

Why are some countries rich and some poor?

- There are some countries w/ lots of resources that are very poor.

- Eastern Europe and Latin America

- These countries started off wealthy but did not grow as fast as the rest of the world

- Protestant countries are way richer than Catholic countries.

- Protestants are more 'this worldly' - Max Weber
- "More rational"  $\Rightarrow$  more efficient

- Towns/countries taken over by Protestants (Scotland, Geneva) tended not to do well. They were not great centers of growth.

- Lutherans, in order to get support of political leaders, gave unquestioning support to society's rules. "Compromise religions" like this did well

- Theocratic puritans made the wrong rules for good economic growth.

- England was taken over by a moderate form of Protestantism. (So did Holland) They had religions that promoted democracy and respect for the laws of the state

- Blind faith in Democracy lends itself towards economic growth.

- There is something in Democratic forces that allows for high levels of growth.

- Protestantism + Democracy  $\Rightarrow$  growth

$$\frac{\text{GDP}}{\text{population}} = \beta_1 + \beta_2 \text{Civil Reverence} + \beta_3 \text{Colony?} + \beta_4 \text{Democracy} + \beta_5 (\text{Civil Reverence}) * (\text{Democracy}) + \epsilon$$

$$R^2 \approx 0.97. \quad \hat{\beta}_3 < 0, \quad \hat{\beta}_5 > 0, \quad \pm(\hat{\beta}_5) \text{ large}$$

States which were taken over by economic ideologies fell apart because vital institutions were not well-understood.

- Eg guilds were dismantled by fairness ideology. These countries were immediately taken over.

What is democracy doing that is so sensitive to ideology? Which vital institutions are eliminated?

- a hyper-rational country will not fight and will be taken over.

- If everyone else is rational, it is optimal to be aggressive.

Democracy is rational when it is working and is thus difficult to defend. How do you defend yourself? Create special institutions which will override Democratic forces. (ie conscription, guilds which have been trained to throw resources at a country being attacked.)

Holland adopted laissez-faire ideology (de la Coort) and attacked guilds. Holland also had a non-expandable money supply. These allowed for Holland to be attacked by England.

Afterward (1694-5), England adopts a gold-standard. Shortly afterwards, they suspend convertibility

and expand money supply, which allowed for a great defense system. In addition, they floated some bonds with low interest rates.

England no longer needed guilds to finance defense, and they were phased out in the 1730s. This did not spur growth because they were replaced by income taxes.

Why does Democracy develop these countries?

Democracy does not work in Eastern Europe, because they do not believe normal people know how to run things.

There is a market failure that does not have an authoritarian solution.




- Underdevelopment traps and the hold-up problem

Need a sequence of investments.

◦ In Laissez-Faire, the investments would be made.

◦ If investments were simultaneous, there would be a problem.

◦ Coordination problem

			
	Mine	road	Port
Benefit of investment	\$100	\$100	\$100
Cost	\$60	\$60	\$60
Profit	\$40	\$40	\$40

	Invest	Not
Invest	40, 40	-60, 0
Not	0, -60	0, 0

Is (not, not) a legitimate equilibrium?

When you introduce a market, there are prices which provide a signal, so it is not a good assumption to believe that producers would not be informed.

- This holds for private goods.

What about collective goods?

- There could be a plausible story for the bad equilibrium. (No market providing signals)

- If you make things sequential, the whole argument goes away.

Poor countries have not made their investments. Why?

Introduce cooperation costs: (ie cost of vertically integrating is greater than \$120;  $C > 120$ )

Suppose  $120 < C < 200$ . ie spse  $C = 150$

- legitimate underdevelopment traps

- others are vicious poverty cycles

- so poor you cannot save to become richer.

- staying poor is still Pareto optimal. This is not a normative theory. There is nothing we can do.

It is easy for two parties to join and impose (through Democracy) on the third party.

- ie nationalize the port

- if you have a bureaucracy that is not civilly reverent, then there will be problems.

- the bureaucrat can still hold-up the others.

The IMF does not think this problem exists.  
They only believe in vicious poverty cycles.  
◦ The IMF should work on civil reverence.  
◦ promote Western education.

Tribal underdevelopment - very, very poor  
◦ ruled by tribalism = common property ownership