EC583:
POLITICAL ECONOMY ESSAY

Student Name: Federico Sacco Student Number: 16885683

TOPIC ③

Colonialism can be defined as the expansion of a nation over territories and people beyond its borders, often in order to facilitate the economic domination on the resources, labor and trade. The process is called colonization. Now, talking about institutions, economic development is favoured as much as capitalistic institutions get closer to a competitive situation, because it determines the efficient allocation of resources within an industry, by pushing prices closer to production costs and by pushing capital and labor to move to the most advantageous jobs, thus reducing performance differences. Examples of institutions can be those who protect property rights, those that provide old age pensions, or guarantee the upholding of contracts or oversee safe and fair elections or norms of reciprocity and sanctions. The lack of such institutions, or their maladministration, is a serious obstacle to investments, business development and innovation: in short, to economic growth. History deeply conditions the creation of institutions, especially for countries that have been colonized by other Nations. Whenever a country gets colonized by a great Nation, its entire structure is influenced and modified, and this consequently affects population and economic growth. In the colonized country are then established new laws and new institutions, but how will this change, due to colonialism, affect the economic growth of that country?
To answer this question, we will firstly point out some premises that will then be refuted or corroborated at the end of our analysis, after having examined what Sokoloff and Engerman (JEP 2000) said about this argument and after having evaluated in detail what Acemoglu, Johnson and Robinson (2001) have analysed in their review:" The Colonial Origins of Comparative Development: An Empirical Investigation". At the end of our analysis, we will draw a conclusion.

First of all, it is a common opinion that a country with good institutions, with more secure property rights and less distortionary policies, ensures a greater level of income because it will invest more in human and physical capital. This means that institutions matter, but the effect of institutions on economic performance still has to be clarified. It is presumed that richer economies have or can afford better institutions. But it is also true that to a given economy corresponds a certain institution and a certain income, so different economies will differ in these two factors. For instance, extractive or plantation economies are characterized by inequality, where institutions favour elites and limit the access to economic opportunities to much of the population. This situation is harmful for the economic growth and give rise in turn to new bad institutions that keep on ruining the growth trajectory of the country.

This is well explained by Sokoloff and Engerman in “History Lessons: Institutions, Factor Endowments, and Paths of Development in the New World”, where they argue that bad institutions may self-generate worse institutions as the beneficiaries struggles to keep their benefits and this theory establishes one of the main causes behind the difference between North and South America. Two completely different economies were created: In South America there was an elite that held the power, the type of economy was based on native and slave labor and on the extraction of raw materials from mines. This was due to the presence of huge mineral riches and lots of native labour. In North America, on the other hand, there was not a large amount of native labour, there was a lack of mineral riches and the climate was not appropriate for sugar, therefore there was less slave labor for sugar plantations. All these effects caused a different development in institutions, for instance political power was equally distributed, there was equality in human capital and a very small percentage of native and slave labour. All these consequences generated better institutions through the years. Therefore, we can assert, as concluded by Sokoloff and Engerman, that the differences that we find across the New World economies can be a direct consequence of the types of economic institutions that have been created in the past. Hence, every time that institutions have favoured an elite, limiting the access of a great part of the population to economic opportunities, the members of that elite were able to maintain their status over time, damaging, however, the society, that could not realize the full economic potential of disadvantaged groups. We can, thus, conclude that every path of institutional development can, in turn, affect the growth trajectory of a country. But, can we say that this is one of the fundamental causes of differences in income per capita across countries? Is it true that the quality of institutions mainly depends on the wealth of a country? What does the quality of an institution really depend upon?

Acemoglu, Johnson and Robinson proposed a theory of institutional differences among countries colonized by Europeans in “The Colonial Origins of Comparative Development: An Empirical Investigation” to investigate the impact of institutions on economic performance. This theory rests on three premises:

1 – Different colonization policies created different sets of institutions;

2 – The colonization strategy was influenced by the environment of the settlements;

3 – Colonial state and institutions persisted after independence.

Starting from these premises, we can use mortality rates expected by the first European settlers in the colonies as instrument for current institutions in the countries. Schematically, it can be summarized as follow:

(potential) settler mortality → settlements → early institutions → current institutions → current performance.

Using the data on the mortality rates of soldiers, bishops, and sailors stationed in the colonies between the seventeenth and nineteenth centuries, we can get this graph:

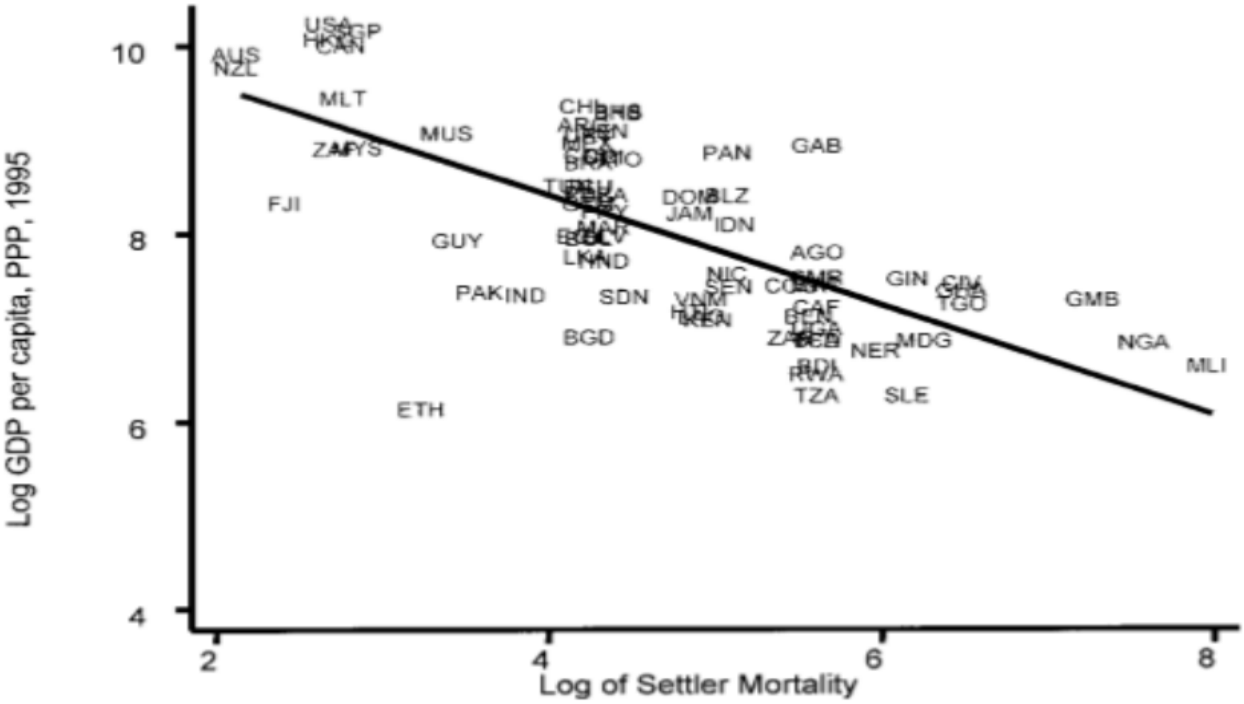

FIGURE 1. REDUCED-FORM RELATIONSHIP BETWEEN INCOME AND SETTLER MORTALITY

It shows a strong negative relationship between settler mortality rates and current institutions, which means that income per capita increases as settler mortality decreases and vice-versa. The regression shows that mortality rates faced by the settlers more than 100 years ago explains over 25 percent of the variation in current institutions. Using an overidentification test with measures of European migration to the colonies and early institutions as additional instruments, they tried to detect whether settler mortality has a direct effect on current performance; the results were encouraging as they generated no evidence for a direct effect of settler mortality on economic outcomes. This could mean that there are other important variables to consider in order to understand the causes of different economic performances.

After a few calculations, it has also been concluded that, once the effect of institutions on economic performance is controlled for, neither distance from the equator nor the dummy for Africa is significant. These results suggest that Africa is poorer than the rest of the world not because of pure geographic or cultural factors, but because of worse institutions.

It has then been calculated the relationship between the potential settler mortality rates and the index of institutions by using the log of the settler mortality rates. It showed that ex-colonies where Europeans faced higher mortality rates have substantially worse institutions today.

Determinants of whether Europeans could go and settle in the colonies have an important effect on institutions today. Throughout the investigation made by Acemoglu, Johnson and Robinson, it has been analysed that there is a high correlation between mortality rates in the colonies and European settlements, between European settlements and early measures of institutions and between early institutions and institutions today. They estimated large effects of institutions on income per capita using that source of variation and, after documented that the relationship is not driven by outliers and is robust to controls for latitude, climate, current disease environment, religion, natural resources, soil quality, ethnolinguistic fragmentation and current racial composition, we have the confirmation that the impact of mortality rates faced by settlers likely directly affect institutions. But, they do not reject the hypothesis that they are equal at the 5-percent significance level, so this shows that there is no evidence that mortality rates faced by settlers have a direct effect on income per capita. So, overall, the outcome of this review is that these results suggest substantial economic gains from improving institutions and they also indicate that reducing expropriation risk would result in significant gains in income per capita, even though it does not point out what concrete steps would lead to an improvement in these institutions.

Concluding, we can assert that the quality of institutions is very important to define differences in income per capita across countries; Also, the quality of institutions does not mainly depend on the wealth of a country but also on other factors, such as mortality rates, but we are still unable to define what concrete steps we need to follow to improve the quality of institutions.

We have taken in our analysis on what Sokoloff and Engerman said in the first part of our discussion, pointing out that institutional features of colonialism have affected North and South America in two completely opposite ways: In South America there is a descending growth trajectory, while in North America it is ascending. After that, we have analysed what Acemoglu, Johnson and Robinson investigated, concluding that colonialism has been affected by some factors, such as mortality rates, and therefore has, in turn, caused different effects and modified the economic growth in different ways, depending on the pros and cons of each country and on which kind of resources they could offer to the Europeans settlers.

References:

- Acemoglu, S. Johnson and J.A. Robinson, "*The Colonial Origins of Comparative Development: An Empirical Investigation*", American Economic Review, 91, pp. 1369-1401. December 2001.
- Kenneth L. Sokoloff and Stanley L. Engerman, "*History Lessons: Institutions, Factor Endowments, and Paths of Development in the New World*", Journal of Economic Perspectives—Volume 14, Number 3—Summer 2000—Pages 217–232.