Colombian Development in the Long-Run: Some Preliminary Ideas

Daron Acemoglu (MIT)
Leopoldo Fergusson (Los Andes)
Simon Johnson (MIT)
Pablo Querubín (Los Andes)
James A. Robinson (Berkeley)

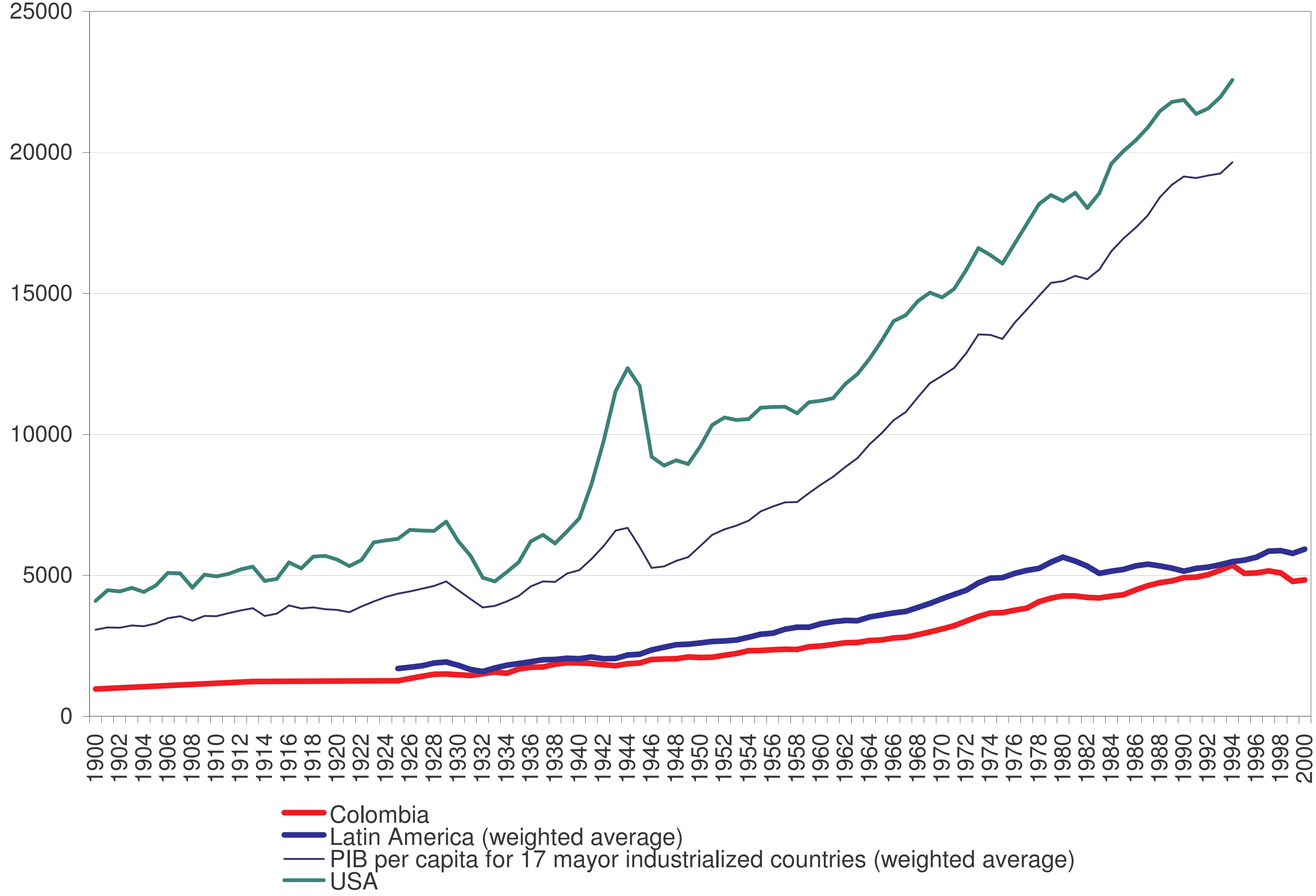
The McGreevey Effect

- **Theorem:** If a gringo academic claims that x is true about Colombia, Colombian scholars adamantly assert that not x is true.
- **Proof:** *The Economic History of Colombia* by William McGreevey.
- **Corollary:** No more gringos write about Colombian economic history.
- Latest application of the Theorem: The "Alesina project".
- Next application – this project?

Facts about Colombian Development

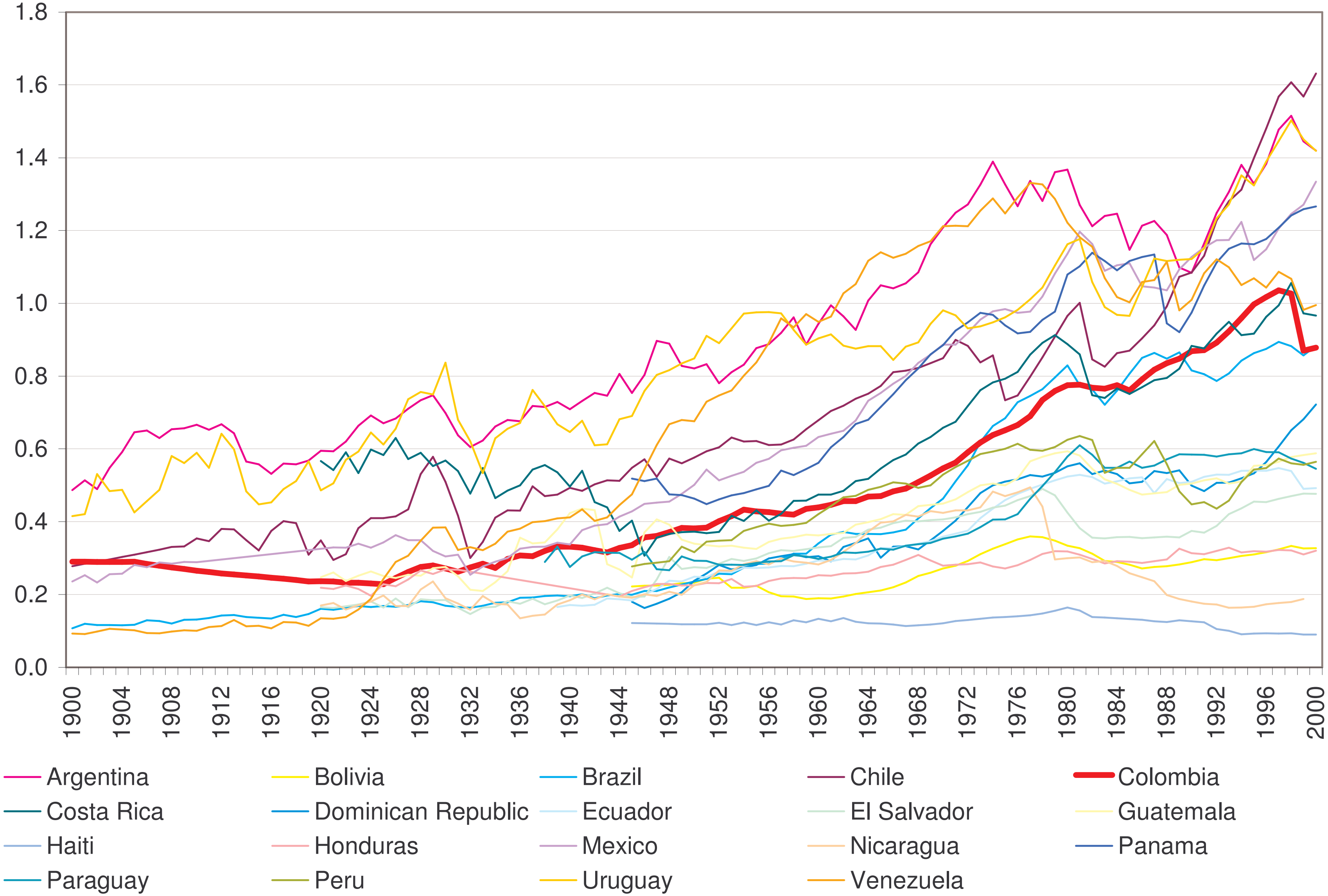
- Maddison (2002) and Oxford, Figures 1 and 2.
- Proximate versus Fundamental Explanations of Development.
- **Proximate:** Factor accumulation, technical change, economic policy.
- **Fundamental:** Institutions, geography, culture.
- Acemoglu, Johnson, Robinson (2001, 2002) – institutions the key.

Figure 1: Colombia's Long -Run Comparative Performance, 1900-2000 (GDP per capita, PPP dollars of 1990)



Source: Maddison and GRECO. Latin America´s Average includes Argentina, Brazil, Chile, Colombia, México, Peru, Venezuela

Figure 2: Within Latin America (everybody), 1900-2000
(GDP per capita, PPP dollars of 1970, thousands)



Source: Oxford Latin American historical database

Figure 3: Fundamental versus Proximate Explanations of Growth

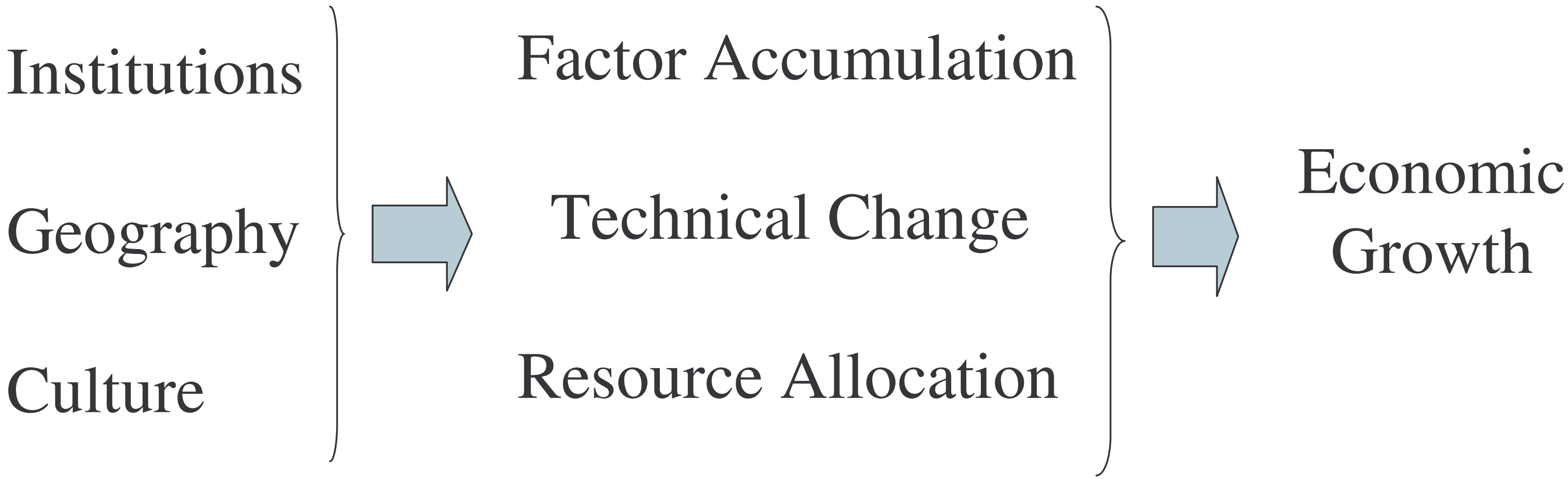
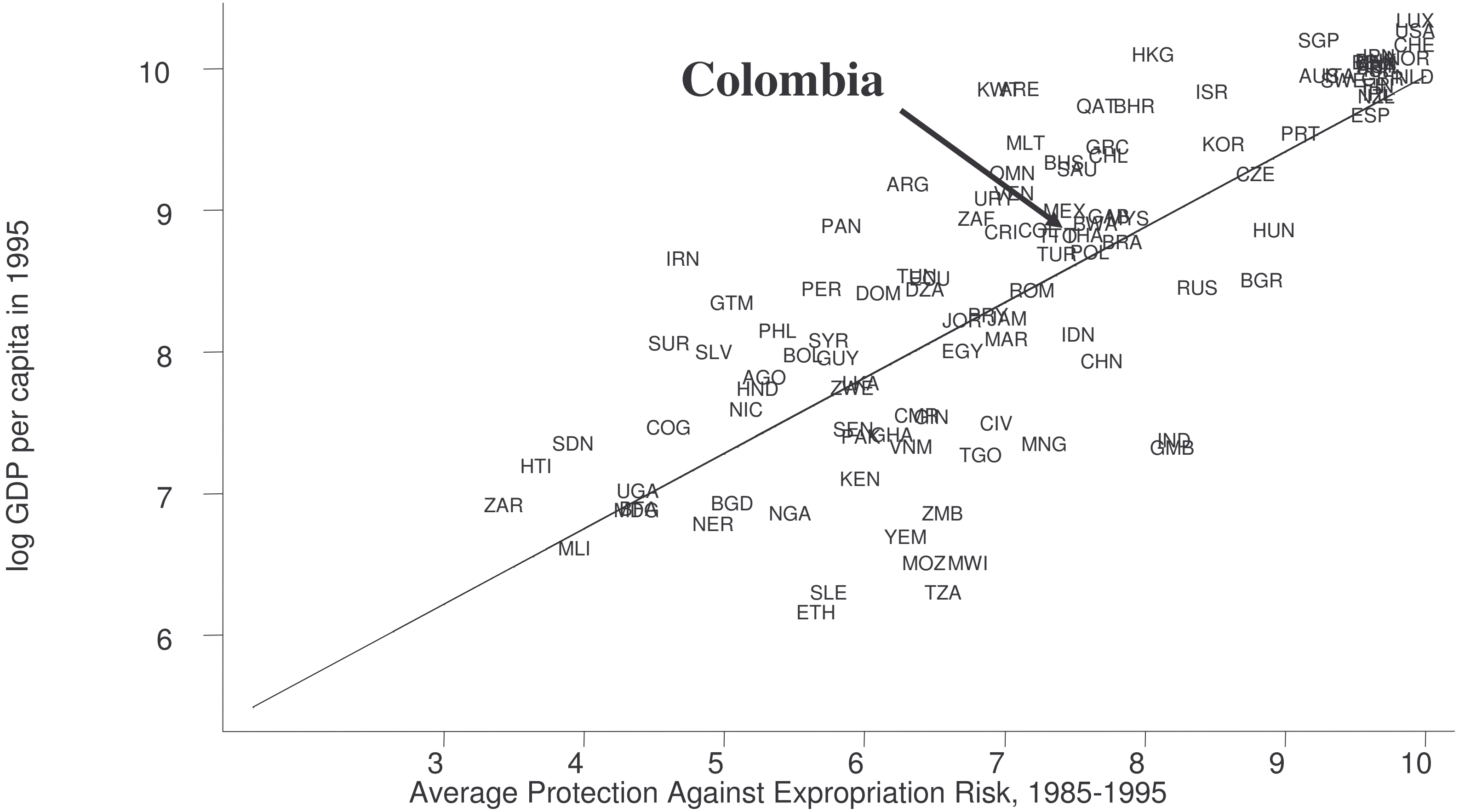


Figure 4: Institutions and economic performance



Institutions and Development

- *Economic institutions*, such as property rights, markets, law, determine per-capita income levels.
- But why do some countries have better economic institutions than others?
- Institutions are intrinsically collective choices. Therefore, whoever has *political power* can determine them.
- Political power is determined by two factors: (1) *political institutions*, (2) *intrinsic political power* (extra-legal, collective action, brute force).
- E.g. Political institutions endow President Uribe with political power, but the FARC has considerable intrinsic power. Both sources of power are important (witness recent events in Bolivia).

Figure 5: The Dynamics of Institutions

$$\left.\begin{array}{l}\text{Political institutions}_t \\[2em] \text{Intrinsic power}_t\end{array}\right\} \begin{array}{l}\text{political} \\ \text{power}_t\end{array} \Rightarrow \left\{\begin{array}{l}\text{Economic institutions}_t \\[2em] \text{Economic policies}_t \\[2em] \text{Political institutions}_{t+1}\end{array}\right.$$

- Political power used to maximize rents **not** prosperity.
- Economic institutions, political institutions and political power interact to determine a dynamic path.
- Both vicious and virtuous circles are possible.
- But what sets such a path in motion?
- Historical processes, events, *critical junctures* or massive political or economic shocks that lead to significant reorganizations of society, changes in the structure of economic activity, or dramatic shifts in the balance of political power.

The Colombian case

- The most obvious example of a critical juncture which reorganized society and precipitated a particular path is the colonization by the Spanish.
- It is uncontroversial that the institutional and social legacy of this reorganization persisted long after independence.
- Could it be that this reorganization of Colombian society still determined the development path?
- Since 1538 (the year when Bogotá) was founded, there have been many crises and shocks to the Colombian political economy that might have led to fundamental institutional changes.

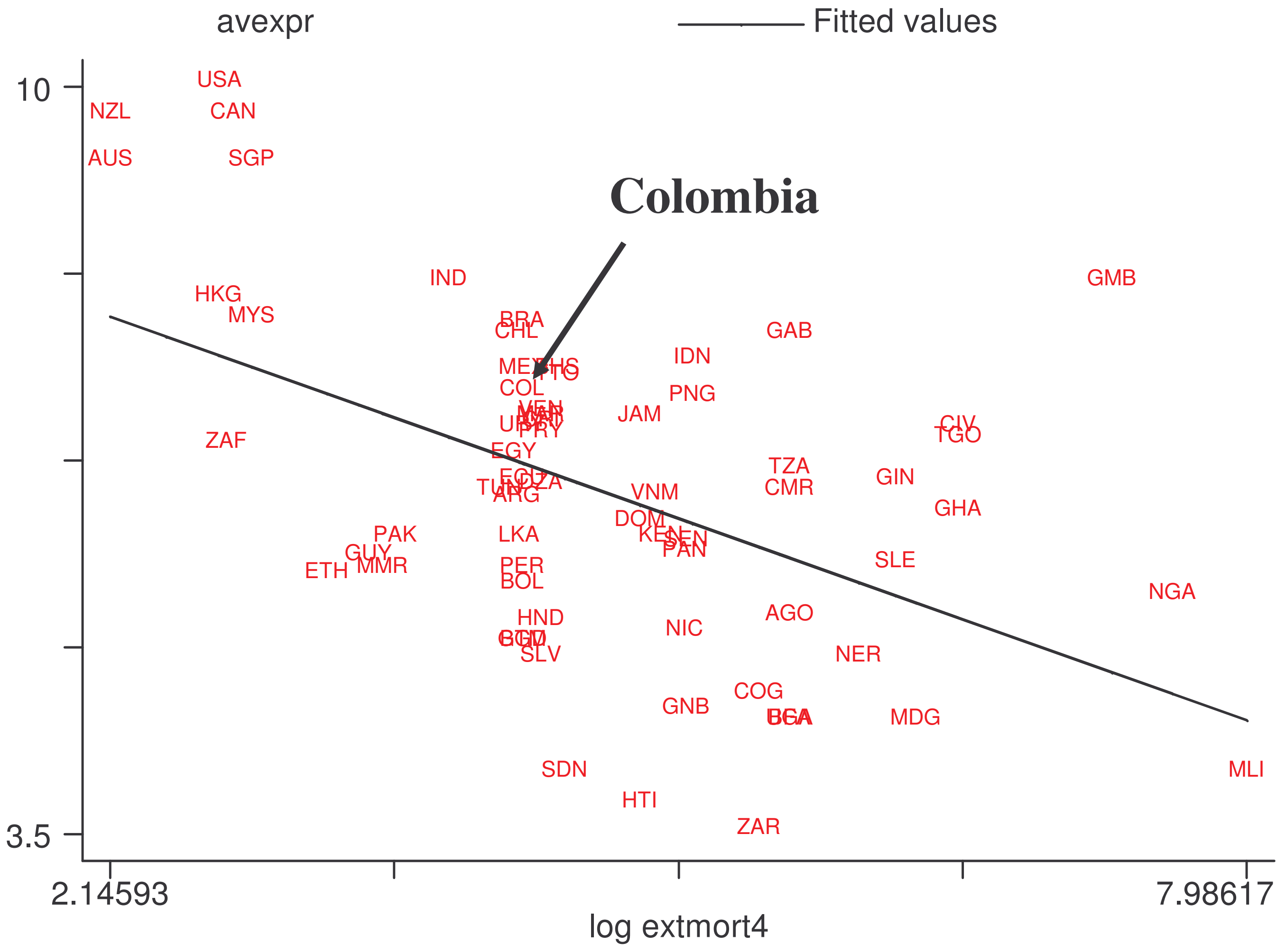
Potential Critical Junctures?

- Independence.
- The Liberal revolution.
- Expansion of the coffee economy and the integration into the world market.
- The War of a Thousand Days.
- The beginnings of industrialization.
- The great depression.
- López Pumarejo's *Revolución en Marcha* and the expansion of the state.
- *La Violencia*.
- the rise of the drug mafias.
- 1991 Constitution

Origins of the Colombian Growth Path

- We first show that Colombia’s GDP-per capita is explained by current economic institutions (back to Figure 4).
- We next show that current economic institutions can be explained by initial conditions during the colonial period, particularly population density and urbanization in 1500 and mortality rates faced by Europeans. Figure 6.

Figure 6: Average Expropriation Risk vs. log settler mortality



European colonization as an institutional experiment

- After the discovery of the New World and the rounding of the Cape of Good Hope, Europeans dominated many previously diverse societies, and fundamentally affected their social organizations (institutions).
- Many factors, including geographic, ecological and climatic ones, constant, while big changes in institutions.
- Europeans established relatively better institutions/social organizations in places that were previously poor and sparsely settled and where the disease environment was relatively benign.
  - e.g., compared United States vs. the Caribbean or Peru.

Understanding the patterns from 1500 to 2000

- Institutions have persisted and affected the evolution of income, especially during the era of industrialization
- Better institutions – private property, access to land, representative institutions, checks and balances on political authority.
- Why not set up better institutions?
- More profitable to set up “bad” institutions in places with high population density and/or with resources to extract. Bad institutions may not promote development but they generate a lot of rents for beneficiaries (Spanish Crown, Liberal and Conservative parties?).
- Also makes sense to establish better institutions in places where Europeans will live themselves as the majority.

Some Evidence on Institutional Persistence

- Gurr's Polity Dataset codes 'constraints on the executive' from independence.
- Scale 1-7. 1 unconstrained, 7 most highly constrained.
- Empirically, constraints on the executive highly correlated with stability of property rights, measures of 'good' economic institutions (e.g. financial market depth).
- We know Spanish colonial state much less constrained than British colonial state in the US. After 1621 (Virginia) representative assemblies in American Colonies, no such thing in Spanish America.
- US emerged at independence with more constraints and built on them (e.g. Constitution). Spanish American colonies did not. European nations in the 19th century also had much greater constraints. Figures 7, 8, and 9.

Figure 7: Constraints on the executive, 1800-2003

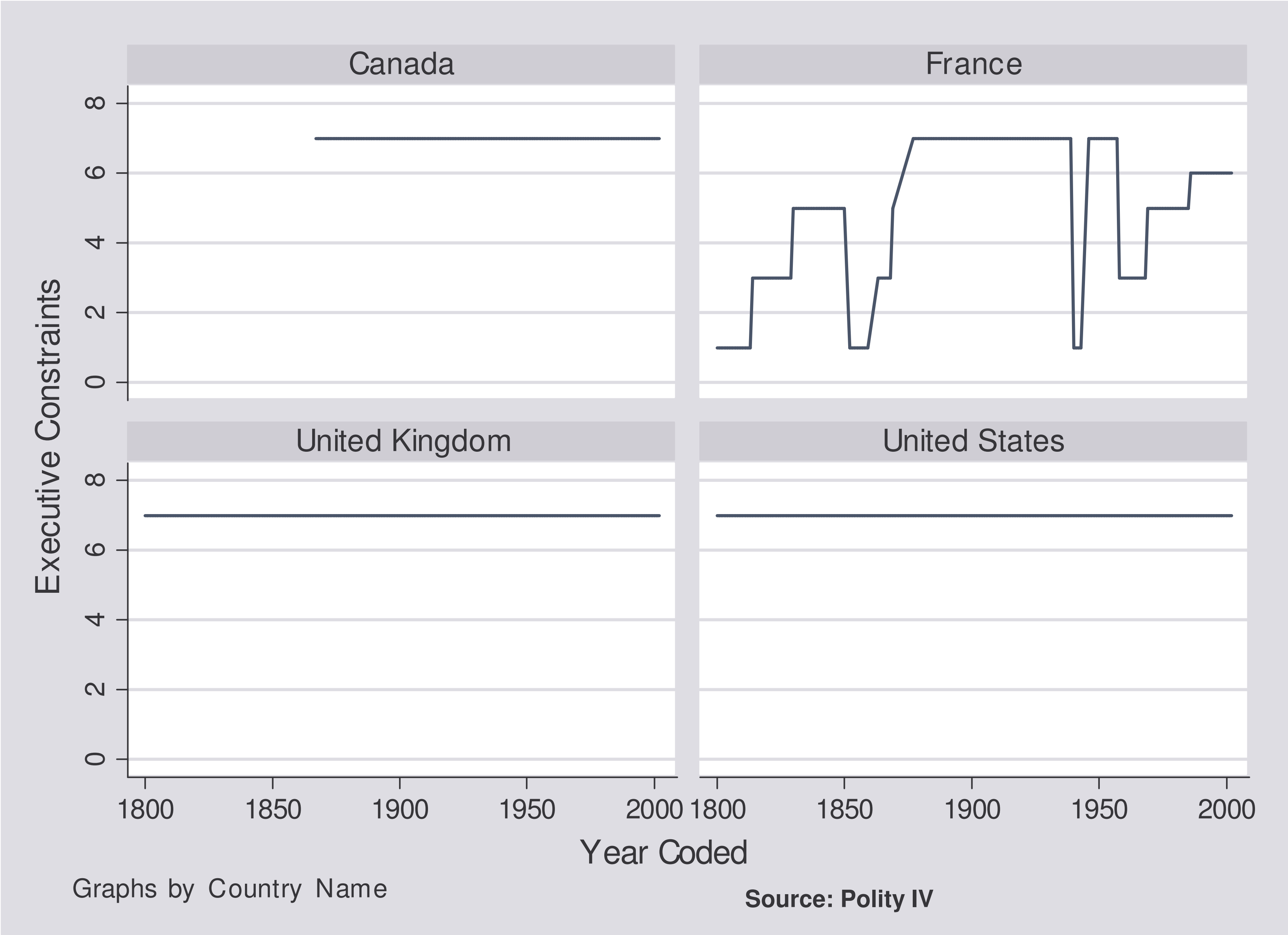


Figure 8: Constraints on the executive, 1800-2003

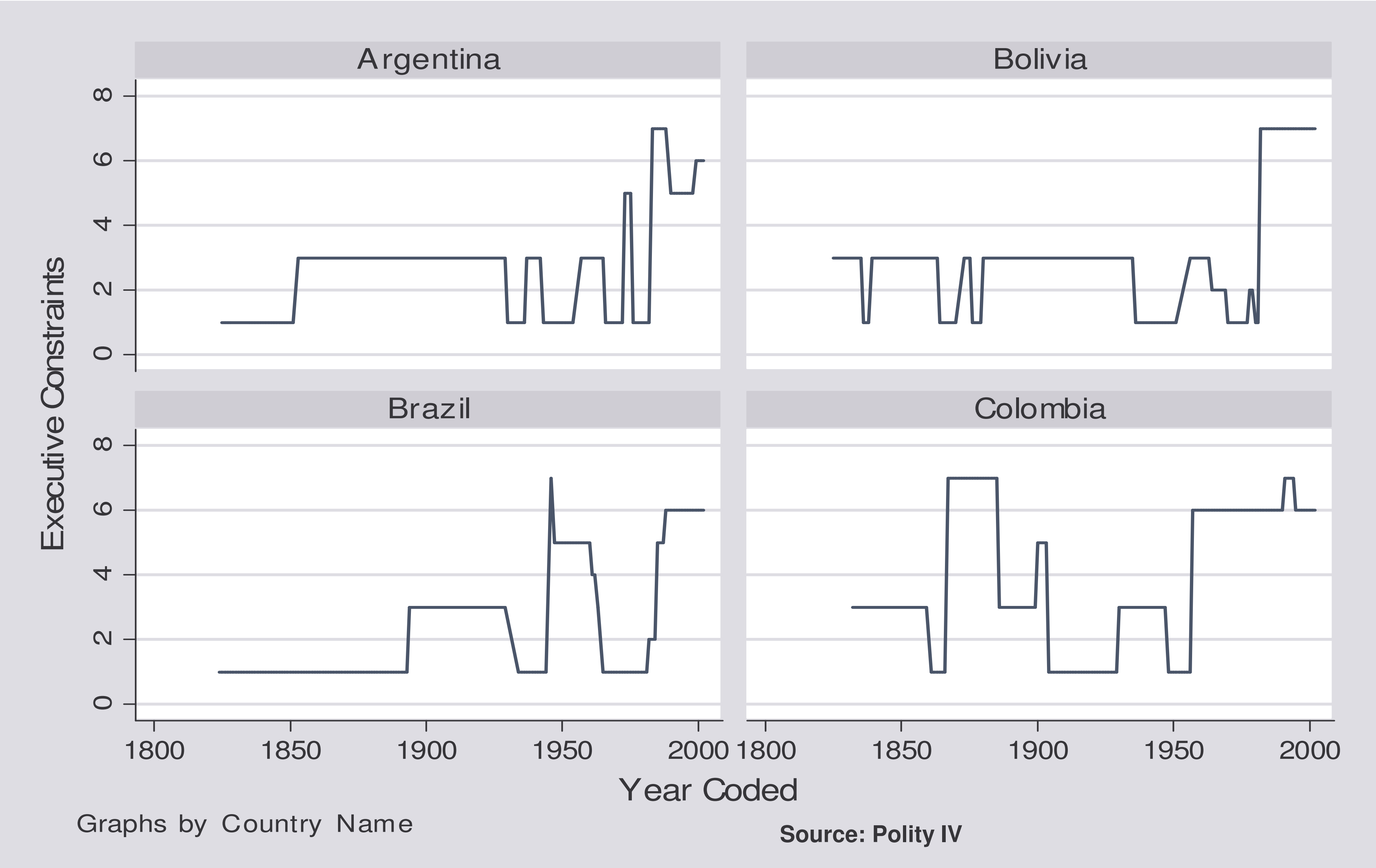
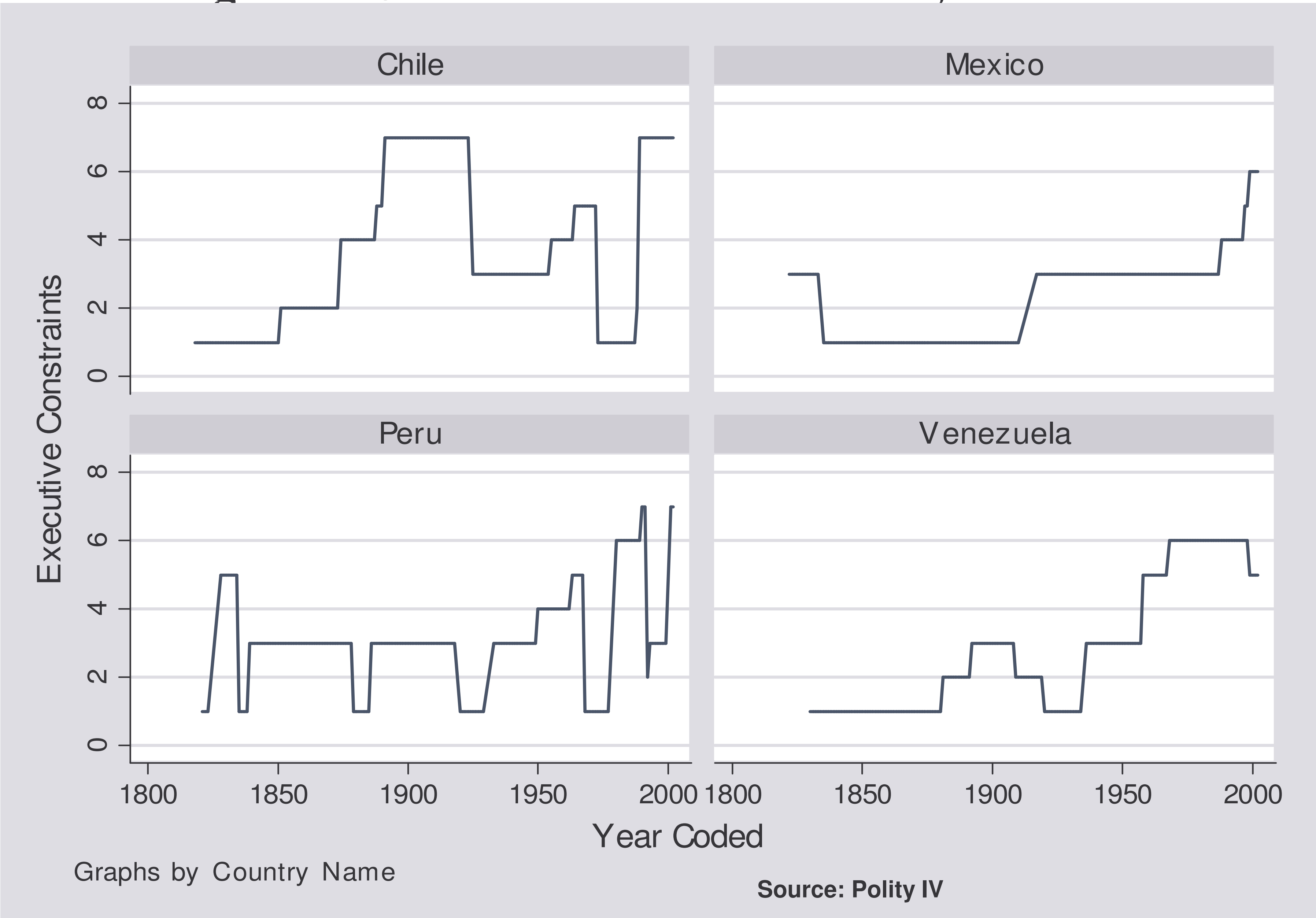


Figure 9: Constraints on the executive, 1800-2003



Back To Colombia

- According to our estimates Colombia is right on the regression line.
- Colombia has the institutions you would expect given its initial conditions during colonization.
- Given its historically determined institutions, Colombia has the per-capita income level you'd expect.
- But what about Colombian exceptionality?
- No populism, no hyperinflation, no debt crisis in the 1980's, good exchange rate and agricultural policy.
- **This does not matter for growth in the long-run!**

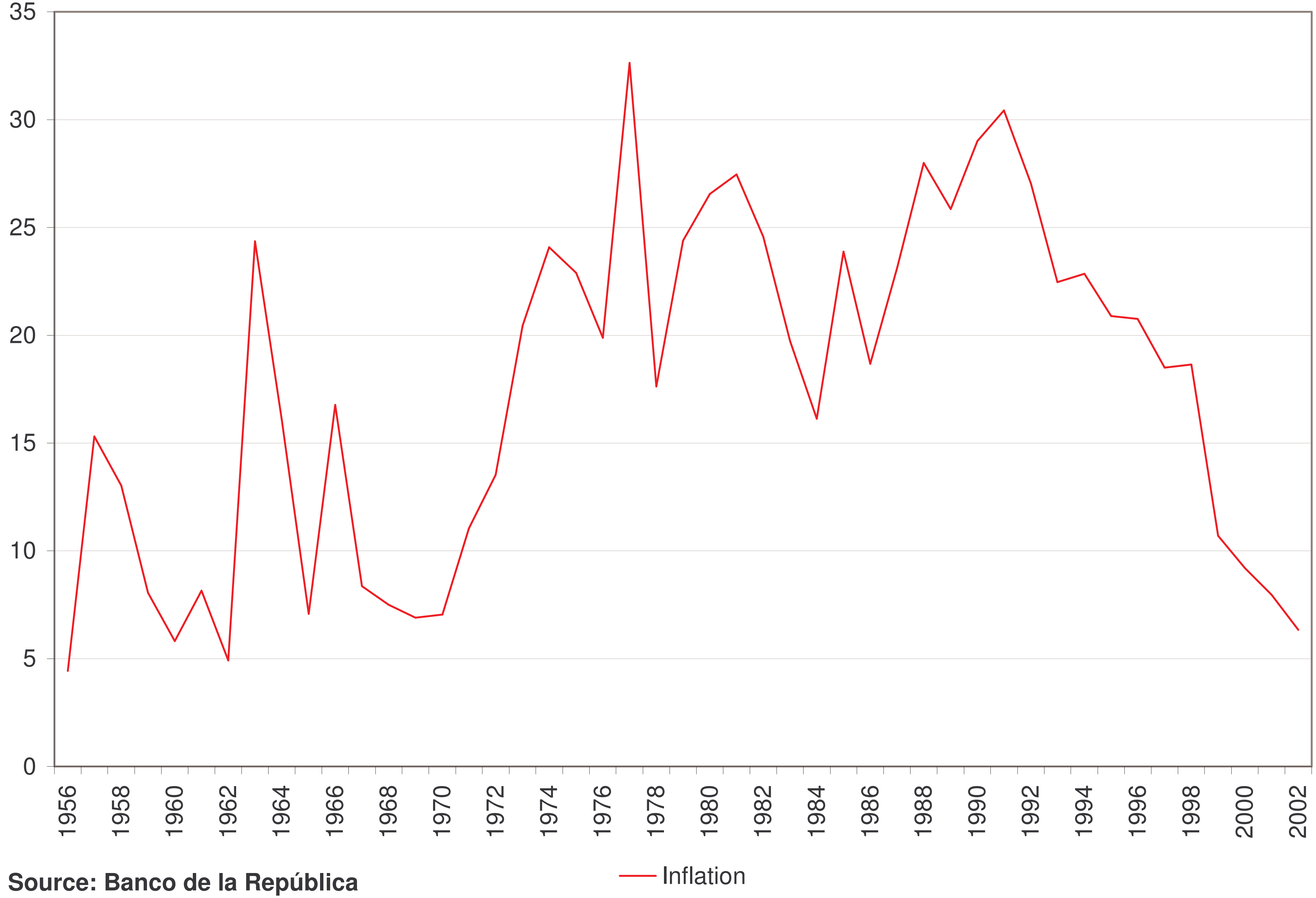
Two Interpretations: *See-Saw Effect*

- Economic policy is **not** a key intervening variable between bad institutions and economic outcomes in Colombia (Acemoglu, Johnson, Robinson and Thaicharoen, 2003).
- Or, economic policy is important, but good policy is bought at a price – other policies get worse in compensation so that the growth path is unaltered.
- We call such an idea the *See-Saw Effect*. When one end of a see-saw goes up, the other end goes down!

Evidence of a See-Saw Effect in Colombia?

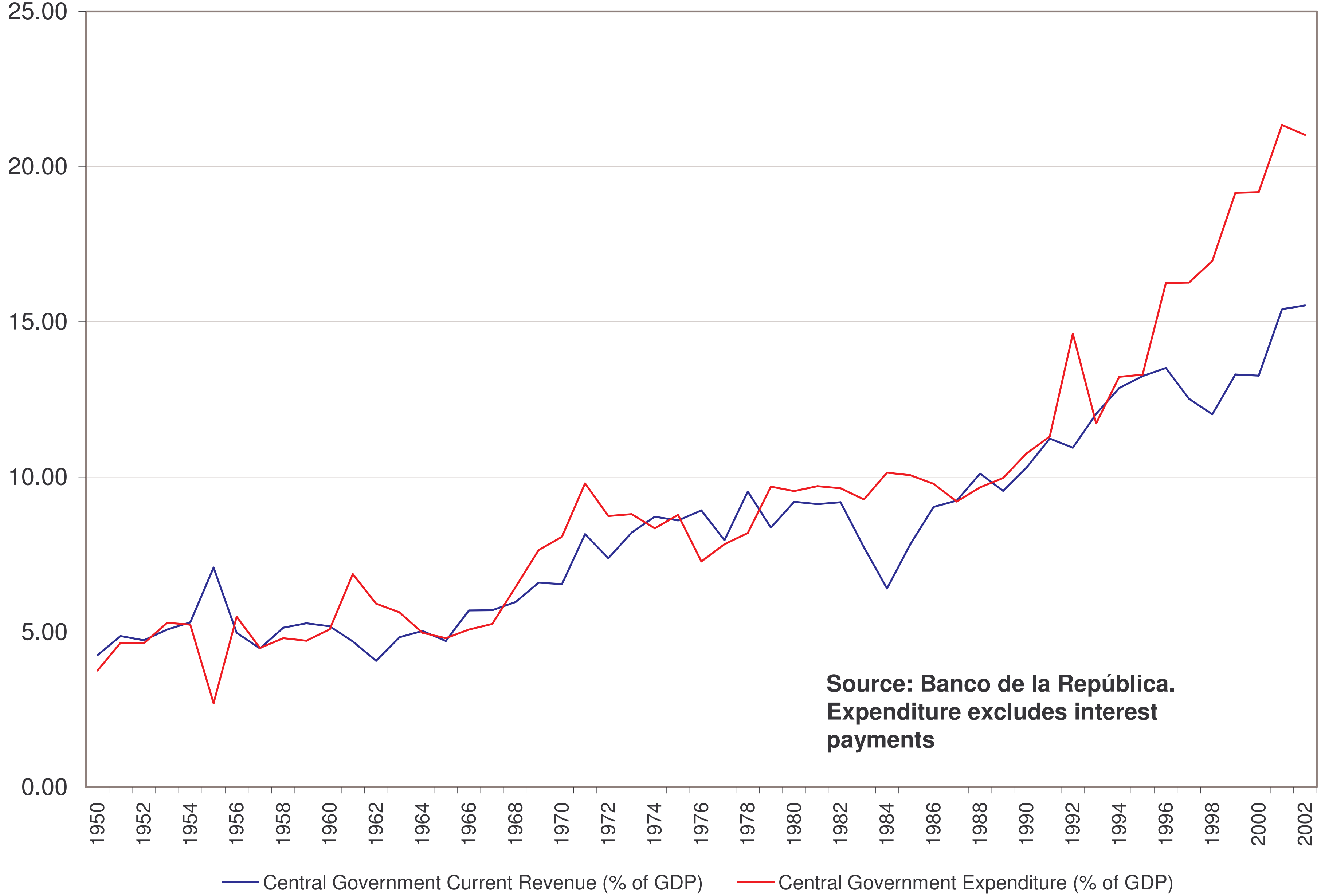
- To isolate this effect need to examine the impact of shocks or reforms that do not change the fundamental development path, but nevertheless lead to some changes.
- Colombian Reforms 1988-1992. Political Reforms – introduction of tarjeton, election of mayors, change in rules for election of Senate. Economic Reforms – trade liberalization, fiscal decentralization, mandated spending on public goods, independence of Central Bank
- The See-Saw effect predicts that with the fundamental institutional equilibrium unchanged, such reforms have no net effect on growth.
- E.g. making the Central Bank independent may bring down the inflation rate, but other things will get worse to compensate.

Figure 10: Inflation rate, 1956-2003 (CPI annual % increase)



Source: Banco de la República

Figure 11: Central Government Revenue and Expenditure, 1950-2002



Interpretation

- Deep seated distributional conflict in Colombian society.
- Since independence search for a stable political order, but one which excluded large segments of society. E.g. *voto incompleto*, National Front, barriers to entry of third political party.
- Conflict manifests itself in political instability and in an institutional structure the aim of which is to redistribute rather than promote prosperity.
- Constitution of 1991 – political crisis leads to an assembly designed to represent wide range of preferences, result: inconsistent claims on the social product, result: the see-saw.
- Making the Central Bank independent removes a redistributive instrument which will be substituted with something else in equilibrium.

A Long-Run See-Saw Effect?

- The evidence is consistent with a see-saw over the last 20 years in Colombia.
- Could there be a long-run see-saw effect which explains why good economic policy has not improved Colombia's performance?
- What could have got worse to compensate for good economic policy?

What to Do Next?

- **Option 1:** Apply the McGreevey Effect (i.e. ignore all of the above!!!!!!).
- **Option 2:** Attempt to understand the determinants of the institutional (general) equilibrium in Colombia (our agenda).
- **Implication:** Institutional change along the lines of the Alesina Project unlikely to promote growth – subject to the see-saw effect.
- You need to understand **a lot about Colombia** to know what to do.
- **Ending on a Positive Note:** Bogotá versus Santa Marta.
- Why has the political equilibrium improved so much in Bogotá?