

# **From Poverty to Prosperity: Understanding Economic Development**

**(Notes of Edx.org course taught by Sir Paul Collier)**

# **Module I**

## **From Anarchy to Centralized State**

# 1.1 Centralized State

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**Centralized State** is an entity that has a monopoly of violence in the territory. It is only one actor that is capable of wreaking violence over others in a territory. **Anarchy** is the complete absence of any monopoly of violence. It is the absence of government.

## A Society of Farmers

Strong	Weak	
Good (A1)	Good (A2)	Productive
Bad (B1)	Bad (B2)	Unproductive

### What activities occur in this society when there is no centralized state?

- A1 is strong and productive. He has incentive to farm because he is productive. If he doesn't farm he will get hungry.
- B2 is weak and unproductive. This doesn't matter because he can farm and still try to be good.
- B1 is lousy farmer but strong. Because he is strong, he looks other producing crops especially A2, who is weak but productive. B1 will go to A2 and demand some crops. **In no state situation**, B1 can threaten A2 for some crops.

### Two types of economic activities

- Production, if no production society will die.
- Rational use of violence

### How does political economy 101 differ from econ 101?

Econ 101 presupposes that there is a state that maintains law and order.

## 1.2 Scale of Economies in Violence

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### The Three Valleys

		Strength				Strength				Strength	
Productivity	F	F	Productivity	F	F	Productivity	F	F	Productivity	F	F
	V	<del>F</del>		V	<del>F</del>		V	<del>F</del>		V	<del>F</del>

- V for violence and F for farming
- Three societies with 4 people in each.
- Introduce assumption about economies of violence.

### Scale Economies in Violence

- If we double the inputs, we more than double the output. **But what is the output of violence?** The payoff of violence is victory.

### Why place scale of economies in violence not in production?

People took a long time before they realized scope for scale economies in production. Until about 1750 when Adam Smith noticed scale economies in production in factories of Scotland.

- The bad (unproductive), weak is just clinging for his/her life and may be dead.
- Good, weak farmer is paying to violent guy. 3 violent guys in each valley are specialized in violence.
- Strong and productive farmers can defend themselves. But 3 violent guys can band up and threaten a strong, productive guy of a valley. Other productive, strong farmers in other valley may ignore it thinking dispute of some other valley not their problem.
- 3 violent farmers have incentive to form alliance. This is the **emergence of entity larger than individual.**

# 1.3 Taxation

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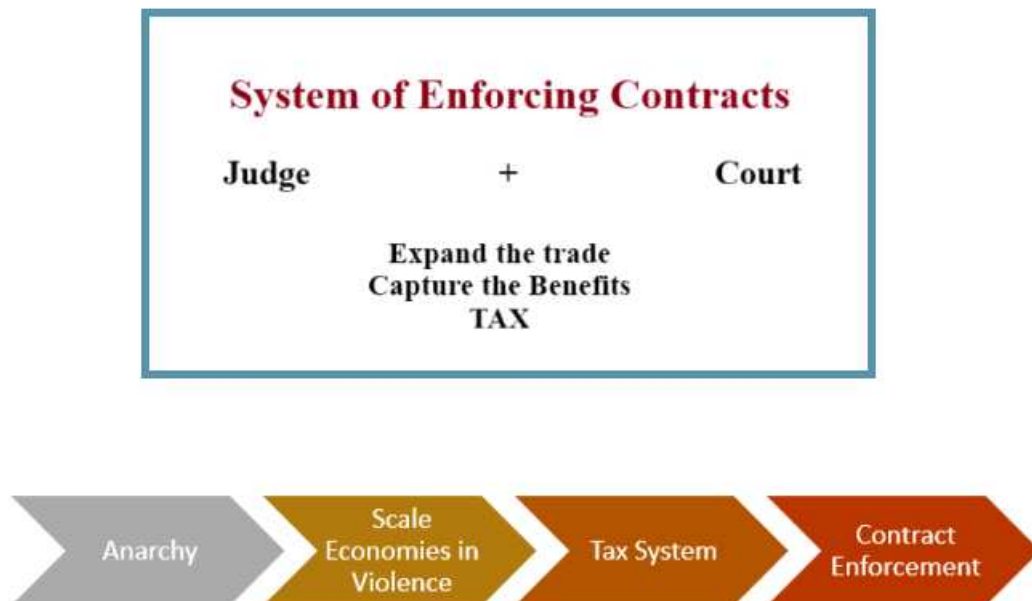
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- **Tax Service** - A service that observes economic activity. Tax officers collect information on what people are producing and how much they are able to pay without starving to death. **Doomsday** book is a comprehensive record of the extent, value, ownership, liabilities of land in England (1086) by order of William I.
- Weak pay to strong for protection - **Introduction of Tax System**.
- **Why the violent ones are doing it? Taxing People?** Revenue from tax is used to increase the capacity for violence. They need to do it because there is some other guys on other side doing exactly the same and bigger force can always win over small ones. **Fear** is driving force behind expanding the scale economies of violence and tax system.

# 1.4 Contract Enforcement

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Two farmers - one produce apples other wheat. They want to trade but they don't trust each other. So, What's next? To prevent the dishonour of contract between these two farmers, the leader (king) can try to enforce contract. When apple and wheat grower did a deal, they can come to leader and put a stamp on the deal. If one party violate the contract, the king can send his men to beat the violator. This means **building system of enforcing contracts**. But it will require people (judges) who work on court to ensure the enforcement of contract.



The leader is growing the economy out of self-interest. Contract Enforcement increases trade and consequently the tax revenue to build up new army.

# 1.5 Infrastructure Investment

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- **How Would people trade? Rudimentary Infrastructure** - Roads and bridges help people connect, enables the economy to grow. It will increase the trade and tax revenue. The leader is growing the economy out of self-interest because he needs bigger army to fight external forces.
- **What can be done beyond roads and bridges?** Trade involves coordination problem. If I bring my apples, it only make sense if you bring your wheat. **Market** is a solution to coordination problem. In medieval period, duke conducted fairs. They were not doing for people but for themselves to get more tax. Tax booth would be set up at fair.

# 1.6 Sharing Power

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- **Time - consistency problem** - an incentive to make a promise but not to keep it.
- **Suppose the king wants his councilor to provide their wealth to the king to strengthen the defense against external forces. The king promises to pay back once they defend against external forces. What will his councilors do?** The problem is that once they have given money, the king has no incentive to pay back. King has too much power and the councilors don't trust king paying them back. Councilors only lend the king money if he share some of his power with the councilors.
- A big charter like **Magna Carta** in which wealthy people sit in the parliament and decide over defense budget. Because of power sharing, wealthy people has incentive to allocate budget for defense or the external threat could come and defeat them.
- **Commitment Technology** - Shedding power in leader's own interest.





# 1.7 Why not everywhere

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## 1.7.1 Population Density and Land Productivity

Unproductive, strong runs extortion racket against productive, weak. But sometimes productive, weak may have option other than paying. Productive, weak may have option to move away. For eg. In a hunter gatherer society, if a strong hunter gatherer threatens weak one, the weak one can just move elsewhere. That's why aboriginal Australia never developed states. Because strong unproductive couldn't build substantial production racket.

Scale economies of Violence exhaust themselves quite rapidly. Big armies need to be fed. Territory need to be rich enough (production) to feed large armies. Romans were unbeatable in Europe. In Britain, as they went up (north), productivity decreased especially in highland of Scotland. However, they didn't control whole of Scotland. It would cost more to build an army to control the territory than they generate revenue from those lands.

## 1.7.2 Tax System

Why might a leader not build tax system?

- According to Tim Besley, The thug that is precariously in power knows that at any day it might be usurped. Building tax system is slow, long process. Soldiers have to be converted to tax collectors and it takes years before the tax system to generate revenue. Other stronger thug might take over before tax system is working.
- Mobutu - Patronage system to raise money. Mobutu would allow people to have rights to certain economic activities for some money. It was easier for Mobutu to collect money this way than through tax system.

## 1.7.3 Trade Opportunities and Colonialism

Territories without **ecological variation** did not develop into larger states. James Fenske studied this in Africa. He found out that place with more ecological variation had more trade opportunities and states were larger.

**Colonialism** is an exogenous factor, an inorganic process that establish states. The scale economies of violence doesn't occur within the land but comes from outside (imported violence). But once colonialist left, the state crumble, leaving only the arbitrary boundary (Romans leaving Britain).

# 1.8 Key Takeaways

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- In a rural society, there are two types of economic activities of equal status: production and violence.
- Armies manifest as a result of the scale economies of violence.
- As armies grow bigger more revenue is needed to sustain them. This created a need for a bureaucracy capable of observing what people have got, in order to extract more from them, which resulted in the emergence of the tax system.
- With a tax system in place, there is an incentive for the leader to grow the economy. One way to grow the economy is to encourage trade. However, trade requires people to trust each other, which led to the concept of contract enforcement as a state function, and a provided the base for a rudimentary rule of law.
- To encourage more trade, investment in infrastructure is required to connect people from different areas. Infrastructure includes roads, bridges, and markets.
- If a leader reaches the maximum revenues that can be extracted by taxation, and still needs more resources for the armies, one possible channel could be to borrow from the wealthy elite. However, the elite are not likely to trust the leader to pay them back. Therefore, at that stage the leader needs to share some of the power with the wealthy elite and give them control over key decisions such as the budget. This typically led to the creation of a parliament whose members are the wealthy elite.

## **Some of the reasons this did not happen everywhere include:**

- Population density: in a low-density population with plenty of other farm areas to move to, or in a hunter-gatherer society, people can just relocate run away instead of paying up. In an environment where people can just run away, you don't get the first step in the emergence of a state.
- Land productivity: a lot of territories will just be too unproductive to support the scale of an army to control the territory and the scale economies collide with the economic inability to maintain a big enough army to meet those scale economies.
- Tax systems: not all states implemented tax systems and continued with a patronage system.
- Trade opportunities: the opportunities for trade depends on ecological variation.
- Colonialism: states were created where violence was imposed externally by colonizing powers and when colonization ended, they left behind very unstable territories.

## **Module II**

### **From Centralized State to Inclusive State**

## 2.1 Inclusive State

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**Acemoglu and Robinson** - Centralized state becomes Inclusive state because power, political power shifts from thug dictatorship, not just wealthy but to everybody. People in power have no choice but to work for interest of ordinary people. They would be voted out if they don't.

**Besely and Perrson's common interest state** - Common interest state start with the thug's **redistributive state**. Redistributive state involves redistribution from weak to the powerful; the strong unproductive redistributing food and resources from the weak productive to themselves. Besely and Perrson's start from thug to common interest state but they may or may not end up into democracy unlike Acemoglu and Robinson. This **common interest state** is a state where people in power have their own interest is broadly coincident with the interests of ordinary people.

One reason the interest may be common is that it's a democracy and they can be voted out. So, they have no choice. But it doesn't have to be democracy. The interests of elite sometimes happens to be coincident with that of ordinary people. **Acemoglu and Robinson predicts that China can't be a developed state because it is not democracy. However, Besely and Perrsons don't have same prediction because China is a common interest state.**

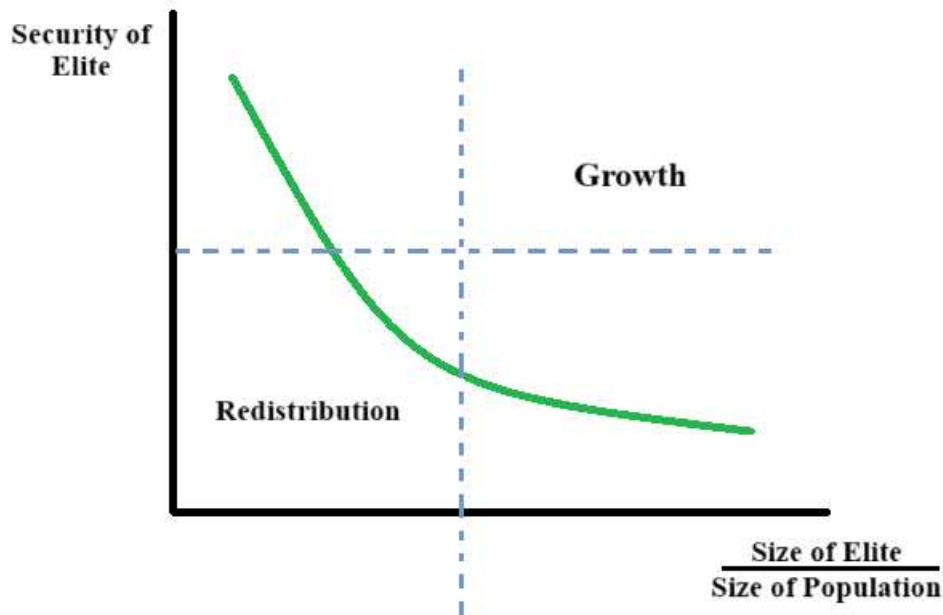
## 2.2 Routes to Inclusive State

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### 2.2.1 Minor Route to an Inclusive State

Ruler has two choice - grow the economy and benefit his/her patronage elite or transfer income from other people in the society to him and his elite. Which is better?

It is a choice and it depends on the characteristics of the country.



- One dimension is security of elite - how secure is the individual in power?
- Other dimension is size of his elite.

Sometimes, it is rational to go for growth and other times for redistribution. This redistribution is opposite to welfare state redistribution.

**When to go for growth?** Growth takes long time to take place. So, for any size of elite, the more secure you are, it is rational to go for growth. Similarly, for any size of elite, the bigger the size of elite, it is harder to satisfy elites by grabbing from others. So, it makes sense to go for growth.

Secure elites which are rather large will go for growth. Insecure elites which are smaller in size go for redistribution. Elite go for growth not because they want to benefit everybody. It's an inadvertent consequence of the choice. It benefits everyone and this becomes the common interest state even though it is not democracy.

### 2.2.1.1 Countries that have taken minor route

#### **Growth vs Redistribution**

In 1970, both Malaysia and Burma were rather poor. However, Malaysia chose a growth strategy and have since grown their economy around 40 times. Although there are some aspects of democracy in Malaysia, it was primarily the elite's choice to go for growth that benefited most of their society.

In contrast, for many years Burma was controlled by a narrow military elite and did not grow because it was massively redistributing wealth from ordinary people to its elite.

#### **Structure of Identity**

- **Fragmented Identities**

A typical African state is the product of an external, colonial military power enforcing borders where there are many different ethnic and religious identities. In these countries, our 'thug' will come from one of these groups. Because of his bias, he will build his power on the redistribution of wealth from everyone else to favour his group. In other words, fragmented identities may produce a redistributive outcome rather than growth, which is why the size of the elite might be quite small.

- **Shared Identities**

When South Korea emerged in the early 1950s, it had a shared identity under a military dictatorship. Thanks to a common enemy (North Korea), they developed a unified identity that resulted in a lot of policies which benefited everyone.

But a shared national identity is not enough because, over the border in North Korea, the people all identified themselves as North Koreans. Despite their shared identity, the rulers of North Korea still chose a strategy that benefited a tiny elite.

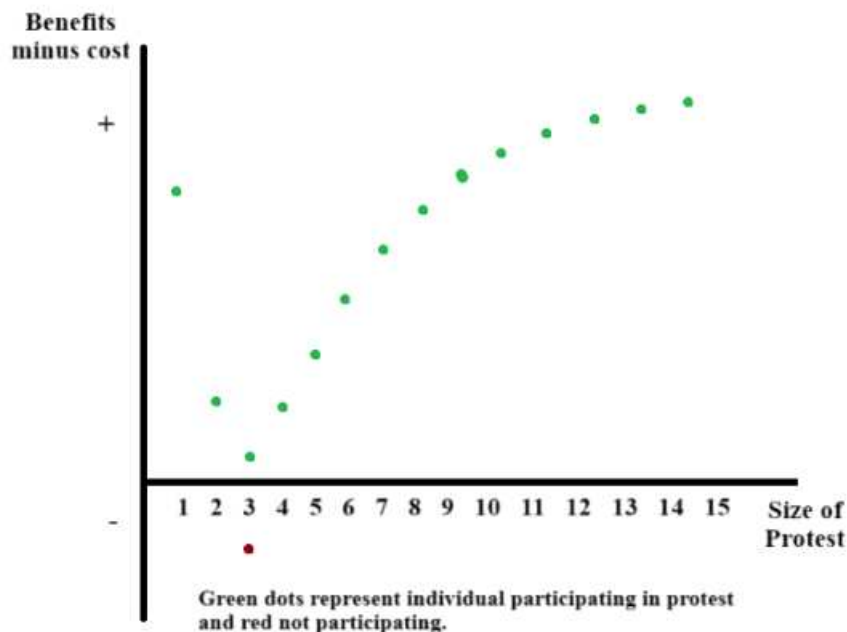
### 2.2.2 Major route - Pressure from below to share power.

Acemoglu and Robinson struggle where through pressure, ordinary people force their way into political power.

- **The major Route: Protest**

Ordinary people see the power controlled by the top and wealthy around him and widening gap between rich and themselves. So, at any state, they protest. The pressure forces the regime to change.

The protest succeed only large numbers of people join and there are big net benefits to this.



There is always the first person to start a protest, who may have real grievance against the government. The second person may be courageous and thinks the first person is right. So, he joins the first person. Third person may think about the cost-benefit. He/she may join or not join the protest. If he/she joins, it can catapult to other people joining the protest and protest succeed. But if he/she doesn't, the protest may die due to small size of protest. Whether or not the protest succeed depends on each guy staying with a net benefit from protesting. Protest has to roll up to succeed.

- **Technologies of Protest: Social Media**

Arab Spring (2011) - massive protest scaled to fast for authorities to handle? How did it happen? It was because of change in technology, especially social media amongst the young. Social media allowed them to coordinate and form protest too fast.

The first use of social media was 2008/9 election by Barack Obama.

Repressive states have wised up. So, now they try to control and monitor social media.