

The Determinants of Institutional Quality. How Leaders' Perceived Threat of Losing Power Without Compensation Affects Economic Development

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Overall objective

Since the 1950s, countries in the developing world have followed radically different paths of economic development. For example, when in the 1950s, Ghana, Cambodia, Bolivia, and South Korea were equally poor; today South Korea is 16 times as rich as Bolivia, 33 times as rich as Ghana, and 36 times as rich as Cambodia. This is puzzling considering that most researchers in fact expected convergence between developed and developing countries (Solow 1956; Baumol 1986).

There is now a general consensus holding that variation in institutional quality is the major source of cross-country differences in economic growth and prosperity (Bates 2006; Acemoglu, Johnson & Robinson 2001; 2002; Knack & Keefer 1995). Especially in poverty-stricken developing countries, efficient institutions have been argued to be necessary in order to create economic efficiency and growth. Asked to review the lessons of the World Bank

policies for alleviating poverty in developing countries, Lawrence Summers – former Chief Economist of the World Bank – argues that “an overwhelming lesson that I think we have learned in the 1990s is... the transcendent importance of the quality of institutions and the closely-related questions of the efficacy of political administration” (cited in Besley 2007: 571). In the same vein, it has been argued that the “miraculous” economic growth in Western Europe that started in the late 17th century can be explained by the presence of high quality institutions (North 1990). If this is the case, the question of how such efficient institutions can be established should be a top priority for the social sciences. Yet, so far the question of how efficient institutions can be established has attracted surprisingly little attention both in economics, political science, and economic sociology. In fact, in the recently published “Handbook of Political Economy” (Weingast & Wittman 2006), to which a large number of the leading scholars within the field have contributed, *none* of the sixty-seven chapters deals with the problem of how to establish efficient institutions. As a consequence, there is still limited knowledge concerning what determines institutional quality (Acemoglu 2006; North 2006). With this project, we aim to fill this gap. More specifically, the overall objective of this project is to develop and test the argument that institutional quality and resulting divergent paths of economic development can be understood as a result of differences in leaders' perceived threat of losing power without compensation. The relationship between the perceived threat of losing power without compensation, institutional quality, and economic development is explored in a qualitative analysis of six countries that have followed dif-

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ferent development trajectories since the 1950s (Botswana, Ghana, Chile, Bolivia, South Korea, and Cambodia). In particular, the project explores the threats to leaders in these countries in the form of: the strength of civil society, the degree of inter-group inequality, the political role of the middle class, the role of the military, shocks and crises, and the character of international influences. By comparing the countries along these dimensions, the project will give an answer to the empirical question: *Have leaders in the more economically developed countries experienced greater or different threats of losing power without compensation than have leaders in the less economically developed countries?*

Main contributions

The empirical and theoretical contributions of the project are multi-fold. First, the perspective presented departs from earlier analyses of institutions and economic development as we do not focus exclusively on the *effects* of institutions but rather on the *determinants* of institutional quality. Secondly, the project contributes to a deeper understanding of the process of economic development through an integrated contextual, institutional, and actor-oriented theoretical approach, and should hence be of interest not only to scholars within the field of economic development, institutional theory, and comparative political economy, but also to policymakers and donors. Thirdly, by conducting a small-n comparative study, we endorse a methodological approach quite different from previous ones that are predominantly either purely theoretical, focus on single-case case studies, or focus exclusively on large-N quantifications.

Theoretical framework

There is now general agreement that institutions are crucial determinants of the differing development trajectories among countries (Rodrik, Subramanian & Trebbi 2004; Deininger 2003; Acemoglu, Johnson & Robinson 2002; 2001; Collier & Gunning 1999; Knack & Keefer 1995; North 1990). Differing development trajectories thus, "... [have] little to do with natural resource availability, climate, foreign aid, or luck. [Rather, they are] a function of whether incentives within a given society steer wealth-maximizing individuals toward producing new wealth or toward diverting it from others" (Knack 2003:1). Hence, development economics has by and large shifted its focus from factors such as capital accumulation and technological progress to instead highlight that poor countries are poor due to lack of institutions that lower uncertainty in human interaction (Acemoglu & Robinson 2006; Goldsmith 2004; Barzel 2002; Easterly 2002; Hall & Jones 1999; Evans 1989). Poverty is in this perspective preventable since it is not the product of ignorance or of inevitable natural forces but rather a result of reversible institutional and political failures caused by the political elite (Bueno de Mesquita et al. 2003). However, despite the acknowledged importance of such institutions for achieving development, far from all leaders have adopted them. A central question that still remains unanswered is in other words: Why do the leaders of some states choose or end up with institutions that are good for economic development (i.e. institutions that maximize aggregate welfare) while others do not?

The starting point for this project is that, contrary to what is often presumed, there is in fact only little reason to expect

that leaders will voluntarily adopt institutions that maximize aggregate welfare. As Douglass North (1998: 249) has put it: “institutions are not necessarily or even usually created to be socially efficient.” More precisely, why should we assume that leaders will act for the common good when we at the same time assume that their subjects are more or less strictly self-interested (Clague et al. 1996, Evans 1989; Levi 1988)? First of all, leaders of poor states do not usually suffer from institutions that do not serve to enhance aggregate welfare in the short term. This is not at least evident if we consider the longevity and wealth of many highly predatory leaders in sub-Saharan Africa (Bueno de Mesquita et al. 2003). Furthermore, even though aggregate welfare increases through the adoption of institutions that add predictability to human exchange, the welfare of leaders does not necessarily increase. That is, while it is true that high-quality institutions may fatten the cow the leader has the power to milk, if uncertain being the ones to reap the future benefits of institutional reform, leaders are not likely to alter the prevailing arrangement (Bardhan 2005). In other words, it is reasonable to believe that groups with political power, i.e. elites, generally choose to increase their income in the short term and directly or indirectly transfer resources from the rest of society to themselves (Acemoglu & Robinson 2006; Acemoglu 2006; Goldsmith 2004; Bates, Greif, & Singh 2002; Bates 2001). In line with this argumentation, the puzzle recent research aims to explain is why *any* state leaders choose or end up with institutions that enhance aggregate welfare.

There is now growing consensus that leaders will adopt institutions that promote aggregate welfare when the cost of not adopting such institutions is higher

than the loss of income derived from institutions that do not maximize aggregate welfare but rather the welfare of the political elite (Acemoglu & Robinson 2006; Acemoglu 2006; Goldsmith 2004; Bates 2001). In short, leaders will adopt high quality institutions only if they benefit from it. However, there is considerably less agreement on the question of which factors impact on the calculation of leaders. In an attempt to fill this gap, in this project we test the theoretical proposition that *leaders will be more likely to establish or end up with institutions that maximize aggregate welfare when their perceived threat of losing power without compensation is comparatively high* (Acemoglu 2006; North et al. 2009). Losing power without compensation implies the loss of all political influence and income possibilities, the threat of political exile, and/or immediate threats of execution. According to previous research (Acemoglu & Robinson 2006), the following factors as such constitute a *high* perceived threat among leaders of losing power without compensation: a strong civil society, medium inter-group inequality, a politically strong middle class, a military not loyal to the elites, political and economic shocks and crises, and international threats of war and sanctions. By comparing countries along these dimensions that have followed different paths of economic development since the 1950s, this project will be able to answer the question: *Have leaders in the more successful countries been subject to greater threats of losing power without compensation than have leaders in the less successful countries?*

Methodology

Methodologically, the approach falls under comparative political economy. The aim is to conduct a systematic, compara-

tive qualitative study of the relationship between leaders' perceived threat of losing power without compensation, institutional quality, and economic development. The design of the study corresponds to the classic "indirect method of difference" in which the idea is to select cases that vary with respect to the dependent variable, i.e. economic development. In total, we select six countries of which three are regarded as success cases and three are regarded as less successful cases in terms of institutional quality and economic development. To increase generalizability, we choose cases from three different developing regions. From sub-Saharan Africa, we choose the success case of Botswana and the less successful case of Ghana, from Asia the successful case of South Korea and the less successful case of Cambodia, and from Latin America the successful case of Chile and the less successful case of Bolivia.

A process-tracing method will be used to map and compare the independent variable – i.e. leaders' perceived threat of losing power without compensation – in each country from the 1950s. If our argument saying that variation in institutional quality (and, hence, economic development) can be explained by variation in the degree of leaders' perceived threat of losing power without compensation is correct, the successful countries should to a greater extent than the less successful ones be characterized by a strong civil society, a medium degree of inter-group inequality, a politically strong middle class, a military not supporting the elite, shocks and crises, and a greater international threat of war and sanctions.

Concerning data collection, the development of cross-national evidence requires an idea of how we can recognize the phenomena we want to study empiri-

cally. Our first dimension of leaders' perceived threat of losing power without compensation, i.e. *a strong civil society*, can be recognized by the density of social networks, the number of cross-cutting ties, and the degree of inter-group conflict in a society (Putnam 1993; 2000). The stronger the civil society, the higher the density of social networks, the larger the number of cross-cutting ties, and the lesser the degree of inter-group conflict. In terms of our second and third indicator, a country with medium *inter-group inequality* refers to a country with medium income dispersion while a country with a strong *middle class* can be recognized by the income share earned by that group. The larger the income share of this group, the stronger the middle class is argued to be. The *loyalty of the military* is higher in countries in where the elites themselves are military or come from a military background. Economic and political turmoil, i.e. *shocks and crises*, is indicated by financial or debt crises, macro-economic shocks, short-term fluctuations in de facto political power, popular riots and demonstrations, as well as rebellions and warfare towards the state stemming from internal groupings. Finally, we will track to what extent a country is exposed to international threats of war and sanctions.

The data on the different dimensions of leaders' perceptions of losing power without compensation will be gathered from a large number of different sources, spanning from interviews with regional experts, previous case studies, quantitative indicators, and various official documents. The quantitative data will be collected from the Quality of Government Institute's data set on institutional quality and its potential correlates. This data will be a valuable complement to our in-depth, qualitative analysis of the six cases.

The project will be based at the Quality of Government (QoG) Institute at the Department of Political Science, University of Gothenburg, co-founded and led by Professor Bo Rothstein.

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