Why are Some Countries Poor?

ECON 383: Economics of Discrimination

Winter 2018

"Why are we having all these people from shithole countries come here?"

Donald Trump, January 11, 2018

The economics of "shitholes"

1. Why are some countries richer than others?
2. What are the economic consequences of allowing immigration from poor countries?

Today we'll talk about question 1.

Growth economics

- *Economic growth* determines whether countries are rich or poor
- Growth is the change in (aggregate or average) income over time
- Rich countries aren't created rich, they grew into what they are
- Why were they able to grow? Why can't all countries grow?

The rule of 72

- Growth rates are exponential, small changes can have significant consequences
- Suppose average income grows at a rate $g\%$ per year
- Income will double every $\frac{72}{g}$ years Examples:
- US: $g = 1.6$. Time to double: 45 years
- China: $g = 6.7$. Time to double: 10.7 years

Proximate causes

Many things are correlated with growth:

- Population growth
- Capital accumulation
- Human capital (education)
- Health Do these things cause growth, or does growth cause them?

Fundamental causes

The fundamentals determine the proximate causes:

- History
- Culture
- Geography
- Institutions

Acemoglu, Johnson, Robinson (AJR)

- The most important source of growth is institutions
- Douglass North: Institutions are "the humanly devised constraints that structure political and social interaction"
- The set of marketplace rules, enforcement, redistribution, etc that determine how economic agents interact

Examples

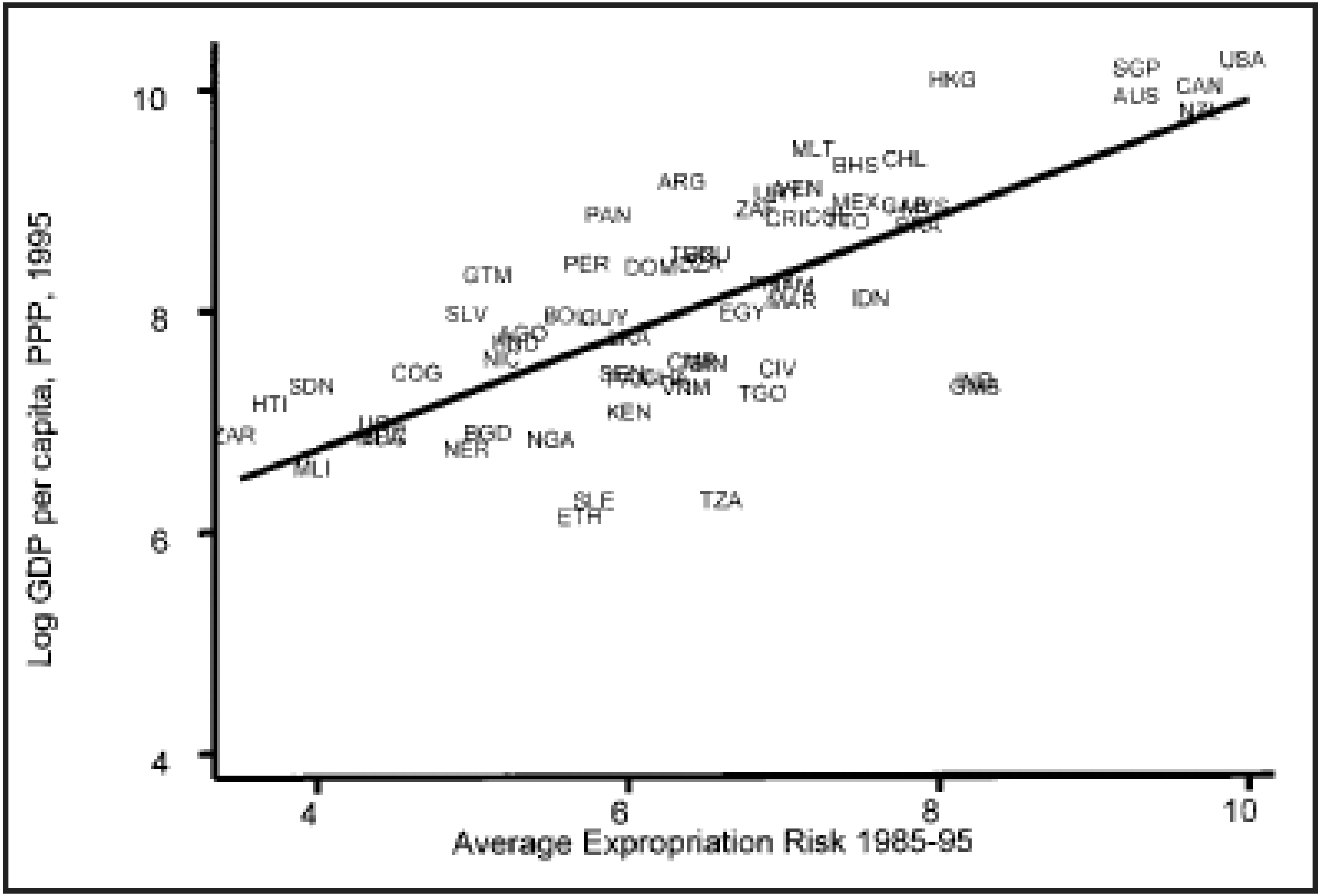
- North and South Korea
- East and West Germany
- Nogales, Sonora and Nogales, Arizona

Measuring institutions

Protection from government expropriation:

> *Government expropriation is not the only institutional feature that matters. Our view is that there is a "cluster of institutions," including constraints on government expropriation, independent judiciary, property rights enforcement, and institutions providing equal access to education and ensuring civil liberties, that are important to encourage investment and growth. Expropriation risk is related to all these institutional features.*

- How likely is it that the government will take your property?



Log GDP per capita, PPP, 1995
Average Expropriation Risk 1985-95
10
8
6
4
4
6
8
10
HKG
SGP
AUS
USA
CAN
MLT
BHS
CHL
ARG
PAN
MEX
GTM
PER
IDN
SLV
EGY
COG
CIV
SDN
HTI
TGO
KEN
BGD
NGA
NER
MLI
TZA
SLE
ETH

Problem

- Institutions caused by growth?
- Richer countries may demand more accountable, fair government
- Need to find an "exogenous change" in institutions that allow us to measure effects

The theory

- Institutions are persistent. Historical institutions strongly predict current institutions
- European colonialists created institutions in the countries they colonized
- Some countries got "inclusive" institutions, others got "extractive" institutions
- Institutional structure determined by whether colonists wanted to settle a region (US) or extract resources and leave (Central and South America)
- Colonists wanted to stay in places where they didn't die (disease, hostile indigenous people, good soil, etc)

Causality

- Early European settlers arrive in a location
- News of the conditions reaches their homeland
- **Hospitable place** = more settlers move
- Settlers create institutions that give political rights to citizens
- **Inhospitable place** = nobody moves
- Colonialists attempt to extract as many resources from the area as possible before going home
- Set up institutions that strongly favor elites, "exploit" non-elites

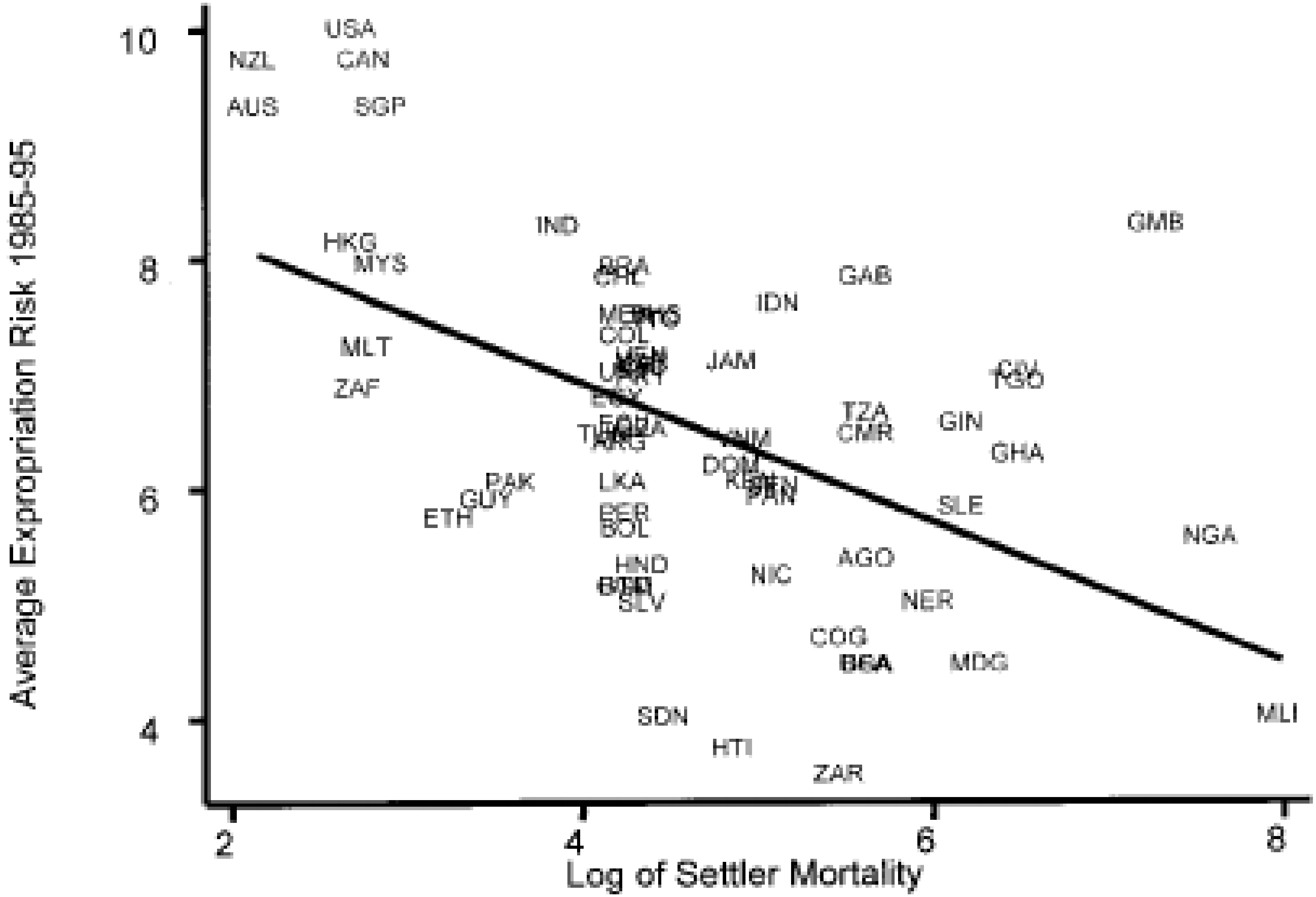


FIGURE 3. FIRST-STAGE RELATIONSHIP BETWEEN SETTLER MORTALITY AND EXPROPRIATION RISK

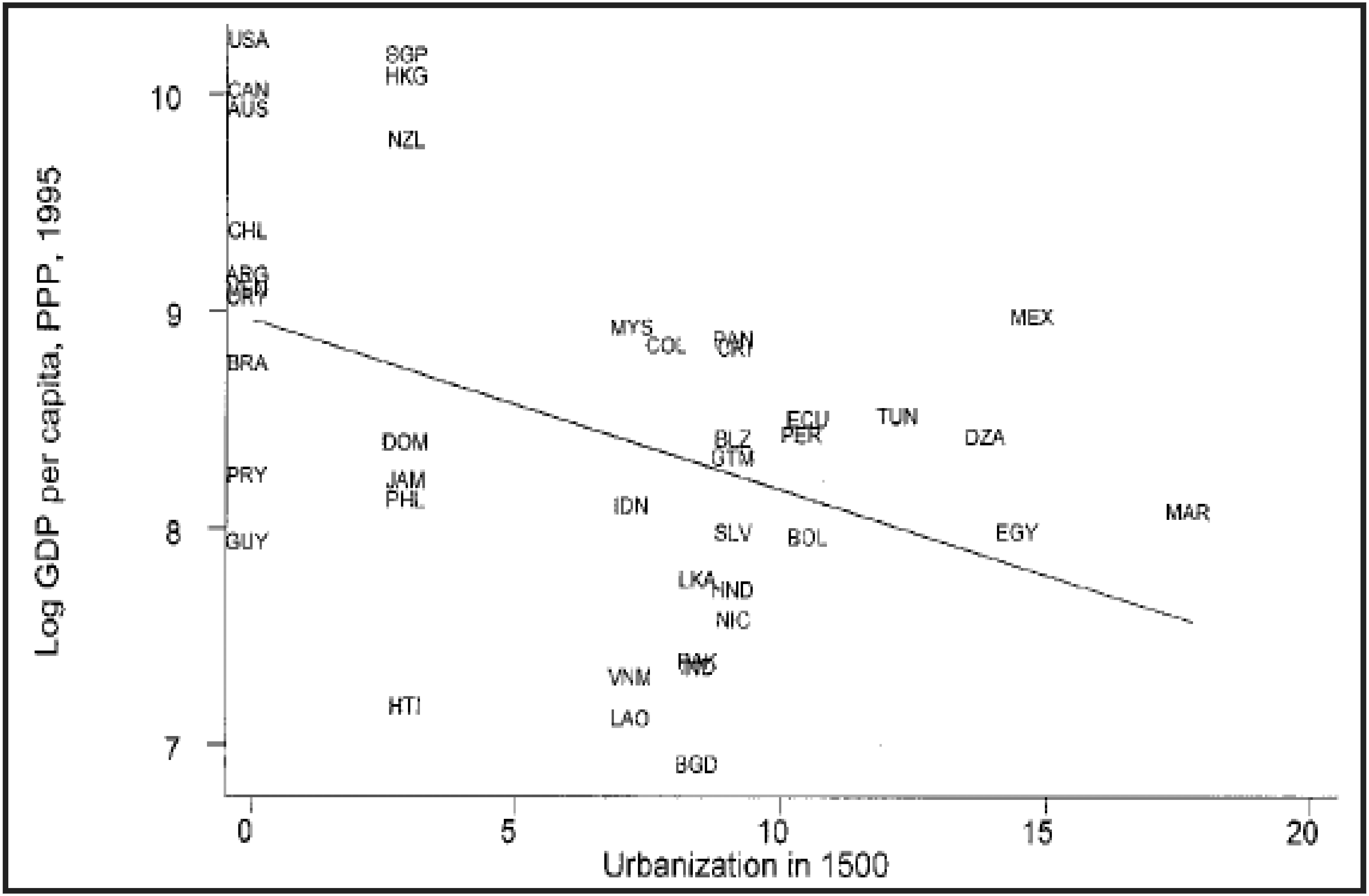
Current institutions

- Largely determined by settler institutions
- Extractive colonialists = extractive institutions today
- "Inclusive" colonialists = inclusive institutions today
- Colonial institutions caused growth -- no other factors significant!

Reversal of fortunes

- Did colonists extract from countries that were already poor?
- No! Colonized countries that are poor today were generally more wealthy in 1500!

> *"High population density, by providing a supply of labor that could be forced to work in agriculture or mining, made extractive institutions more profitable for the Europeans."*


Log GDP per capita, PPP, 1995
Urbanization in 1500
10
9
8
7
0
5
10
15
20
USA
SGP
HKG
CAN
AUS
NZL
CHL
ARG
BRA
PRY
GUY
MYS
COL
PAN
MEX
ECU
TUN
BLZ
PER
DZA
DOM
GTM
JAM
PHL
IDN
MAR
SLV
BOL
EGY
LKA
HND
NIC
VNM
HTI
LAO
BGD

Reversal examples

Poor areas in 1500:

- US and Canada
- Australia and New Zealand

Rich areas in 1500

- Sub-Saharan Africa (Songhai Empire)
- Central and South America (Aztec, Inca)
- India (Mughal Empire)

Uncolonized Rich areas in 1500

- Western Europe

Institutions and the reversal

- Rich to poor countries all have similarly extractive institutions today
- Poor to rich countries have similarly inclusive institutions today, same as countries with no reversal