

They provided an explanation for why some countries are rich and others poor

*This year's laureates have provided new insights into why there are such vast differences in prosperity between nations. One important explanation is persistent differences in societal institutions. By examining the various political and economic systems introduced by European colonisers, **Daron Acemoglu, Simon Johnson and James A. Robinson** have been able to demonstrate a relationship between institutions and prosperity. They have also developed theoretical tools that can explain why differences in institutions persist and how institutions can change.*

The richest 20 per cent of the world's countries are now around 30 times richer than the poorest 20 per cent. Moreover, the income gap between the richest and poorest countries is persistent; although the poorest countries have become richer, they are not catching up with the most prosperous. Why? This year's laureates have found new and convincing evidence for one explanation for this persistent gap – differences in a society's institutions.

Providing evidence for this is no easy task. A correlation between the institutions in a society and its prosperity does not necessarily mean that one is the cause of the other. Rich countries differ from poor ones in many ways – not just in their institutions – so there could be other reasons for both their prosperity and their types of institutions. Perhaps prosperity affects a society's institutions, rather than vice-versa. To arrive at their answer, the laureates used an innovative empirical approach.

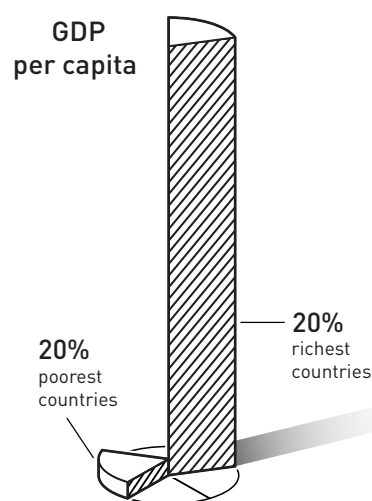
Acemoglu, Johnson and Robinson examined Europeans' colonisation of large parts of the globe. One important explanation for the current differences in prosperity is the political and economic systems that the colonisers introduced, or chose to retain, from the sixteenth century onwards. The laureates demonstrated that this led to a reversal of fortune. The places that were, relatively speaking, the richest at their time of colonisation are now among the poorest. In addition, they used mortality figures for the colonisers, among other things, and found a relationship – the higher mortality among the colonisers, the lower today's GDP per capita. Why is this? The answer is settler mortality – how 'dangerous' it was to colonise an area – affected the types of institutions that were established.

The laureates have also developed an innovative theoretical framework that explains why some societies become stuck in a trap with what the laureates call extractive institutions, and why escaping from this trap is so difficult. However, they also show that change is possible and that new institutions can be formed. In some circumstances, a country can break free of its inherited institutions to establish democracy and the rule of law. In the long run, these changes also lead to reduced poverty.

How can we see the traces of these colonial institutions in the present day? In one of their works, the laureates use the city of Nogales, on the border between the USA and Mexico, as an example.

A tale of two cities

Nogales is cut in half by a fence. If you stand by this fence and look north, Nogales, Arizona, USA stretches out ahead of you. Its residents are relatively well off, have long average lifespans and most



children receive high school diplomas. Property rights are secure and people know they will get to enjoy most of the benefits from their investments. Free elections provide residents with the opportunity to replace politicians with whom they are not satisfied.

If you look south instead, you see Nogales, in Sonora, Mexico. Even though this is a relatively wealthy part of Mexico, the residents here are in general considerably poorer than on the north side of the fence. Organised crime makes starting and running companies risky. Corrupt politicians are difficult to remove, even if the chances of this have improved since Mexico democratised, just over 20 years ago.

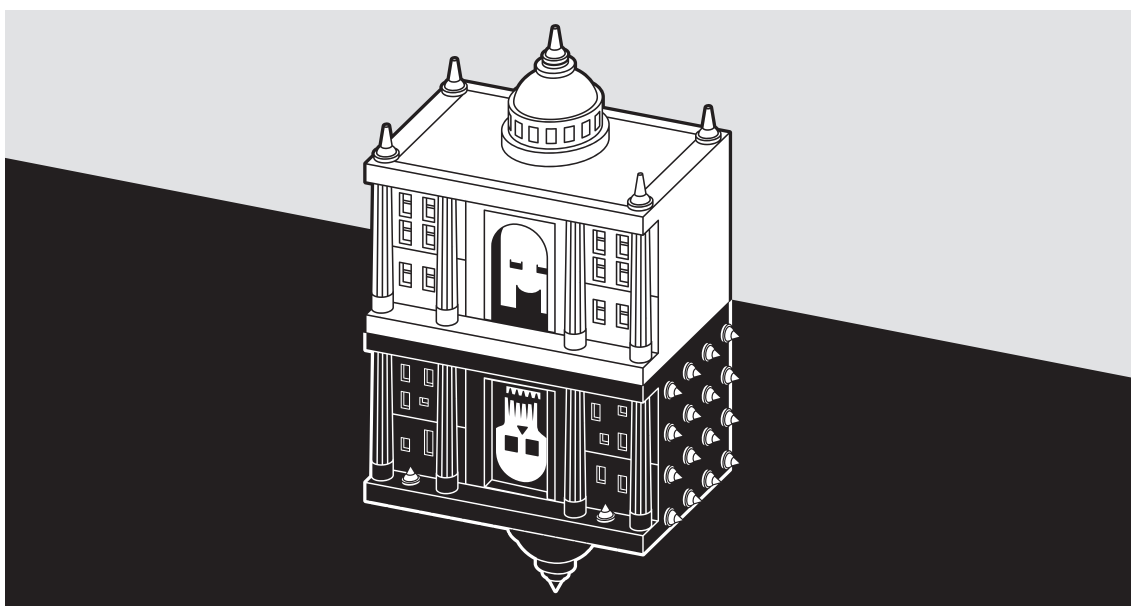
Why do these two halves of the same city have such vastly different living conditions? Geographically they are in the same place, so factors such as the climate are exactly the same. The two populations also have similar origins; historically, the northern area was actually in Mexico, so long-term residents of the city have many common ancestors. There are also many cultural similarities. People eat similar food and listen to more or less the same kind of music on both sides of the fence.

The decisive difference is thus not geography or culture, but institutions. The people who live north of the fence live in the USA's *economic* system, which gives them greater opportunities to choose their education and profession. They are also part of the USA's *political* system, which gives them broad political rights. South of the fence, residents are not as fortunate. They live under other economic conditions, and the political system limits their potential to influence legislation. This year's laureates have shown that the divided city of Nogales is not an exception. Instead, it is part of a clear pattern with roots that go back to colonial times.

Colonial institutions

When Europeans colonised large parts of the world, the existing institutions sometimes changed dramatically, but not in the same way everywhere. In some colonies, the purpose was to exploit the indigenous population and extract natural resources to benefit the colonisers. In other cases, the colonisers built inclusive political and economic systems for the long-term benefit of European settlers.

One important factor that influenced the type of colony that developed was the population density of the area that was to be colonised. The denser the indigenous population, the greater the resistance that could be expected. On the other hand, a larger indigenous population – once defeated – offered lucrative



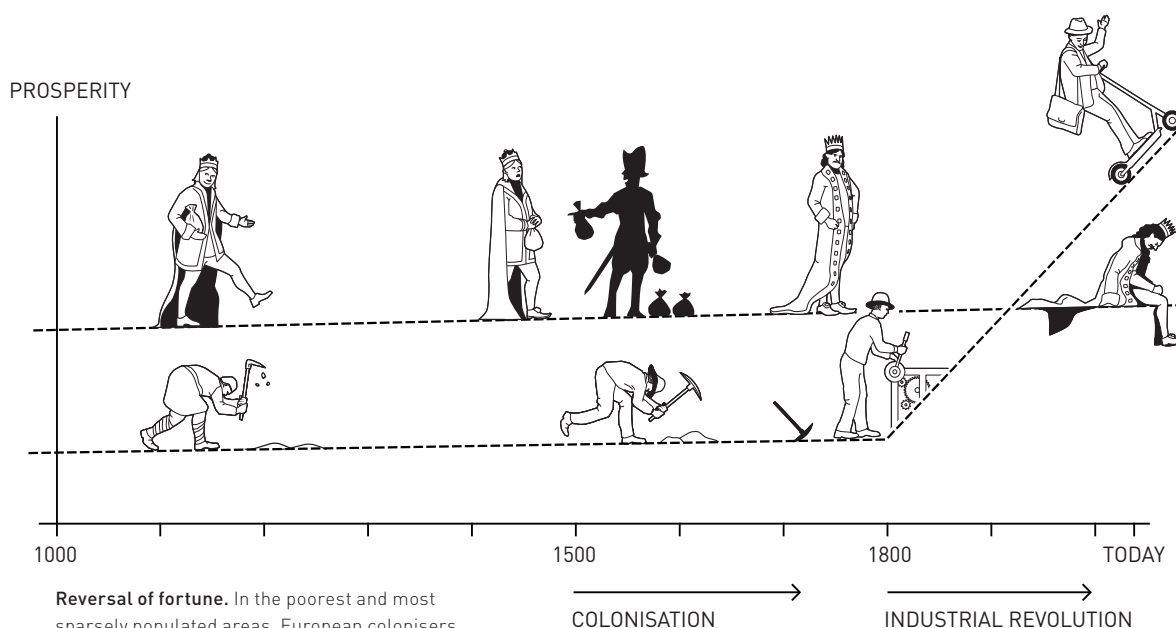
opportunities for cheap labour. This resulted in fewer European settlers moving to already densely populated colonies. Places that were more sparsely populated offered less resistance to the colonisers and less labour to exploit, so more European colonisers moved to these sparsely populated places.

In turn, this influenced the political and economic systems that developed. When there were few colonisers, they took over or established extractive institutions that focused on benefitting a local elite at the expense of the wider population. There were no elections and political rights were extremely limited. In contrast, colonies with many colonisers – settler colonies – needed to have inclusive economic institutions that incentivised settlers to work hard and invest in their new homeland. In turn, this led to demands for political rights that gave them a share of the profits. Of course, the early European colonies were not what we would now call democracies but, compared to the densely populated colonies to which few Europeans moved, the settler colonies provided considerably more extensive political rights.

Reversal of fortune

This year’s laureates have demonstrated that these initial differences in colonial institutions are an important explanation for the vast differences in prosperity that we see today. The contemporary differences in living conditions between Nogales, USA, and Nogales, Mexico, are thus largely due to the institutions that were introduced in the Spanish colony that later became Mexico, and in the colonies that became the USA. This pattern is similar across the colonised world, and does not depend on whether the colonisers happened to be British, French, Portuguese or Spanish.

Paradoxically, this means that the parts of the colonised world that were relatively the most prosperous around 500 years ago are now those that are relatively poor. If we look at urbanisation as a measure of prosperity, this was greater in Mexico under the Aztecs than it was at the same time in the part of North America that is now called Canada and the USA. The reason is that in the poorest and most sparsely populated places, European colonisers introduced or kept institutions that promoted long-run prosperity. However, in the richest and most densely populated colonies, institutions were more extractive and – for the local population – less likely to lead to prosperity.



Reversal of fortune. In the poorest and most sparsely populated areas, European colonisers introduced societal institutions that contributed to long-run prosperity. After the industrial revolution, this meant that the former colonies that were once the poorest became the richest.

This reversal of relative prosperity is historically unique. When the laureates studied urbanisation in the centuries prior to colonisation, they did not find a similar pattern: the more urban and thus richer parts of the world remained more urban and richer. In addition, if we look at the parts of the globe that were *not* colonised, we do not find any reversal of fortune.

The laureates have also shown that this reversal mainly occurred in association with the industrial revolution. As late as the mid-eighteenth century, for example, industrial production in what is now India was higher than in the USA. This has changed fundamentally since the start of the nineteenth century, which speaks to the reversal primarily being a result of differences in institutions. The technical innovations sweeping across the world were only able to take hold in places where institutions had been established that would benefit the wider population.

Settler mortality

The most direct explanation for the type of colonial institutions was thus the number of European settlers. The more European settlers, the greater the probability of establishing economic systems that promoted long-run economic growth. The laureates have shown that another factor that contributed to institutional differences was the severity of the diseases that spread through the settler communities.

The prevalence of deadly disease varied greatly between the northern and southern areas of America, just as in African regions that are closer to the equator than the southernmost regions. Similarly, the diseases that were found in India were considerably more numerous and dangerous to the British colonisers than those in New Zealand or Australia. The incidence of disease, which can be seen in historical statistics of mortality during colonial times, is strongly associated with current economic prosperity. The places where diseases were most dangerous for Europeans are where we now find dysfunctional economic systems and the most poverty, as well as the greatest corruption and weakest rule of law. One important reason for this is the extractive institutions that the European colonisers either established or chose to keep, if it benefitted them.

This year's laureates have added a new dimension to previous explanations for the current differences in the wealth of countries around the globe. One of these relates to geography and climate. Ever since Montesquieu published his famous book *The Spirit of Laws* (1748), there has been an established idea that societies in more temperate climate zones are more economically productive than those in the tropics. And there is a correlation: countries closer to the equator are poorer. However, according to the laureates, this is not only due to climate. If that were true, then the huge reversal of fortune could not have occurred. One important explanation for why hotter countries are also poorer countries is instead their societal institutions.

Escaping the trap

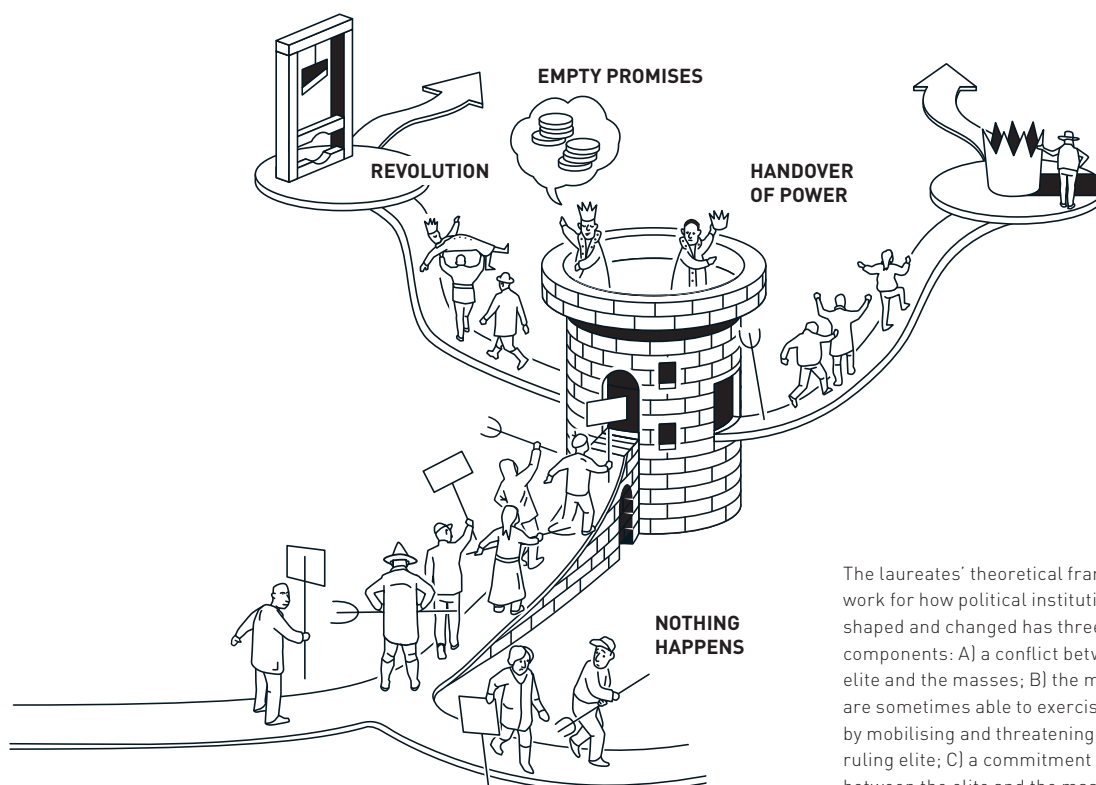
Acemoglu, Johnson and Robinson have uncovered a clear chain of causality. Institutions that were created to exploit the masses are bad for long-run growth, while ones that establish fundamental economic freedoms and the rule of law are good for it. Political and economic institutions also tend to be very long-lived. Even if the extractive economic systems provide short-term gains for a ruling elite, the introduction of more inclusive institutions, less extraction and the rule of law would create long-term benefits for everyone. So why don't the elite simply replace the existing economic system?

The laureates' explanation focuses on conflicts over political power and the problem of credibility between the ruling elite and the population. As long as the political system benefits the elites, the population cannot trust that promises of a reformed economic system will be kept. A new political system, which allows the population to replace leaders who do not keep their promises in free elections, would allow the economic system to be reformed. However, the ruling elites do not believe the population will compensate them for the loss of economic benefits once the new system is in place. This is known as the commitment problem; it is difficult to overcome and means that societies are trapped with extractive institutions, mass poverty and a rich elite.

However, the laureates have also shown that the inability to make credible promises can also explain why transitions to democracy do sometimes happen. Even if the population of a non-democratic nation lack formal political power, they have a weapon that is feared by the ruling elite – they are many. The masses can mobilise and become a revolutionary threat. Although this threat can include violence, the fact is that the revolutionary threat may be greatest if this mobilisation is peaceful, because it allows the greatest number of people to join the protests.

The elite are faced with a dilemma when this threat is most acute; they would prefer to stay in power and simply try to placate the masses by promising economic reforms. But such a promise is not credible because the masses know that the elite, if they remain in power, can rapidly return to the old system once the situation has calmed down. In this case, the only option for the elite may be to hand over power and introduce democracy.

The laureates' model for explaining the circumstances under which political institutions are formed and changed has three components. The first is a conflict over how resources are allocated and who holds decision-making power in a society (the elite or the masses). The second is that the masses sometimes have the opportunity to exercise power by mobilising and threatening the ruling elite; power in a society is thus more than the power to make decisions. The third is the commitment problem, which means that the only alternative is for the elite to hand over decision-making power to the populace.



The laureates' theoretical framework for how political institutions are shaped and changed has three main components: A) a conflict between the elite and the masses; B) the masses are sometimes able to exercise power by mobilising and threatening the ruling elite; C) a commitment problem between the elite and the masses.

The model has been used to explain the democratisation process in Western Europe at the end of the nineteenth century and in the early twentieth century. In Great Britain, suffrage was expanded in several stages, each of which was preceded by general strikes and widespread protests. The British elite were unable to credibly meet this revolutionary threat with promises of social reforms; instead they were forced, often reluctantly, to share power. The situation in Sweden was similar, where the decision on general suffrage in December 1918 was made after extensive rioting in the wake of the Russian revolution. The model has also been used to explain why some countries alternate between democracy and non-democracy. It can also be used to show why it is so difficult for countries that do not have inclusive institutions to achieve growth equal to those that do, and why ruling elites can sometimes benefit from blocking new technology.

Daron Acemoglu, Simon Johnson and James Robinson have contributed innovative research about what affects countries' economic prosperity in the long run. Their empirical research demonstrates the fundamental importance of the type of political and economic institutions that were introduced during colonialisation. Their theoretical research has contributed to our understanding of why it is so difficult to reform extractive institutions, while also pointing out some of the circumstances in which this can nevertheless happen. The laureates' work has had a decisive influence on continued research in both economics and political science. Their insights regarding how institutions influence prosperity show that work to support democracy and inclusive institutions is an important way forward in the promotion of economic development.

FURTHER READING

Additional information on this year's prizes, including a scientific background in English, is available on the website of the Royal Swedish Academy of Sciences, www.kva.se, and at www.nobelprize.org, where you can watch video from the press conferences, the Nobel Lectures and more. Information on exhibitions and activities related to the Nobel Prizes and the Prize in Economic Sciences is available at www.nobelprizemuseum.se.

The Royal Swedish Academy of Sciences has decided to award the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2024 to

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“for studies of how institutions are formed and affect prosperity”

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