

# A brief introduction to Why Nations Fail

Based on

Why Nations Fail: The Origins of Power, Prosperity and Poverty  
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# What it mainly tried to explain

- Why some countries are rich and well-developed, while the others are in poverty
- What is the main cause for world wide inequality

# Theories that don't work

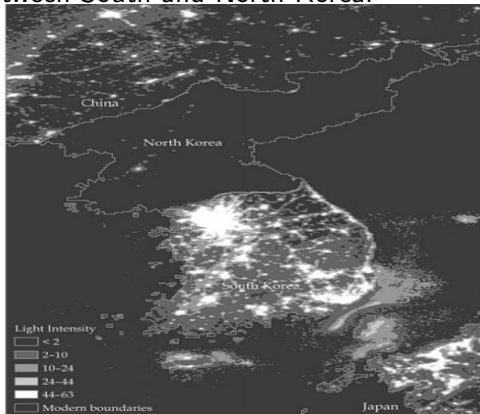
- The geography hypothesis is that the great divide between rich and poor countries is created by geographical differences. Obvious facts that support this hypothesis are many poor countries, such as those of Africa, Central America, and South Asia, are between the tropics of Cancer and Capricorn. Rich nations, in contrast, tend to be in temperate latitudes.
- The culture hypothesis relates prosperity to the culture including religion, values, beliefs and ethics.
- The ignorance hypothesis asserts that world inequality exists because we or our rulers do not know how to make poor countries rich.

# Theory that works

- The institutions: The politics determines institutions that a nation has; institutions determine incentives for different individuals; incentives determines individual's behavior; and then, individuals' behaviors determines whether the nation is in prosperity or poverty.

# The two Koreas

- An intuitive feeling about the big difference in economic development between South and North Korea.



Map 7: Lights in South Korea and darkness in the North

# The two Koreas

- The people of South Korea have living standards similar to those of Portugal and Spain. To the north, in the so-called Democratic Peoples Republic of Korea, or North 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; the average North Korean can expect to live ten years less than his 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.

# The two Koreas

Why they are so different?

- Ethnic, they are the same ethnic.
- Culture, they share the same culture,
- Geography, their geographical conditions are very close. It's impossible to find two countries that their geographical conditions are totally the same.
- Ignorance of rulers? About Kim Il-Sung, I don't know much about his education; however, Kim Jong-Il had good educations in North Korea and Kim Jong-un had good educations in Switzerland. It's hard to say they are ignorant.

# The two Koreas

Why they are so different?

- 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 Syngman Rhee, with significant support from the United States. Rhee and his famous successor, General Park Chung-Hee governed a market economy where private property was recognized.



# The two Koreas

Why they are so different?

- The north of the 38th parallel was quite a different story. Kim Il-Sung established himself as dictator by 1947 and, with the help of the Soviet Union, introduced a rigid form of centrally planned economy 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 grandson.

# The two Koreas

Why they are so different?

- Under the institutions of North Korea, incentives for individuals to work hard are not enough. Imagine that, in the absence of private property, a very big share of fruits of your hard work is extracted by the politic and economic system, what would you do? If everyone does not want to work hard, what happens to our economy?

# The two Koreas

Why they are so different?

- Also, it's actually the same story about the Great Leap Forward in China. There was a policy called "people's communes" in agriculture. The communes were relatively self-sufficient co-operatives where wages and money were replaced by work points; private plots were entirely abolished and communal kitchens were introduced. All the outputs belonged to collectives; if you worked, you can eat for free at the commune canteens. **The consequence: famines.**

# Toward a theory of institutions

## Main concepts

- **Extractive economic institutions:** Lack of law and order. Insecure property rights; entry barriers and regulations preventing functioning of markets and creating a nonlevel playing field.
- **Extractive political institutions—in the limit “absolutism”:** Political institutions concentrating power in the hands of a few, without constraints, checks and balances or “rule of law”.

# Toward a theory of institutions

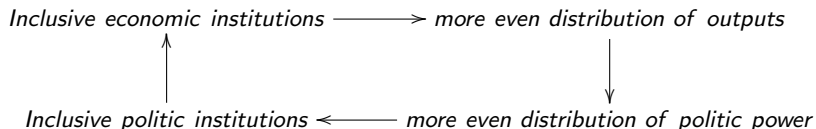
## Main concepts

- **Inclusive economic institutions:** Secure property rights, law and order, markets and state support (public services and regulation) for markets; open to relatively free entry of new businesses; uphold contracts; access to education and opportunity for the great majority of citizens.
- **Inclusive economic institutions:** Political institutions allowing broad participation– pluralism–and placing constraints and checks on politicians; rule of law (closely related to pluralism).
  - But also some degree of political centralization for the states to be able to effectively enforce law and order.

# Toward a theory of institutions

## Two circles

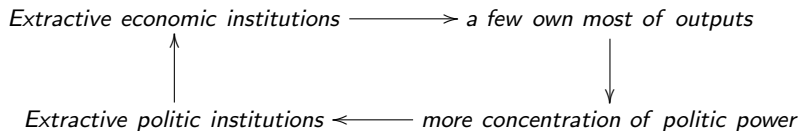
### • The Virtuous Cycle:



# Toward a theory of institutions

## Two circles

- **The Vicious Cycle:**



- The base determines the superstructure, yet their relation is not strictly causal, because the superstructure often influences the base.

# Toward a theory of institutions

Two circles

		Economic Institutions	Institutions
		Inclusive	Extractive
Political Institutions	Inclusive	↻	← ↓
	Extractive	↑ →	↻

- These transitions process partially leave to history contingency.



# Toward a theory of institutions

why are extractive institutions so common in history and today?

- **Creative distruction**
- Growth will create both winners and losers.
- **Economic losers:** those who will lose their incomes, for example their monopolies, because of changes in institutions or introduction of new technologies.
- **Political losers:** those who will lose their politically privileged position, their unconstrained monopoly of power, because of growth and its supporting institutions.

# Toward a theory of institutions

why are extractive institutions so common in history and today?

- It's reasonable that if you are a winner, you will try your best to keep yourself the winner.
- To keep yourself the winner, you would not give others opportunities to challenge you.
- Extractive institutions come in.

# Summary

- The institutions is the main cause for world wide development inequality.
- Extractive institutions destroy incentives for most individuals in a society to work hard.
- However, a few can keep themselves the winner at the cost of others by extractive institutions.

- Undoubtedly, the key word for this book is institutions.
- But, for me, I feel that it is the incentives changed everything in societies. We need consider it when we are considering the strategy of development or others' behaviors.

- For example, according to Hirschman, maybe the sequence B-C-A is the best for a society. However, for a few who have the power to make decision, C-A-B is the sequence by which they can keep themselves the winner. What would they do?
- If planners want to do something that is really good for a society, they must ensure that, for guys who are able to make it take place, they have enough incentives.

- Another example is that Chinese central government has slowed down the target economic growth rate for the purpose of adjusting economy structure. What is the logic behind it?
- My answer is that under the political institutions in China, every chief officer of “xian”, for the purpose of getting promoted, competes in GDP growth rate with others.

- Assume that, in a region, industry A leads to a high growth rate; other chief officers would think that industry A is good, let's introduce it to our "xian". Usually, chief officers would imitate strategies of the others. These imitations lead to a bad structure of the economy.
- Slowing down the target growth rate decreases their pressures to do the same thing.

**Thank you**