vote by threatening upheaval if they do not take it.

Elites agree. Sometimes elites agree to draw the fangs of revolution. Sometimes to boost their share of the vote for a fragment of the elite that thought it would benefit from having a larger electorate.

Sometimes elites acquiesced because it was the right thing to do.

Sometimes elites acquiesced in order to create a strong and prosperous nation. Look at Bismarckian socialism in Germany in the late 1800s.

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Look at Otto von Bismarck, first chancellor of the German empire established in 1871. The German empire established by war. Otto von Bismarck, militarist and authoritarian, best known for his speech in 1848 that democrats and parliamentarians were silly: “for it is not by speeches and majority votes that the great issues of the day will be decided, but by blood and iron”.

Yet here is Otto von Bismarck as chancellor in 1884, giving a speech before the German empire's parliament, the Reichstag, on the law for worker's compensation that he is trying to push through parliament:

>Does the state have the responsibility to care for its helpless fellow citizens, or does it not? I maintain that it does have this duty.... Those goals that the community can fulfill with justice and profit should be relinquished to the community... the help of persons in distress and the prevention of such justified complaints as in fact provide excellent material for exploitation by the Social Democrats.

>That is the responsibility of the state from which the state will not be able to withdraw in the long run.

>If one argues against my position that this is 'socialism', then I do not fear that at all.

>The question is, where do the justifiable limits of state socialism lie?... Each law for poor relief is socialism....

“I remind you of France... the remarkable social politician, Léon Say\*... expresses the French view that every French citizen has the right to starve, and that the state has no responsibility to hinder him in the exercise of his right...

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But why did western European elites, during the long march from 1620 to today of political democratization, engage in franchise extension and in negotiation rather than in repression?

Well, sometimes the answer was repression—especially when the rich good could find a charismatic rabble rouser who they thought could serve as their frontman, most prominently in Germany in 1933 with the rise of Adolf Hitler and the Nazis, and in Italy in 1921 with the rise of Mussolini and the Italian fascists. And there are reactions earlier as well.

Melissa Dell cites Daron Acemoglu and James Robinson's thoughts about what happens in the event of a political shock that momentarily raises the power of the poor. In response, the rich can:

1. promise a less unequal distribution in the future
2. share power via franchise extension
3. repress

If they repress, they had better hope that repression is successful, that it does not lead to revolution. For then they lose everything.

(1) is simply not credible.

So sometimes—and often enough for it to matter for the great sweep of history—they chose (2). When repression seems too risky, then to sharing power via franchise extension is a way to try to calm down the system and prevent there from being chaos. Witness Britain's First Lord of the Treasury Earl Grey on the Great Reform Bill of 1831:

>There is no-one more decided against annual parliament[ary elections], universal suffrage and the [secret] ballot than I am. My object is not to favor, but to put an end to such hopes and projects ... The principal of my reform is to prevent the necessity of revolution ... reforming to preserve and not to overthrow...

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Western European elites did fear revolution and change. They were subject, relatively and also absolutely, to being creatively destroyed. But their response was more often than not to eschew repressing their opponents. Rather, it was by trying to figure out a way to work change to their advantage—coopting some into the power structure by further liberalizing the system, hoping to produce other bases of power than simply force, law, and history.

They were the rich. They were in an environment in which they were the rich and they were facing demands for income redistribution and more opportunity on the part of the poor.

Perhaps they could assemble a ruling coalition by focusing on some other potential societal cleavages and bases of The nation against the nation's enemies? The religious against the not so religious? Order and things-as-they-were against anarchy and change? Issues on which they would have a majority of the electorate on their side?

And of course in some places there was revolution—and then change became more radical. And that made elites fearful of trying to put your finger in the dike to hold back the flood. If the flood was not channeled, it would overwhelm—as the French aristocracy had been overwhelmed in the Great French Revolution.



That was when France became the first country to adopt universal male suffrage in 1792. It served as an example of what others might fear, and why they should be gladly offering more minor franchise extensions.

(Curiously, France was also one of the very last year Western European countries to grant women the right to vote, waiting until 1944 and its liberation from the Nazis to do so.)

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Can we tell much about whether franchise extension and political liberalization—establishment of a level playing field, secure property rights, and rules of the game that made all equal (as opposed to making some aristocrats more equal than others)—whether that was the cause of rapid economic growth or the consequence? Acemoglu, Cantoni, Johnson, & Robinson use the variation within present day Germany as a result of French rule in the Napoleonic era to try to find out. They think the legacy of the spread of the French Revolution and its institutions via Napoleon's conquests from 1800-1815 gives them a clue.

In the map ver on the right, the dark green shows the areas that were annexed to the French empire under Napoleon between 1804 and 1815. These were the areas that introduced modern French institutions. Guilds were more likely to be disestablished. Equality under the law was imposed. A written civil legal code was adopted. And in those dark green parts of Germany, we see faster economic growth thereafter. (This is also the case for Tuscany and Latium vis-a-vis elsewhere in Italy. This is also the case in Dalmatia over on the other side of the Adriatic).

We do see faster economic growth in the Rhineland and in North Germany around Hamburg. near the North sea. ACJR argue that the imposition of French institutions in some places but not others was exogenous to what the potential for economic growth was. France decided where to conquer

via a military logic. Thus they interpret all of this correlation as a causal chain running from institutions to growth.

That institutional reform was the cause and growth was largely the effect I agree. But all? Yes, there is a discontinuity where the French conquered. But I do not believe that military concerns were unconnected to growth potential. Thus I don't think the evidence they presented is as strong as they think it is. France conquered regions close to France, with good transportation networks. Those are related to growth potential, as well as satisfying the military logic.

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By contrast, in eastern Europe and sometimes in central and Southern Europe as well, we see elites that are much less eager to compromise and much more eager to repress. My teachers' teacher Alexander Gerschenkron on Russia, in his *Europe in the Russian Mirror: Four Lectures in Economic History*:

>Economic progress began to be viewed with great suspicion and the railroads came to be regarded, not as welcome carriers of goods and persons, but as carriers of the dreaded revolution. Then the State clearly became an obstacle to the economic development of the country...

Jerome Blum points to early 19th century Austria, before 1848:

>These living forces of the traditional economic system were the greatest barrier to development. Their chief supporter was ... Emperor Francis. He knew that the advances in the techniques of production threatened the life of the old order of which he was so determined a protector. Because of his unique position as final arbiter of all proposals for change he could stem the flood for a time. Thus when plans for the construction of a steam

railroad were put before him, he refused to give consent to their execution ‘lest revolution might come into the country’...

Eastern European elite saw what was happening in the West. They recognized that structural change could cause them to lose their power. They did not want to be creatively destroyed by change. And so they tried to freeze things.

This is opposed to the view that “if things are to stay the same, then everything must change”, that we see laid out in the 19th century novel *I Gattopardo*, which described the reaction of elites in the bulk of Western Europe. Western European elites tried to ride the wave—spent time trying to figure out how to deal with the changes that technology and democracy were bringing to the world. Eastern European elites did not: poverty, income gaps, fascism, revolution, and communism were the result.

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And then there is the great divergence in Latin America. The failure to converge in Latin America, independent from the 1820s, not ruled by colonialists, at least formally democratic, is distressing and puzzling to economists.

The formal institutions of the state are republican from the 1820s on. Yet Latin America fell and remains far behind the global North norm in terms of prosperity today.

Popular wisdom emphasizes high rates of inequality and poverty in Latin America. The stakes of politics are higher and the tools used sharper because the elites are richer and feel that they have more to lose by creative destruction from economic change. And because the poor are poor, they are unable to find the resources to educate themselves and become more productive. Yet the situation is complicated. Things matter

at a detailed level. Latin America is not a monolith: For example, between-municipality differences are twice as large as between-country differences. It's not so much that Latin American countries are poorer than others. It's that some regions are much poorer than others. And few regions are very rich. So national -level institutions cannot play a huge and exclusive role.

Yet, of course, comparing Latin America as a whole to the global North, the gap remains huge even between even the richer portions of Latin America and the global north in large part of nation-level institutional differences.

What are the causes of these differences in prosperity, both comparing Latin America as a whole to the north Atlantic and within Latin America? Historical institutions? Historical inequality. Some people stress geographic and ecological factors.

General education levels explain about half of Latin American divergence both within Latin America and compared to the rest of the world. But what accounts for the rest? Where does it come from? Does it come from institutions? Does it come from the failure to provide other public goods besides education? Does it come from geography?

Let's see what we can try to establish.

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Let's start with some maps. Here we see one institutions map and two geography maps.

Here on the left we see Peru, and the boundaries of the “mita”, an institution introduced under Spanish rule to extract a forced labor force to staff the silver mines at Potosi, which was one of the major sources of Spain's wealth from the exploitation of the the American colonies back

when Spain ruled the area region. The silver would not extract itself. And so societies were thrown into turmoil and upheaval as large amounts of men were pulled away from their homes and instead sent into near-slave labor in the mines. That turmoil had impacts on local public economy. “Miita” regions even today appear to be much poorer than those surrounding.

Then we have Brazil, with the hot and wet Northeast settled early by Portuguese poor and devltd to primary product production: sugar cane, coffee, and so forth. Brazil’s south is much more like the southern cone of Latin America. It was settled later. it is more temperate. It is much richer, much more industrialized, much more prosperous, and also cooler. In Mexico as well we see a substantial temperature-humidity-prosperity gradient. It is the Yucatan and the south that are the places in Mexico that are the poorest and the wettest and the hottest, compared at least to the central Valley and central plateau of Mexico.

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As Melissa Dell points out, the historical marks left on Peruvian prosperity today by the silver mines at Potosi and the “mita” forced labor system are quite remarkable and quite apparent. If you were subject to the “mita”, your communities are 25% Porter today. You have fewer roads and lower education levels. You receive fewer public goods. The interruption of livelihoods for the labor draft meant that “mita” re residents became and remain subsistence farmers rather than getting educated and moveing into crafts. And you had few large landowners in “mita” districts—if you were constantly being drafted off and sent to the mines, it was a very difficult to accumulate property. But the lack of accumulated property in the hands of the rich did not mean lots of stable small farms. It did not mean secure property rights. It rather meant, rather, no property rights at all: There was no one with enough wealth and enough of a backing and enough of a

clientele to make their claims to property stick against the central government.

The remarkable and screwy thing is that these effects persist, that what happened centuries ago seems to influence how political economy works today. How much the Peruvian government with the workings of its bureaucracy is willing to support and encourage growth in different regions is, at a very granular level, highly correlated with the social historical imprint of the “mita”.

As Edgar Gonzalez put it:

>It’s certainly not geography, it’s government... some provinces have been favored, with the government—particularly during the large road building campaign in the early 1950’s—choosing to construct roads in some provinces and completely ignore others...

This regression discontinuity at the borders of the “mita” is visible and impressive. It is a sign of how much history is, in fact, a series of butterfly wingflap accidents, with small changes in the distant past sometimes having very large changes in the way things work on the ground today.

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We thus see that have a rather stunning reversal of fortune in the Americas over the past three centuries.

As British commentator, journalist, intellectual and farm expert Arthur Young put it in his *Political Essays Concerning the Present State of the British Empire*:

>It appears on the whole, that the staple productions of our colonies decrease in value in proportion to their distance from the sun. In the West

Indies, which are the hottest of all, they make to the amount of 81£.12s.1d per head... In the northern settlements, to that of 2s. 6d. This scale surely suggests a most important lesson—to avoid colonizing in northern lands...

But those Northern lands—New England and the province of Ontario in Canada—are now the richest in the world, Arthur Young was very, very wrong. Things changed after 1800. The United States and also Canada industrialized and grew rapidly. By 1910 they were the richest regions in the world. They sustained that achievement throughout the 20th century.

By contrast, after independence many Latin American countries underwent sustained economic decline: Mexico. Others suffered stagnation: Brazil and Colombia. Life expectancy in Latin America went from being equal to that in North America in 1700 to around 60% of the level of the United States in 1900

There were transitory catchups: Brazil in the 1960s, Venezuela between the 1930s and 1960s, Chile since 1985.

There also have been examples of sustained divergence. Argentina was prosperous in 1920. Back then it looked a lot like New Zealand or Australia or even Canada. But since the 1920s, Argentina has been on a downward sustained downward relative spiral.

Venezuela, recently, has been worse. It has been on a remarkably rapid downward relative spiral with respect to the global north since 1980

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The importance of chance, of luck, of a particular setup that gives you bad institutions by giving you too-unequal a distribution of income and too-dominant an oligarchy at the start. The long and very dark shadow cast by

such things down the centuries in terms of “extractive” rather than “developmental” institutions.

How are we to understand this?

I think this is best understood by going to German sociologist, Robert Michels and his Iron Law of Oligarchy: the general rule that 80% of the stuff is grabbed by 20% of the people. Yes, humans are friendly gift exchange animals. Yes, humans are empathic animals. But humans are also animals that to some degree like there to be a dominance hierarchy.

As Michels put it, the elite can change—a partial or total circulation or replacement—but a power elite of some sort will remain. A good society will have a stable elite interested in win-win cooperation. A bad society will have an unstable elite fearful of its place focusing on win-lose exploitation.

As Michel put it:

>Society cannot exist without a “dominant” or “political” class, and that ruling class, while its elements are subject to frequent partial renewal, nevertheless constitutes the only factor of sufficiently durable efficacy in the history of human development.

>The government, or... the state, cannot be anything other than the organization of a minority. It is the aim of this minority to impose upon the rest of society a “legal order” which is the outcome of the exigencies of dominion and of the exploitation of the mass.... Even when the discontent of the masses culminates in a successful attempt to deprive the bourgeoisie of power, this is... effected only in appearance; always and necessarily there springs from the masses a new organized minority which raises itself to the rank of a governing class...



We see this, of course, most impressively in Russia and in China, Russia and China go through the most unbelievable and prolonged revolutionary processes throughout the years of the 1900s. Yet Russia started out with a czar: Nicholas II Romanov. Russia ends with a Czar: Vladimir Putin. China started out with a court: the late Qing dominated by Cixi of the Ching dynasty, China ends with a court—this time dominated by Xi Jinping.

The question is, rather, how powerful are the institutions that provide voice and that provide a check on the exploitation of the mass by the elite? A situation in which the elite exploit less is one in which there's an opportunity to train the elite that developmental institutions, while they may make its relative dominance much less strong, do make for a better and a wealthier society. Few in America's power elite would change their positions for those of Russia's today.

And that matters.

By contrast, in Latin America, even today, too much of the elite fear, the consequences for themselves of failing to maintain a strong repressive hand. That is because they anticipate that they, should revolution come, should repression fail, will not stay on top afterwards. Their segment of the elite will be replaced by another elite. Very little of Cuba's elite in the 1950s was its elite under Fidel Castro in the 1960s and 1970s. It was a different elite—although still an elite.

Hence the fight tooth and nail to prevent sufficient change to threaten revolution. That plus the fact that the life of an exploiter under extractive institutions is a relatively cushy one even if you do not have managed formal education or much productive skills—that seems to explain a bunch of Latin America's relative decline at a fairly deep and fundamental historical level.

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Thus we have what Engerman and Sokoloff see as very long historical consequences of having been ruled by slave masters. We can see today the imprint on modern societies Latin America's history back centuries and centuries ago.

The different labor systems established in the colonial era as the result of the luck of history and factor endowments leave their legacy. Where it was most profitable to establish unfree labor systems, they were established.

How do you establish an unfree labor system? Through domination. How do you maintain an unfree labor system? Through domination? What does having an unfree labor system due to elite incentives? It creates an elite focused on domination, rather than an elite focused on developing resources in cooperation with others.

Does the elite control the economy by and large? Yes. If so, does it control it in its own long run interests? The answer is that an elite that sees itself as exploitative is going to be much less interested in education, in infrastructure, in anything other than maximizing the amount of surplus extracted in the short run. And that focus is not even in the elite's interests if we look at it as a boy echoing down the generations.

And so we see the great reversal of fortune between Latin America and North America between 1700 and today.

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This slide is a reminder that American economic ascendancy and the ascendancy of the global north more generally is one of the most extraordinary features of all of modern economic history. Such divergence and exceptionalism in a world that is as small in transport and

communications and ideas! How can that environment be consistent with such huge divergence in terms of income and wealth?

I also present a poem from Carl Sandburg, Chicago, celebrating the exuberant industrialization and culture of that Midwestern metropolis. Read it. It's fun. Better yet, find a skilled poetry reciter to read it to you. It's better:

>Hog Butcher for the World,  
Tool Maker, Stacker of Wheat,  
Player with Railroads and the Nation's Freight Handler;  
Stormy, husky, brawling,  
City of the Big Shoulders:  
They tell me you are wicked and I believe them, for I have  
    seen your painted women under the gas lamps luring the  
    farm boys.  
And they tell me you are crooked and I answer: Yes, it is true I  
    have seen the gunman kill and go free to kill again.  
And they tell me you are brutal and my reply is: On the faces  
    of women and children I have seen the marks of wanton  
    hunger  
And having answered so I turn once more to those who sneer at  
    this my city, and I give them back the sneer and say to them:  
Come and show me another city with lifted head singing so  
    proud to be alive and coarse and strong and cunning....  
Laughing the stormy, husky, brawling laughter of Youth, half-  
    naked, sweating, proud to be Hog Butcher, Tool Maker,  
Stacker of Wheat, Player with Railroads and Freight Handler to the  
Nation.

## **Notes, etc.**

Presentation file: <<https://github.com/braddelong/public-files/blob/master/econ-115-lecture-15.pptx>>