

Why Nations Fail

THE ORIGINS OF POWER,
PROSPERITY, AND POVERTY

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I.

SO CLOSE AND YET SO DIFFERENT

THE ECONOMICS OF THE RIO GRANDE

THE CITY OF NOGALES is cut in half by a fence. If you stand by it and look north, you'll see Nogales, Arizona, located in Santa Cruz County. The income of the average household there is about \$30,000 a year. Most teenagers are in school, and the majority of the adults are high school graduates. Despite all the arguments people make about how deficient the U.S. health care system is, the population is relatively healthy, with high life expectancy by global standards. Many of the residents are above age sixty-five and have access to Medicare. It's just one of the many services the government provides that most take for granted, such as electricity, telephones, a sewage system, public health, a road network linking them to other cities in the area and to the rest of the United States, and, last but not least, law and order. The people of Nogales, Arizona, can go about their daily activities without fear for life or safety and not constantly afraid of theft, expropriation, or other things that might jeopardize their investments in their businesses and houses. Equally important, the residents of Nogales, Arizona, take it for granted that, with all its inefficiency and occasional corruption, the government is their agent. They can vote to replace their mayor, congressmen, and senators; they vote in the presidential elections that determine who will lead their country. Democracy is second nature to them.

Life south of the fence, just a few feet away, is rather different. While the residents of Nogales, Sonora, live in a relatively prosperous part of Mexico, the income of the average household there is about one-third that in Nogales, Arizona. Most adults in Nogales, Sonora, do

not have a high school degree, and many teenagers are not in school. Mothers have to worry about high rates of infant mortality. Poor public health conditions mean it's no surprise that the residents of Nogales, Sonora, do not live as long as their northern neighbors. They also don't have access to many public amenities. Roads are in bad condition south of the fence. Law and order is in worse condition. Crime is high, and opening a business is a risky activity. Not only do you risk robbery, but getting all the permissions and greasing all the palms just to open is no easy endeavor. Residents of Nogales, Sonora, live with politicians' corruption and ineptitude every day.

In contrast to their northern neighbors, democracy is a very recent experience for them. Until the political reforms of 2000, Nogales, Sonora, just like the rest of Mexico, was under the corrupt control of the Institutional Revolutionary Party, or Partido Revolucionario Institucional (PRI).

How could the two halves of what is essentially the same city be so different? There is no difference in geography, climate, or the types of diseases prevalent in the area, since germs do not face any restrictions crossing back and forth between the United States and Mexico. Of course, health conditions are very different, but this has nothing to do with the disease environment; it is because the people south of the border live with inferior sanitary conditions and lack decent health care.

But perhaps the residents are very different. Could it be that the residents of Nogales, Arizona, are grandchildren of migrants from Europe, while those in the south are descendants of Aztecs? Not so. The backgrounds of people on both sides of the border are quite similar. After Mexico became independent from Spain in 1821, the area around "Los dos Nogales" was part of the Mexican state of Vieja California and remained so even after the Mexican-American War of 1846–1848. Indeed, it was only after the Gadsden Purchase of 1853 that the U.S. border was extended into this area. It was Lieutenant N. Michler who, while surveying the border, noted the presence of the "pretty little valley of Los Nogales." Here, on either side of the border, the two cities rose up. The inhabitants of Nogales, Arizona, and No-

gales, Sonora, share ancestors, enjoy the same food and the same music, and, we would hazard to say, have the same "culture."

Of course, there is a very simple and obvious explanation for the differences between the two halves of Nogales that you've probably long since guessed: the very border that defines the two halves. Nogales, Arizona, is in the United States. Its inhabitants have access to the economic institutions of the United States, which enable them to choose their occupations freely, acquire schooling and skills, and encourage their employers to invest in the best technology, which leads to higher wages for them. They also have access to political institutions that allow them to take part in the democratic process, to elect their representatives, and replace them if they misbehave. In consequence, politicians provide the basic services (ranging from public health to roads to law and order) that the citizens demand. Those of Nogales, Sonora, are not so lucky. They live in a different world shaped by different institutions. These different institutions create very disparate incentives for the inhabitants of the two Nogaleses and for the entrepreneurs and businesses willing to invest there. These incentives created by the different institutions of the Nogaleses and the countries in which they are situated are the main reason for the differences in economic prosperity on the two sides of the border.

Why are the institutions of the United States so much more conducive to economic success than those of Mexico or, for that matter, the rest of Latin America? The answer to this question lies in the way the different societies formed during the early colonial period. An institutional divergence took place then, with implications lasting into the present day. To understand this divergence we must begin right at the foundation of the colonies in North and Latin America.

THE FOUNDING OF BUENOS AIRES

Early in 1516 the Spanish navigator Juan Díaz de Solís sailed into a wide estuary on the Eastern Seaboard of South America. Wading ashore, de Solís claimed the land for Spain, naming the river the Río

de la Plata, "River of Silver," since the local people possessed silver. The indigenous peoples on either side of the estuary—the Charrúas in what is now Uruguay, and the Querandí on the plains that were to be known as the Pampas in modern Argentina—regarded the newcomers with hostility. These locals were hunter-gatherers who lived in small groups without strong centralized political authorities. Indeed it was such a band of Charrúas who clubbed de Solís to death as he explored the new domains he had attempted to occupy for Spain.

In 1534 the Spanish, still optimistic, sent out a first mission of settlers from Spain under the leadership of Pedro de Mendoza. They founded a town on the site of Buenos Aires in the same year. It should have been an ideal place for Europeans. Buenos Aires, literally meaning "good airs," had a hospitable, temperate climate. Yet the first stay of the Spaniards there was short lived. They were not after good airs, but resources to extract and labor to coerce. The Charrúas and the Querandí were not obliging, however. They refused to provide food to the Spaniards, and refused to work when caught. They attacked the new settlement with their bows and arrows. The Spaniards grew hungry, since they had not anticipated having to provide food for themselves. Buenos Aires was not what they had dreamed of. The local people could not be forced into providing labor. The area had no silver or gold to exploit, and the silver that de Solís found had actually come all the way from the Inca state in the Andes, far to the west.

The Spaniards, while trying to survive, started sending out expeditions to find a new place that would offer greater riches and populations easier to coerce. In 1537 one of these expeditions, under the leadership of Juan de Ayolas, penetrated up the Paraná River, searching for a route to the Incas. On its way, it made contact with the Guaraní, a sedentary people with an agricultural economy based on maize and cassava. De Ayolas immediately realized that the Guaraní were a completely different proposition from the Charrúas and the Querandí. After a brief conflict, the Spanish overcame Guaraní resistance and founded a town, Nuestra Señora de Santa María de la Asunción, which remains the capital of Paraguay today. The conquistadors married the Guaraní princesses and quickly set themselves up as a

new aristocracy. They adapted the existing systems of forced labor and tribute of the Guaraní, with themselves at the helm. This was the kind of colony they wanted to set up, and within four years Buenos Aires was abandoned as all the Spaniards who'd settled there moved to the new town.

Buenos Aires, the "Paris of South America," a city of wide European-style boulevards based on the great agricultural wealth of the Pampas, was not resettled until 1580. The abandonment of Buenos Aires and the conquest of the Guaraní reveals the logic of European colonization of the Americas. Early Spanish and, as we will see, English colonists were not interested in tilling the soil themselves; they wanted others to do it for them, and they wanted riches, gold and silver, to plunder.

FROM CAJAMARCA . . .

The expeditions of de Solís, de Mendoza, and de Ayolas came in the wake of more famous ones that followed Christopher Columbus's sighting of one of the islands of the Bahamas on October 12, 1492. Spanish expansion and colonization of the Americas began in earnest with the invasion of Mexico by Hernán Cortés in 1519, the expedition of Francisco Pizarro to Peru a decade and a half later, and the expedition of Pedro de Mendoza to the Río de la Plata just two years after that. Over the next century, Spain conquered and colonized most of central, western, and southern South America, while Portugal claimed Brazil to the east.

The Spanish strategy of colonization was highly effective. First perfected by Cortés in Mexico, it was based on the observation that the best way for the Spanish to subdue opposition was to capture the indigenous leader. This strategy enabled the Spanish to claim the accumulated wealth of the leader and coerce the indigenous peoples to give tribute and food. The next step was setting themselves up as the new elite of the indigenous society and taking control of the existing methods of taxation, tribute, and, particularly, forced labor.

When Cortés and his men arrived at the great Aztec capital of Tenochtitlan on November 8, 1519, they were welcomed by

Moctezuma, the Aztec emperor, who had decided, in the face of much advice from his counselors, to welcome the Spaniards peacefully. What happened next is well described by the account compiled after 1545 by the Franciscan priest Bernardino de Sahagún in his famous Florentine Codices.

[At] once they [the Spanish] firmly seized Moctezuma . . . then each of the guns shot off . . . Fear prevailed. It was as if everyone had swallowed his heart. Even before it had grown dark, there was terror, there was astonishment, there was apprehension, there was a stunning of the people.

And when it dawned thereupon were proclaimed all the things which [the Spaniards] required: white tortillas, roasted turkey hens, eggs, fresh water, wood, firewood, charcoal . . . This had Moctezuma indeed commanded.

And when the Spaniards were well settled, they thereupon inquired of Moctezuma as to all the city's treasure . . . with great zeal they sought gold. And Moctezuma thereupon went leading the Spaniards. They went surrounding him . . . each holding him, each grasping him.

And when they reached the storehouse, a place called Teocalco, thereupon they brought forth all the brilliant things; the quetzal feather head fan, the devices, the shields, the golden discs . . . the golden nose crescents, the golden leg bands, the golden arm bands, the golden forehead bands.

Thereupon was detached the gold . . . at once they ignited, set fire to . . . all the precious things. They all burned. And the gold the Spaniards formed into separate bars . . . And the Spanish walked everywhere . . . They took all, all that they saw which they saw to be good.

Thereupon they went to Moctezuma's own store-

house . . . at the place called Totocalco . . . they brought forth [Moctezuma's] own property . . . precious things all; the necklaces with pendants, the arm bands with tufts of quetzal feathers, the golden arm bands, the bracelets, the golden bands with shells . . . and the turquoise diadem, the attribute of the ruler. They took it all.

The military conquest of the Aztecs was completed by 1521. Cortés, as governor of the province of New Spain, then began dividing up the most valuable resource, the indigenous population, through the institution of the *encomienda*. The *encomienda* had first appeared in fifteenth-century Spain as part of the reconquest of the south of the country from the Moors, Arabs who had settled during and after the eighth century. In the New World, it took on a much more pernicious form: it was a grant of indigenous peoples to a Spaniard, known as the *encomendero*. The indigenous peoples had to give the *encomendero* tribute and labor services, in exchange for which the *encomendero* was charged with converting them to Christianity.

A vivid early account of the workings of the *encomienda* has come down to us from Bartolomé de las Casas, a Dominican priest who formulated the earliest and one of the most devastating critiques of the Spanish colonial system. De las Casas arrived on the Spanish island of Hispaniola in 1502 with a fleet of ships led by the new governor, Nicolás de Ovando. He became increasingly disillusioned and disturbed by the cruel and exploitative treatment of the indigenous peoples he witnessed every day. In 1513 he took part as a chaplain in the Spanish conquest of Cuba, even being granted an *encomienda* for his service. However, he renounced the grant and began a long campaign to reform Spanish colonial institutions. His efforts culminated in his book *A Short Account of the Destruction of the Indies*, written in 1542, a withering attack on the barbarity of Spanish rule. On the *encomienda* he has this to say in the case of Nicaragua:

Each of the settlers took up residence in the town allotted to him (or encomended to him, as the legal

phrase has it), put the inhabitants to work for him, stole their already scarce foodstuffs for himself and took over the lands owned and worked by the natives and on which they traditionally grew their own produce. The settler would treat the whole of the native population—dignitaries, old men, women and children—as members of his household and, as such, make them labor night and day in his own interests, without any rest whatsoever.

For the conquest of New Granada, modern Colombia, de las Casas reports the whole Spanish strategy in action:

To realize their long-term purpose of seizing all the available gold, the Spaniards employed their usual strategy of apportioning among themselves (or encommending, as they have it) the towns and their inhabitants . . . and then, as ever, treating them as common slaves. The man in overall command of the expedition seized the King of the whole territory for himself and held him prisoner for six or seven months, quite illicitly demanding more and more gold and emeralds from him. This King, one Bogotá, was so terrified that, in his anxiety to free himself from the clutches of his tormentors, he consented to the demand that he fill an entire house with gold and hand it over; to this end he sent his people off in search of gold, and bit by bit they brought it along with many precious stones. But still the house was not filled and the Spaniards eventually declared that they would put him to death for breaking his promise. The commander suggested they should bring the case before him, as a representative of the law, and when they did so, entering formal accusations against the King, he sentenced him to torture should he persist in not honoring the bargain. They tortured him with the strappado, put burning tal-

low on his belly, pinned both his legs to poles with iron hoops and his neck with another and then, with two men holding his hands, proceeded to burn the soles of his feet. From time to time, the commander would look in and repeat that they would torture him to death slowly unless he produced more gold, and this is what they did, the King eventually succumbing to the agonies they inflicted on him.

The strategy and institutions of conquest perfected in Mexico were eagerly adopted elsewhere in the Spanish Empire. Nowhere was this done more effectively than in Pizarro's conquest of Peru. As de las Casas begins his account:

In 1531 another great villain journeyed with a number of men to the kingdom of Peru. He set out with every intention of imitating the strategy and tactics of his fellow adventurers in other parts of the New World.

Pizarro began on the coast near the Peruvian town of Tumbes and marched south. On November 15, 1532, he reached the mountain town of Cajamarca, where the Inca emperor Atahualpa was encamped with his army. The next day, Atahualpa, who had just vanquished his brother Huáscar in a contest over who would succeed their deceased father, Huayna Capac, came with his retinue to where the Spanish were camped. Atahualpa was irritated because news of atrocities that the Spanish had already committed, such as violating a temple of the Sun God Inti, had reached him. What transpired next is well known. The Spanish laid a trap and sprang it. They killed Atahualpa's guards and retainers, possibly as many as two thousand people, and captured the king. To gain his freedom, Atahualpa had to promise to fill one room with gold and two more of the same size with silver. He did this, but the Spanish, reneging on their promises, strangled him in July 1533. That November, the Spanish captured the Inca capital of Cusco, where the Incan aristocracy received the same treatment as Atahualpa, being imprisoned until they produced gold and silver.

When they did not satisfy Spanish demands, they were burned alive. The great artistic treasures of Cusco, such as the Temple of the Sun, had their gold stripped from them and melted down into ingots.

At this point the Spanish focused on the people of the Inca Empire. As in Mexico, citizens were divided into *encomiendas*, with one going to each of the conquistadors who had accompanied Pizarro. The *encomienda* was the main institution used for the control and organization of labor in the early colonial period, but it soon faced a vigorous contender. In 1545 a local named Diego Gualpa was searching for an indigenous shrine high in the Andes in what is today Bolivia. He was thrown to the ground by a sudden gust of wind and in front of him appeared a cache of silver ore. This was part of a vast mountain of silver, which the Spanish baptized El Cerro Rico, "The Rich Hill." Around it grew the city of Potosí, which at its height in 1650 had a population of 160,000 people, larger than Lisbon or Venice in this period.

To exploit the silver, the Spanish needed miners—a lot of miners. They sent a new viceroy, the chief Spanish colonial official, Francisco de Toledo, whose main mission was to solve the labor problem. De Toledo, arriving in Peru in 1569, first spent five years traveling around and investigating his new charge. He also commissioned a massive survey of the entire adult population. To find the labor he needed, de Toledo first moved almost the entire indigenous population, concentrating them in new towns called *reducciones*—literally "reductions"—which would facilitate the exploitation of labor by the Spanish Crown. Then he revived and adapted an Inca labor institution known as the *mita*, which, in the Incas' language, Quechua, means "a turn." Under their *mita* system, the Incas had used forced labor to run plantations designed to provide food for temples, the aristocracy, and the army. In return, the Inca elite provided famine relief and security. In de Toledo's hands the *mita*, especially the Potosí *mita*, was to become the largest and most onerous scheme of labor exploitation in the Spanish colonial period. De Toledo defined a huge catchment area, running from the middle of modern-day Peru and encompassing most of modern Bolivia. It covered about two hundred thousand square miles. In this area, one-seventh of the male inhabitants, newly arrived in their



Map 1: The Inca Empire, the Inca road network, and the mining *mita* catchment area

reducciones, were required to work in the mines at Potosí. The Potosí *mita* endured throughout the entire colonial period and was abolished only in 1825. Map 1 shows the catchment area of the *mita* superimposed on the extent of the Inca empire at the time of the Spanish conquest. It illustrates the extent to which the *mita* overlapped with the heartland of the empire, encompassing the capital Cusco.

Remarkably, you still see the legacy of the *mita* in Peru today. Take the differences between the provinces of Calca and nearby

Acomayo. There appears to be few differences among these provinces. Both are high in the mountains, and each is inhabited by the Quechua-speaking descendants of the Incas. Yet Acomayo is much poorer, with its inhabitants consuming about one-third less than those in Calca. The people know this. In Acomayo they ask intrepid foreigners, "Don't you know that the people here are poorer than the people over there in Calca? Why would you ever want to come here?" Intrepid because it is much harder to get to Acomayo from the regional capital of Cusco, ancient center of the Inca Empire, than it is to get to Calca. The road to Calca is surfaced, the one to Acomayo is in a terrible state of disrepair. To get beyond Acomayo, you need a horse or a mule. In Calca and Acomayo, people grow the same crops, but in Calca they sell them on the market for money. In Acomayo they grow food for their own subsistence. These inequalities, apparent to the eye and to the people who live there, can be understood in terms of the institutional differences between these departments—institutional differences with historical roots going back to de Toledo and his plan for effective exploitation of indigenous labor. The major historical difference between Acomayo and Calca is that Acomayo was in the catchment area of the Potosí *mita*. Calca was not.

In addition to the concentration of labor and the *mita*, de Toledo consolidated the *encomienda* into a head tax, a fixed sum payable by each adult male every year in silver. This was another scheme designed to force people into the labor market and reduce wages for Spanish landowners. Another institution, the *repartimiento de mercancías*, also became widespread during de Toledo's tenure. Derived from the Spanish verb *repartir*, to distribute, this *repartimiento*, literally "the distribution of goods," involved the forced sale of goods to locals at prices determined by Spaniards. Finally, de Toledo introduced the *trajin*—meaning, literally, "the burden"—which used the indigenous people to carry heavy loads of goods, such as wine or coca leaves or textiles, as a substitute for pack animals, for the business ventures of the Spanish elite.

Throughout the Spanish colonial world in the Americas, similar institutions and social structures emerged. After an initial phase of

looting, and gold and silver lust, the Spanish created a web of institutions designed to exploit the indigenous peoples. The full gamut of *encomienda*, *mita*, *repartimiento*, and *trajin* was designed to force indigenous people's living standards down to a subsistence level and thus extract all income in excess of this for Spaniards. This was achieved by expropriating their land, forcing them to work, offering low wages for labor services, imposing high taxes, and charging high prices for goods that were not even voluntarily bought. Though these institutions generated a lot of wealth for the Spanish Crown and made the conquistadors and their descendants very rich, they also turned Latin America into the most unequal continent in the world and sapped much of its economic potential.

. . . TO JAMESTOWN

As the Spanish began their conquest of the Americas in the 1490s, England was a minor European power recovering from the devastating effects of a civil war, the Wars of the Roses. She was in no state to take advantage of the scramble for loot and gold and the opportunity to exploit the indigenous peoples of the Americas. Nearly one hundred years later, in 1588, the lucky rout of the Spanish Armada, an attempt by King Philip II of Spain to invade England, sent political shockwaves around Europe. Fortunate though England's victory was, it was also a sign of growing English assertiveness on the seas that would enable them to finally take part in the quest for colonial empire.

It is thus no coincidence that the English began their colonization of North America at exactly the same time. But they were already latecomers. They chose North America not because it was attractive, but because it was all that was available. The "desirable" parts of the Americas, where the indigenous population to exploit was plentiful and where the gold and silver mines were located, had already been occupied. The English got the leftovers. When the eighteenth-century English writer and agriculturalist Arthur Young discussed where profitable "staple products," by which he meant exportable agricultural goods, were produced, he noted:

It appears upon the whole, that the staple productions of our colonies decrease in value in proportion to their distance from the sun. In the West Indies, which are the hottest of all, they make to the amount of 8l. 12s. 1d. per head. In the southern continental ones, to the amount of 5l. 10s. In the central ones, to the amount of 9s. 6 1/2d. In the northern settlements, to that of 2s. 6d. This scale surely suggests a most important lesson—to avoid colonizing in northern latitudes.

The first English attempt to plant a colony, at Roanoke, in North Carolina, between 1585 and 1587, was a complete failure. In 1607 they tried again. Shortly before the end of 1606, three vessels, *Susan Constant*, *Godspeed*, and *Discovery*, under the command of Captain Christopher Newport, set off for Virginia. The colonists, under the auspices of the Virginia Company, sailed into Chesapeake Bay and up a river they named the James, after the ruling English monarch, James I. On May 14, 1607, they founded the settlement of Jamestown.

Though the settlers on board the ships owned by the Virginia Company were English, they had a model of colonization heavily influenced by the template set up by Cortés, Pizarro, and de Toledo. Their first plan was to capture the local chief and use him as a way to get provisions and to coerce the population into producing food and wealth for them.

When they first landed in Jamestown, the English colonists did not know that they were within the territory claimed by the Powhatan Confederacy, a coalition of some thirty polities owing allegiance to a king called Wahunsunacock. Wahunsunacock's capital was at the town of Werowocomoco, a mere twenty miles from Jamestown. The plan of the colonists was to learn more about the lay of the land. If the locals could not be induced to provide food and labor, the colonists might at least be able to trade with them. The notion that the settlers themselves would work and grow their own food seems not to have crossed their minds. That is not what conquerors of the New World did.

Wahunsunacock quickly became aware of the colonists' presence

and viewed their intentions with great suspicion. He was in charge of what for North America was quite a large empire. But he had many enemies and lacked the overwhelming centralized political control of the Incas. Wahunsunacock decided to see what the intentions of the English were, initially sending messengers saying that he desired friendly relations with them.

As the winter of 1607 closed in, the settlers in Jamestown began to run low on food, and the appointed leader of the colony's ruling council, Edward Marie Wingfield, dithered indecisively. The situation was rescued by Captain John Smith. Smith, whose writings provide one of our main sources of information about the early development of the colony, was a larger-than-life character. Born in England, in rural Lincolnshire, he disregarded his father's desires for him to go into business and instead became a soldier of fortune. He first fought with English armies in the Netherlands, after which he joined Austrian forces serving in Hungary fighting against the armies of the Ottoman Empire. Captured in Romania, he was sold as a slave and put to work as a field hand. He managed one day to overcome his master and, stealing his clothes and his horse, escape back into Austrian territory. Smith had got himself into trouble on the voyage to Virginia and was imprisoned on the *Susan Constant* for mutiny after defying the orders of Wingfield. When the ships reached the New World, the plan was to put him on trial. To the immense horror of Wingfield, Newport, and other elite colonists, however, when they opened their sealed orders, they discovered that the Virginia Company had nominated Smith to be a member of the ruling council that was to govern Jamestown.

With Newport sailing back to England for supplies and more colonists, and Wingfield uncertain about what to do, it was Smith who saved the colony. He initiated a series of trading missions that secured vital food supplies. On one of these he was captured by Opechancanough, one of Wahunsunacock's younger brothers, and was brought before the king at Werowocomoco. He was the first Englishman to meet Wahunsunacock, and it was at this initial meeting that according to some accounts Smith's life was saved only at the intervention of Wahunsunacock's young daughter Pocahontas. Freed on January 2,

1608, Smith returned to Jamestown, which was still perilously low on food, until the timely return of Newport from England later on the same day.

The colonists of Jamestown learned little from this initial experience. As 1608 proceeded, they continued their quest for gold and precious metals. They still did not seem to understand that to survive, they could not rely on the locals to feed them through either coercion or trade. It was Smith who was the first to realize that the model of colonization that had worked so well for Cortés and Pizarro simply would not work in North America. The underlying circumstances were just too different. Smith noted that, unlike the Aztecs and Incas, the peoples of Virginia did not have gold. Indeed, he noted in his diary, "Victuals you must know is all their wealth." Anas Todkill, one of the early settlers who left an extensive diary, expressed well the frustrations of Smith and the few others on which this recognition dawned:

"There was no talke, no hope, no worke, but dig gold, refine gold, load gold."

When Newport sailed for England in April 1608 he took a cargo of pyrite, fool's gold. He returned at the end of September with orders from the Virginia Company to take firmer control over the locals. Their plan was to crown Wahunsunacock, hoping this would render him subservient to the English king James I. They invited him to Jamestown, but Wahunsunacock, still deeply suspicious of the colonists, had no intention of risking capture. John Smith recorded Wahunsunacock's reply: "If your King have sent me presents, I also am a King, and this is my land . . . Your father is to come to me, not I to him, nor yet to your fort, neither will I bite at such a bait."

If Wahunsunacock would not "bite at such a bait," Newport and Smith would have to go to Werowocomoco to undertake the coronation. The whole event appears to have been a complete fiasco, with the only thing coming out of it a resolve on the part of Wahunsunacock that it was time to get rid of the colony. He imposed a trade embargo. Jamestown could no longer trade for supplies. Wahunsunacock would starve them out.

Newport set sail once more for England, in December 1608. He took with him a letter written by Smith pleading with the directors of the Virginia Company to change the way they thought about the colony. There was no possibility of a get-rich-quick exploitation of Virginia along the lines of Mexico and Peru. There were no gold or precious metals, and the indigenous people could not be forced to work or provide food. Smith realized that if there were going to be a viable colony, it was the colonists who would have to work. He therefore pleaded with the directors to send the right sort of people: "When you send againe I entreat you rather to send some thirty carpenters, husbandmen, gardeners, fishermen, blacksmiths, masons, and diggers up of trees, roots, well provided, then a thousand of such as we have."

Smith did not want any more useless goldsmiths. Once more Jamestown survived only because of his resourcefulness. He managed to cajole and bully local indigenous groups to trade with him, and when they wouldn't, he took what he could. Back in the settlement, Smith was completely in charge and imposed the rule that "he that will not worke shall not eat." Jamestown survived a second winter.

The Virginia Company was intended to be a moneymaking enterprise, and after two disastrous years, there was no whiff of profit. The directors of the company decided that they needed a new model of governance, replacing the ruling council with a single governor. The first man appointed to this position was Sir Thomas Gates. Heeding some aspects of Smith's warning, the company realized that they had to try something new. This realization was driven home by the events of the winter of 1609/1610—the so-called "starving time." The new mode of governance left no room for Smith, who, disgruntled, returned to England in the autumn of 1609. Without his resourcefulness, and with Wahunsunacock throttling the food supply, the colonists in Jamestown perished. Of the five hundred who entered the winter, only sixty were alive by March. The situation was so desperate that they resorted to cannibalism.

The "something new" that was imposed on the colony by Gates and his deputy, Sir Thomas Dale, was a work regime of draconian severity for English settlers—though not of course for the elite run-

ning the colony. It was Dale who propagated the "Lawes Divine, Morall and Martiall." This included the clauses

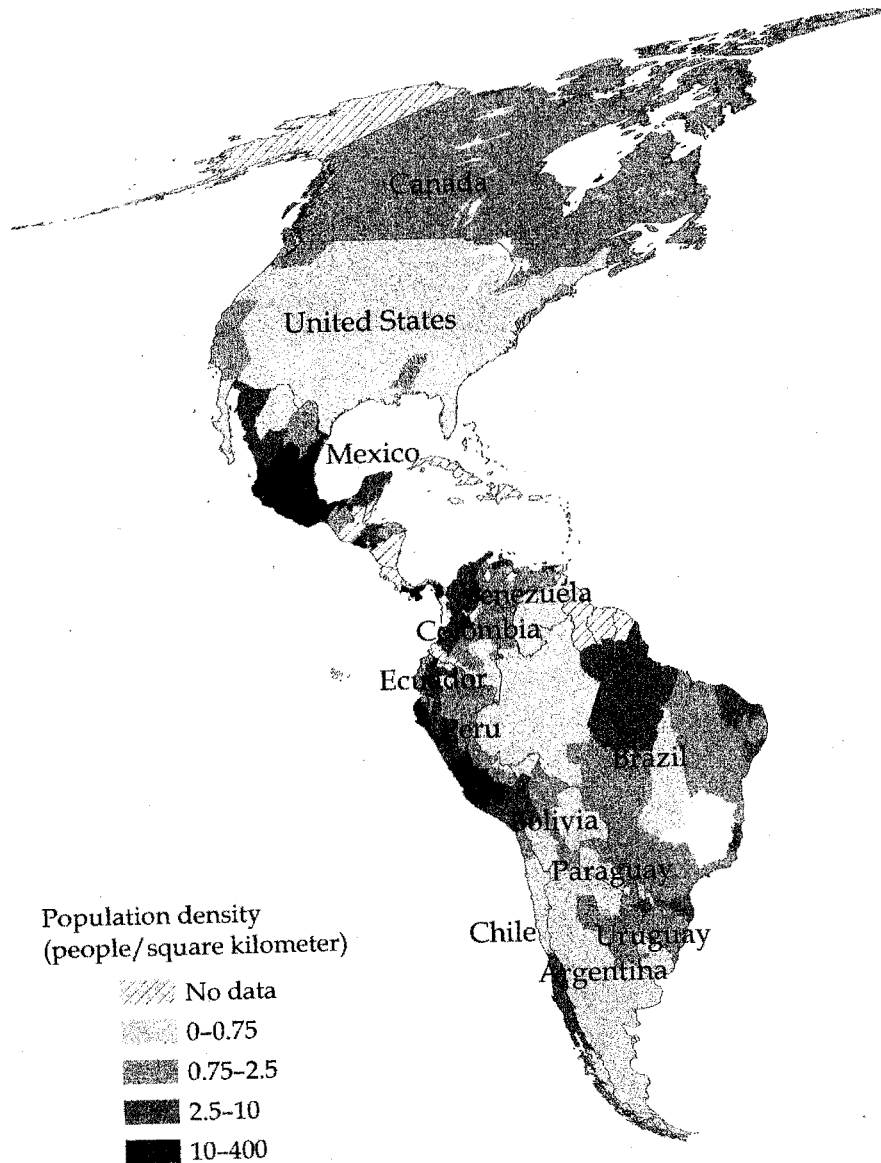
No man or woman shall run away from the colony to the Indians, upon pain of death.

Anyone who robs a garden, public or private, or a vineyard, or who steals ears of corn shall be punished with death.

No member of the colony will sell or give any commodity of this country to a captain, mariner, master or sailor to transport out of the colony, for his own private uses, upon pain of death.

If the indigenous peoples could not be exploited, reasoned the Virginia Company, perhaps the colonists could. The new model of colonial development entailed the Virginia Company owning all the land. Men were housed in barracks, and given company-determined rations. Work gangs were chosen, each one overseen by an agent of the company. It was close to martial law, with execution as the punishment of first resort. As part of the new institutions for the colony, the first clause just given is significant. The company threatened with death those who ran away. Given the new work regime, running away to live with the locals became more and more of an attractive option for the colonists who had to do the work. Also available, given the low density of even indigenous populations in Virginia at that time, was the prospect of going it alone on the frontier beyond the control of the Virginia Company. The power of the company in the face of these options was limited. It could not coerce the English settlers into hard work at subsistence rations.

Map 2 (opposite) shows an estimate of the population density of different regions of the Americas at the time on the Spanish conquest. The population density of the United States, outside of a few pockets, was at most three-quarters of a person per square mile. In central Mexico or Andean Peru, the population density was as high as four hundred people per square mile, more than five hundred times higher. What was possible in Mexico or Peru was not feasible in Virginia.



Map 2: Population density in 1500 in the Americas

It took the Virginia Company some time to recognize that its initial model of colonization did not work in Virginia, and it took a while, too, for the failure of the “Lawes Divine, Morall and Martiall” to sink in. Starting in 1618, a dramatically new strategy was adopted. Since it was possible to coerce neither the locals nor the settlers, the only alternative was to give the settlers incentives. In 1618 the company began the “headright system,” which gave each male settler fifty acres of land and fifty more acres for each member of his family and for all servants that a family could bring to Virginia. Settlers were given their houses and freed from their contracts, and in 1619 a General Assembly was introduced that effectively gave all adult men a say in the laws and institutions governing the colony. It was the start of democracy in the United States.

It took the Virginia Company twelve years to learn its first lesson that what had worked for the Spanish in Mexico and in Central and South America would not work in the north. The rest of the seventeenth century saw a long series of struggles over the second lesson: that the only option for an economically viable colony was to create institutions that gave the colonists incentives to invest and to work hard.

As North America developed, English elites tried time and time again to set up institutions that would heavily restrict the economic and political rights for all but a privileged few of the inhabitants of the colony, just as the Spanish did. Yet in each case this model broke down, as it had in Virginia.

One of the most ambitious attempts began soon after the change in strategy of the Virginia Company. In 1632 ten million acres of land on the upper Chesapeake Bay were granted by the English king Charles I to Cecilius Calvert, Lord Baltimore. The Charter of Maryland gave Lord Baltimore complete freedom to create a government along any lines he wished, with clause VII noting that Baltimore had “for the good and happy Government of the said Province, free, full, and absolute Power, by the Tenor of these Presents, to Ordain, Make, and Enact Laws, of what Kind soever.”

Baltimore drew up a detailed plan for creating a manorial society, a North American variant of an idealized version of seventeenth-century rural England. It entailed dividing the land into plots of thou-

sands of acres, which would be run by lords. The lords would recruit tenants, who would work the lands and pay rents to the privileged elite controlling the land. Another similar attempt was made later in 1663, with the founding of Carolina by eight proprietors, including Sir Anthony Ashley-Cooper. Ashley-Cooper, along with his secretary, the great English philosopher John Locke, formulated the Fundamental Constitutions of Carolina. This document, like the Charter of Maryland before it, provided a blueprint for an elitist, hierarchical society based on control by a landed elite. The preamble noted that “the government of this province may be made most agreeable to the monarchy under which we live and of which this province is a part; and that we may avoid erecting a numerous democracy.”

The clauses of the Fundamental Constitutions laid out a rigid social structure. At the bottom were the “leet-men,” with clause 23 noting, “All the children of leet-men shall be leet-men, and so to all generations.” Above the leet-men, who had no political power, were the landgraves and caziques, who were to form the aristocracy. Landgraves were to be allocated forty-eight thousand acres of land each, and caziques twenty-four thousand acres. There was to be a parliament, in which landgraves and caziques were represented, but it would be permitted to debate only those measures that had previously been approved by the eight proprietors.

Just as the attempt to impose draconian rule in Virginia failed, so did the plans for the same type of institutions in Maryland and Carolina. The reasons were similar. In all cases it proved to be impossible to force settlers into a rigid hierarchical society, because there were simply too many options open to them in the New World. Instead, they had to be provided with incentives for them to want to work. And soon they were demanding more economic freedom and further political rights. In Maryland, too, settlers insisted on getting their own land, and they forced Lord Baltimore into creating an assembly. In 1691 the assembly induced the king to declare Maryland a Crown colony, thus removing the political privileges of Baltimore and his great lords. A similar protracted struggle took place in the Carolinas, again with the proprietors losing. South Carolina became a royal colony in 1729.

By the 1720s, all the thirteen colonies of what was to become the United States had similar structures of government. In all cases there was a governor, and an assembly based on a franchise of male property holders. They were not democracies; women, slaves, and the propertyless could not vote. But political rights were very broad compared with contemporary societies elsewhere. It was these assemblies and their leaders that coalesced to form the First Continental Congress in 1774, the prelude to the independence of the United States. The assemblies believed they had the right to determine both their own membership and the right to taxation. This, as we know, created problems for the English colonial government.

A TALE OF TWO CONSTITUTIONS

It should now be apparent that it is not a coincidence that the United States, and not Mexico, adopted and enforced a constitution that espoused democratic principles, created limitations on the use of political power, and distributed that power broadly in society. The document that the delegates sat down to write in Philadelphia in May 1787 was the outcome of a long process initiated by the formation of the General Assembly in Jamestown in 1619.

The contrast between the constitutional process that took place at the time of the independence of the United States and the one that took place a little afterward in Mexico is stark. In February 1808, Napoleon Bonaparte's French armies invaded Spain. By May they had taken Madrid, the Spanish capital. By September the Spanish king Ferdinand had been captured and had abdicated. A national junta, the Junta Central, took his place, taking the torch in the fight against the French. The Junta met first at Aranjuez, but retreated south in the face of the French armies. Finally it reached the port of Cádiz, which, though besieged by Napoleonic forces, held out. Here the Junta formed a parliament, called the Cortes. In 1812 the Cortes produced what became known as the Cádiz Constitution, which called for the introduction of a constitutional monarchy based on notions of popular sovereignty. It also called for the end of special privileges and the introduction of equality before the law. These demands were all

anathema to the elites of South America, who were still ruling an institutional environment shaped by the *encomienda*, forced labor, and absolute power vested in them and the colonial state.

The collapse of the Spanish state with the Napoleonic invasion created a constitutional crisis throughout colonial Latin America. There was much dispute about whether to recognize the authority of the Junta Central, and in response, many Latin Americans began to form their own juntas. It was only a matter of time before they began to sense the possibility of becoming truly independent from Spain. The first declaration of independence took place in La Paz, Bolivia, in 1809, though it was quickly crushed by Spanish troops sent from Peru. In Mexico the political attitudes of the elite had been shaped by the 1810 Hidalgo Revolt, led by a priest, Father Miguel Hidalgo. When Hidalgo's army sacked Guanajuato on September 23, they killed the intendant, the senior colonial official, and then started indiscriminately to kill white people. It was more like class or even ethnic warfare than an independence movement, and it united all the elites in opposition. If independence allowed popular participation in politics, the local elites, not just Spaniards, were against it. Consequentially, Mexican elites viewed the Cádiz Constitution, which opened the way to popular participation, with extreme skepticism; they would never recognize its legitimacy.

In 1815, as Napoleon's European empire collapsed, King Ferdinand VII returned to power and the Cádiz Constitution was abrogated. As the Spanish Crown began trying to reclaim its American colonies, it did not face a problem with loyalist Mexico. Yet, in 1820, a Spanish army that had assembled in Cádiz to sail to the Americas to help restore Spanish authority mutinied against Ferdinand VII. They were soon joined by army units throughout the country, and Ferdinand was forced to restore the Cádiz Constitution and recall the Cortes. This Cortes was even more radical than the one that had written the Cádiz Constitution, and it proposed abolishing all forms of labor coercion. It also attacked special privileges—for example, the right of the military to be tried for crimes in their own courts. Faced finally with the imposition of this document in Mexico, the elites there decided that it was better to go it alone and declare independence.

This independence movement was led by Augustín de Iturbide, who had been an officer in the Spanish army. On February 24, 1821, he published the Plan de Iguala, his vision for an independent Mexico. The plan featured a constitutional monarchy with a Mexican emperor, and removed the provisions of the Cádiz Constitution that Mexican elites found so threatening to their status and privileges. It received instantaneous support, and Spain quickly realized that it could not stop the inevitable. But Iturbide did not just organize Mexican secession. Recognizing the power vacuum, he quickly took advantage of his military backing to have himself declared emperor, a position that the great leader of South American independence Simón Bolívar described as “by the grace of God and of bayonets.” Iturbide was not constrained by the same political institutions that constrained presidents of the United States; he quickly made himself a dictator, and by October 1822 he had dismissed the constitutionally sanctioned congress and replaced it with a junta of his choosing. Though Iturbide did not last long, this pattern of events was to be repeated time and time again in nineteenth-century Mexico.

The Constitution of the United States did not create a democracy by modern standards. Who could vote in elections was left up to the individual states to determine. While northern states quickly conceded the vote to all white men irrespective of how much income they earned or property they owned, southern states did so only gradually. No state enfranchised women or slaves, and as property and wealth restrictions were lifted on white men, racial franchises explicitly disenfranchising black men were introduced. Slavery, of course, was deemed constitutional when the Constitution of the United States was written in Philadelphia, and the most sordid negotiation concerned the division of the seats in the House of Representatives among the states. These were to be allocated on the basis of a state’s population, but the congressional representatives of southern states then demanded that the slaves be counted. Northerners objected. The compromise was that in apportioning seats to the House of Representatives, a slave would count as three-fifths of a free person. The conflicts between the North and South of the United States were repressed during the constitutional process as the three-fifths

rule and other compromises were worked out. New fixes were added over time—for example, the Missouri Compromise, an arrangement where one proslavery and one antislavery state were always added to the union together, to keep the balance in the Senate between those for and those against slavery. These fudges kept the political institutions of the United States working peacefully until the Civil War finally resolved the conflicts in favor of the North.

The Civil War was bloody and destructive. But both before and after it there were ample economic opportunities for a large fraction of the population, especially in the northern and western United States. The situation in Mexico was very different. If the United States experienced five years of political instability between 1860 and 1865, Mexico experienced almost nonstop instability for the first fifty years of independence. This is best illustrated via the career of Antonio López de Santa Ana.

Santa Ana, son of a colonial official in Veracruz, came to prominence as a soldier fighting for the Spanish in the independence wars. In 1821 he switched sides with Iturbide and never looked back. He became president of Mexico for the first time in May of 1833, though he exercised power for less than a month, preferring to let Valentín Gómez Farías act as president. Gómez Farías’s presidency lasted fifteen days, after which Santa Ana retook power. This was as brief as his first spell, however, and he was again replaced by Gómez Farías, in early July. Santa Ana and Gómez Farías continued this dance until the middle of 1835, when Santa Ana was replaced by Miguel Barragán. But Santa Ana was not a quitter. He was back as president in 1839, 1841, 1844, 1847, and, finally, between 1853 and 1855. In all, he was president eleven times, during which he presided over the loss of the Alamo and Texas and the disastrous Mexican-American War, which led to the loss of what became New Mexico and Arizona. Between 1824 and 1867 there were fifty-two presidents in Mexico, few of whom assumed power according to any constitutionally sanctioned procedure.

The consequence of this unprecedented political instability for economic institutions and incentives should be obvious. Such instability led to highly insecure property rights. It also led to a severe

total assets of \$27.3 billion. Potential inventors in the United States had ready access to capital to start their businesses. Moreover, the intense competition among banks and financial institutions in the United States meant that this capital was available at fairly low interest rates.

The same was not true in Mexico. In fact, in 1910, the year in which the Mexican Revolution started, there were only forty-two banks in Mexico, and two of these controlled 60 percent of total banking assets. Unlike in the United States, where competition was fierce, there was practically no competition among Mexican banks. This lack of competition meant that the banks were able to charge their customers very high interest rates, and typically confined lending to the privileged and the already wealthy, who would then use their access to credit to increase their grip over the various sectors of the economy.

The form that the Mexican banking industry took in the nineteenth and twentieth centuries was a direct result of the postindependence political institutions of the country. The chaos of the Santa Ana era was followed by an abortive attempt by the French government of Emperor Napoleon II to create a colonial regime in Mexico under Emperor Maximilian between 1864 and 1867. The French were expelled, and a new constitution was written. But the government formed first by Benito Juárez and, after his death, by Sebastián Lerdo de Tejada was soon challenged by a young military man named Porfirio Díaz. Díaz had been a victorious general in the war against the French and had developed aspirations of power. He formed a rebel army and, in November of 1876, defeated the army of the government at the Battle of Tecoac. In May of the next year, he had himself elected president. He went on to rule Mexico in a more or less unbroken and increasingly authoritarian fashion until his overthrow at the outbreak of the revolution thirty-four years later.

Like Iturbide and Santa Ana before him, Díaz started life as a military commander. Such a career path into politics was certainly known in the United States. The first president of the United States, George Washington, was also a successful general in the War of Independence. Ulysses S. Grant, one of the victorious Union generals of the Civil War, became president in 1869, and Dwight D. Eisenhower, the

supreme commander of the Allied Forces in Europe during the Second World War, was president of the United States between 1953 and 1961. Unlike Iturbide, Santa Ana, and Díaz, however, none of these military men used force to get into power. Nor did they use force to avoid having to relinquish power. They abided by the Constitution. Though Mexico had constitutions in the nineteenth century, they put few constraints on what Iturbide, Santa Ana, and Díaz could do. These men could be removed from power only the same way they had attained it: by the use of force.

Díaz violated people's property rights, facilitating the expropriation of vast amounts of land, and he granted monopolies and favors to his supporters in all lines of business, including banking. There was nothing new about this behavior. This is exactly what Spanish conquistadors had done, and what Santa Ana did in their footsteps.

The reason that the United States had a banking industry that was radically better for the economic prosperity of the country had nothing to do with differences in the motivation of those who owned the banks. Indeed, the profit motive, which underpinned the monopolistic nature of the banking industry in Mexico, was present in the United States, too. But this profit motive was channeled differently because of the radically different U.S. institutions. The bankers faced different economic institutions, institutions that subjected them to much greater competition. And this was largely because the politicians who wrote the rules for the bankers faced very different incentives themselves, forged by different political institutions. Indeed, in the late eighteenth century, shortly after the Constitution of the United States came into operation, a banking system looking similar to that which subsequently dominated Mexico began to emerge. Politicians tried to set up state banking monopolies, which they could give to their friends and partners in exchange for part of the monopoly profits. The banks also quickly got into the business of lending money to the politicians who regulated them, just as in Mexico. But this situation was not sustainable in the United States, because the politicians who attempted to create these banking monopolies, unlike their Mexican counterparts, were subject to election and reelection. Creating banking monopolies and giving loans to politicians is good business for politicians, if they

can get away with it. It is not particularly good for the citizens, however. Unlike in Mexico, in the United States the citizens could keep politicians in check and get rid of ones who would use their offices to enrich themselves or create monopolies for their cronies. In consequence, the banking monopolies crumbled. The broad distribution of political rights in the United States, especially when compared to Mexico, guaranteed equal access to finance and loans. This in turn ensured that those with ideas and inventions could benefit from them.

PATH-DEPENDENT CHANGE

The world was changing in the 1870s and '80s. Latin America was no exception. The institutions that Porfirio Díaz established were not identical to those of Santa Ana or the Spanish colonial state. The world economy boomed in the second half of the nineteenth century, and innovations in transportation such as the steamship and the railway led to a huge expansion of international trade. This wave of globalization meant that resource-rich countries such as Mexico—or, more appropriately, the elites in such countries—could enrich themselves by exporting raw materials and natural resources to industrializing North America or Western Europe. Díaz and his cronies thus found themselves in a different and rapidly evolving world. They realized that Mexico had to change, too. But this didn't mean uprooting the colonial institutions and replacing them with institutions similar to those in the United States. Instead, theirs was "path-dependent" change leading only to the next stage of the institutions that had already made much of Latin America poor and unequal.

Globalization made the large open spaces of the Americas, its "open frontiers," valuable. Often these frontiers were only mythically open, since they were inhabited by indigenous peoples who were brutally dispossessed. All the same, the scramble for this newly valuable resource was one of the defining processes of the Americas in the second half of the nineteenth century. The sudden opening of this valuable frontier led not to parallel processes in the United States and Latin America, but to a further divergence, shaped by the existing institutional differences, especially those concerning who had access to

the land. In the United States a long series of legislative acts, ranging from the Land Ordinance of 1785 to the Homestead Act of 1862, gave broad access to frontier lands. Though indigenous peoples had been sidelined, this created an egalitarian and economically dynamic frontier. In most Latin American countries, however, the political institutions there created a very different outcome. Frontier lands were allocated to the politically powerful and those with wealth and contacts, making such people even more powerful.

Díaz also started to dismantle many of the specific colonial institutional legacies preventing international trade, which he anticipated could greatly enrich him and his supporters. His model, however, continued to be not the type of economic development he saw north of the Rio Grande but that of Cortés, Pizarro, and de Toledo, where the elite would make huge fortunes while the rest were excluded. When the elite invested, the economy would grow a little, but such economic growth was always going to be disappointing. It also came at the expense of those lacking rights in this new order, such as the Yaqui people of Sonora, in the hinterland of Nogales. Between 1900 and 1910, possibly thirty thousand Yaqui were deported, essentially enslaved, and sent to work in the henequen plantations of Yucatán. (The fibers of the henequen plant were a valuable export, since they could be used to make rope and twine.)

The persistence into the twentieth century of a specific institutional pattern inimical to growth in Mexico and Latin America is well illustrated by the fact that, just as in the nineteenth century, the pattern generated economic stagnation and political instability, civil wars and coups, as groups struggled for the benefits of power. Díaz finally lost power to revolutionary forces in 1910. The Mexican Revolution was followed by others in Bolivia in 1952, Cuba in 1959, and Nicaragua in 1979. Meanwhile, sustained civil wars raged in Colombia, El Salvador, Guatemala, and Peru. Expropriation or the threat of expropriation of assets continued apace, with mass agrarian reforms (or attempted reforms) in Bolivia, Brazil, Chile, Colombia, Guatemala, Peru, and Venezuela. Revolutions, expropriations, and political instability came along with military governments and various types of dictatorships. Though there was also a gradual drift toward greater political rights, it was only

in the 1990s that most Latin American countries became democracies, and even then they remain mired in instability.

This instability was accompanied by mass repression and murder. The 1991 National Commission for Truth and Reconciliation Report in Chile determined that 2,279 persons were killed for political reasons during the Pinochet dictatorship between 1973 and 1990. Possibly 50,000 were imprisoned and tortured, and hundreds of thousands of people were fired from their jobs. The Guatemalan Commission for Historical Clarification Report in 1999 identified a total of 42,275 named victims, though others have claimed that as many as 200,000 were murdered in Guatemala between 1962 and 1996, 70,000 during the regime of General Efraín Ríos Montt, who was able to commit these crimes with such impunity that he could run for president in 2003; fortunately he did not win. The National Commission on the Disappearance of Persons in Argentina put the number of people murdered by the military there at 9,000 persons from 1976 to 1983, although it noted that the actual number could be higher. (Estimates by human rights organizations usually place it at 30,000.)

MAKING A BILLION OR TWO

The enduring implications of the organization of colonial society and those societies' institutional legacies shape the modern differences between the United States and Mexico, and thus the two parts of Nogales. The contrast between how Bill Gates and Carlos Slim became the two richest men in the world—Warren Buffett is also a contender—illustrates the forces at work. The rise of Gates and Microsoft is well known, but Gates's status as the world's richest person and the founder of one of the most technologically innovative companies did not stop the U.S. Department of Justice from filing civil actions against the Microsoft Corporation on May 8, 1998, claiming that Microsoft had abused monopoly power. Particularly at issue was the way that Microsoft had tied its Web browser, Internet Explorer, to its Windows operating system. The government had been keeping an eye on Gates for quite some time, and as early as 1991, the Federal Trade Commission had launched an inquiry into whether Microsoft was abusing its

monopoly on PC operating systems. In November 2001, Microsoft reached a deal with the Justice Department. It had its wings clipped, even if the penalties were less than many demanded.

In Mexico, Carlos Slim did not make his money by innovation. Initially he excelled in stock market deals, and in buying and revamping unprofitable firms. His major coup was the acquisition of Telmex, the Mexican telecommunications monopoly that was privatized by President Carlos Salinas in 1990. The government announced its intention to sell 51 percent of the voting stock (20.4 percent of total stock) in the company in September 1989 and received bids in November 1990. Even though Slim did not put in the highest bid, a consortium led by his Grupo Corso won the auction. Instead of paying for the shares right away, Slim managed to delay payment, using the dividends of Telmex itself to pay for the stock. What was once a public monopoly now became Slim's monopoly, and it was hugely profitable.

The economic institutions that made Carlos Slim who he is are very different from those in the United States. If you're a Mexican entrepreneur, entry barriers will play a crucial role at every stage of your career. These barriers include expensive licenses you have to obtain, red tape you have to cut through, politicians and incumbents who will stand in your way, and the difficulty of getting funding from a financial sector often in cahoots with the incumbents you're trying to compete against. These barriers can be either insurmountable, keeping you out of lucrative areas, or your greatest friend, keeping your competitors at bay. The difference between the two scenarios is of course whom you know and whom you can influence—and yes, whom you can bribe. Carlos Slim, a talented, ambitious man from a relatively modest background of Lebanese immigrants, has been a master at obtaining exclusive contracts; he managed to monopolize the lucrative telecommunications market in Mexico, and then to extend his reach to the rest of Latin America.

There have been challenges to Slim's Telmex monopoly. But they have not been successful. In 1996 Avantel, a long-distance phone provider, petitioned the Mexican Competition Commission to check whether Telmex had a dominant position in the telecommunications

market. In 1997 the commission declared that Telmex had substantial monopoly power with respect to local telephony, national long-distance calls, and international long-distance calls, among other things. But attempts by the regulatory authorities in Mexico to limit these monopolies have come to nothing. One reason is that Slim and Telmex can use what is known as a *recurso de amparo*, literally an “appeal for protection.” An *amparo* is in effect a petition to argue that a particular law does not apply to you. The idea of the *amparo* dates back to the Mexican constitution of 1857 and was originally intended as a safeguard of individual rights and freedoms. In the hands of Telmex and other Mexican monopolies, however, it has become a formidable tool for cementing monopoly power. Rather than protecting people’s rights, the *amparo* provides a loophole in equality before the law.

Slim has made his money in the Mexican economy in large part thanks to his political connections. When he has ventured into the United States, he has not been successful. In 1999 his Grupo Curso bought the computer retailer CompUSA. At the time, CompUSA had given a franchise to a firm called COC Services to sell its merchandise in Mexico. Slim immediately violated this contract with the intention of setting up his own chain of stores, without any competition from COC. But COC sued CompUSA in a Dallas court. There are no *amparos* in Dallas, so Slim lost, and was fined \$454 million. The lawyer for COC, Mark Werner, noted afterward that “the message of this verdict is that in this global economy, firms have to respect the rules of the United States if they want to come here.” When Slim was subject to the institutions of the United States, his usual tactics for making money didn’t work.

TOWARD A THEORY OF WORLD INEQUALITY

We live in an unequal world. The differences among nations are similar to those between the two parts of Nogales, just on a larger scale. In rich countries, individuals are healthier, live longer, and are much better educated. They also have access to a range of amenities and options in life, from vacations to career paths, that people in poor

countries can only dream of. People in rich countries also drive on roads without potholes, and enjoy toilets, electricity, and running water in their houses. They also typically have governments that do not arbitrarily arrest or harass them; on the contrary, the governments provide services, including education, health care, roads, and law and order. Notable, too, is the fact that the citizens vote in elections and have some voice in the political direction their countries take.

The great differences in world inequality are evident to everyone, even to those in poor countries, though many lack access to television or the Internet. It is the perception and reality of these differences that drive people to cross the Rio Grande or the Mediterranean Sea illegally to have the chance to experience rich-country living standards and opportunities. This inequality doesn’t just have consequences for the lives of individual people in poor countries; it also causes grievances and resentment, with huge political consequences in the United States and elsewhere. Understanding why these differences exist and what causes them is our focus in this book. Developing such an understanding is not just an end in itself, but also a first step toward generating better ideas about how to improve the lives of billions who still live in poverty.

The disparities on the two sides of the fence in Nogales are just the tip of the iceberg. As in the rest of northern Mexico, which benefits from trade with the United States, even if not all of it is legal, the residents of Nogales are more prosperous than other Mexicans, whose average annual household income is around \$5,000. This greater relative prosperity of Nogales, Sonora, comes from maquiladora manufacturing plants centered in industrial parks, the first of which was started by Richard Campbell, Jr., a California basket manufacturer. The first tenant was Coin-Art, a musical instrument company owned by Richard Bosse, owner of the Artley flute and saxophone company in Nogales, Arizona. Coin-Art was followed by Memorex (computer wiring); Avent (hospital clothing); Grant (sunglasses); Chamberlain (a manufacturer of garage door openers for Sears); and Samsonite (suitcases). Significantly, all are U.S.-based businesses and businessmen, using U.S. capital and know-how. The greater prosperity of Nogales, Sonora, relative to the rest of Mexico, therefore, comes from outside.

The differences between the United States and Mexico are in turn small compared with those across the entire globe. The average citizen of the United States is seven times as prosperous as the average Mexican and more than ten times as the resident of Peru or Central America. She is about twenty times as prosperous as the average inhabitant of sub-Saharan Africa, and almost forty times as those living in the poorest African countries such as Mali, Ethiopia, and Sierra Leone. And it's not just the United States. There is a small but growing group of rich countries—mostly in Europe and North America, joined by Australia, Japan, New Zealand, Singapore, South Korea, and Taiwan—whose citizens enjoy very different lives from those of the inhabitants of the rest of the globe.

The reason that Nogales, Arizona, is much richer than Nogales, Sonora, is simple; it is because of the very different institutions on the two sides of the border, which create very different incentives for the inhabitants of Nogales, Arizona, versus Nogales, Sonora. The United States is also far richer today than either Mexico or Peru because of the way its institutions, both economic and political, shape the incentives of businesses, individuals, and politicians. Each society functions with a set of economic and political rules created and enforced by the state and the citizens collectively. Economic institutions shape economic incentives: the incentives to become educated, to save and invest, to innovate and adopt new technologies, and so on. It is the political process that determines what economic institutions people live under, and it is the political institutions that determine how this process works. For example, it is the political institutions of a nation that determine the ability of citizens to control politicians and influence how they behave. This in turn determines whether politicians are agents of the citizens, albeit imperfect, or are able to abuse the power entrusted to them, or that they have usurped, to amass their own fortunes and to pursue their own agendas, ones detrimental to those of the citizens. Political institutions include but are not limited to written constitutions and to whether the society is a democracy. They include the power and capacity of the state to regulate and govern society. It is also necessary to consider more broadly the factors that determine how political power is distributed in society, particu-

larly the ability of different groups to act collectively to pursue their objectives or to stop other people from pursuing theirs.

As institutions influence behavior and incentives in real life, they forge the success or failure of nations. Individual talent matters at every level of society, but even that needs an institutional framework to transform it into a positive force. Bill Gates, like other legendary figures in the information technology industry (such as Paul Allen, Steve Ballmer, Steve Jobs, Larry Page, Sergey Brin, and Jeff Bezos), had immense talent and ambition. But he ultimately responded to incentives. The schooling system in the United States enabled Gates and others like him to acquire a unique set of skills to complement their talents. The economic institutions in the United States enabled these men to start companies with ease, without facing insurmountable barriers. Those institutions also made the financing of their projects feasible. The U.S. labor markets enabled them to hire qualified personnel, and the relatively competitive market environment enabled them to expand their companies and market their products. These entrepreneurs were confident from the beginning that their dream projects could be implemented: they trusted the institutions and the rule of law that these generated and they did not worry about the security of their property rights. Finally, the political institutions ensured stability and continuity. For one thing, they made sure that there was no risk of a dictator taking power and changing the rules of the game, expropriating their wealth, imprisoning them, or threatening their lives and livelihoods. They also made sure that no particular interest in society could warp the government in an economically disastrous direction, because political power was both limited and distributed sufficiently broadly that a set of economic institutions that created the incentives for prosperity could emerge.

This book will show that while economic institutions are critical for determining whether a country is poor or prosperous, it is politics and political institutions that determine what economic institutions a country has. Ultimately the good economic institutions of the United States resulted from the political institutions that gradually emerged after 1619. Our theory for world inequality shows how political and economic institutions interact in causing poverty or prosperity, and

how different parts of the world ended up with such different sets of institutions. Our brief review of the history of the Americas begins to give a sense of the forces that shape political and economic institutions. Different patterns of institutions today are deeply rooted in the past because once society gets organized in a particular way, this tends to persist. We'll show that this fact comes from the way that political and economic institutions interact.

This persistence and the forces that create it also explain why it is so difficult to remove world inequality and to make poor countries prosperous. Though institutions are the key to the differences between the two Nogaleses and between Mexico and the United States, that doesn't mean there will be a consensus in Mexico to change institutions. There is no necessity for a society to develop or adopt the institutions that are best for economic growth or the welfare of its citizens, because other institutions may be even better for those who control politics and political institutions. The powerful and the rest of society will often disagree about which set of institutions should remain in place and which ones should be changed. Carlos Slim would not have been happy to see his political connections disappear and the entry barriers protecting his businesses fizzle—no matter that the entry of new businesses would enrich millions of Mexicans. Because there is no such consensus, what rules society ends up with is determined by politics: who has power and how this power can be exercised. Carlos Slim has the power to get what he wants. Bill Gates's power is far more limited. That's why our theory is about not just economics but also politics. It is about the effects of institutions on the success and failure of nations—thus the economics of poverty and prosperity; it is also about how institutions are determined and change over time, and how they fail to change even when they create poverty and misery for millions—thus the politics of poverty and prosperity.

2.

THEORIES THAT DON'T WORK

THE LAY OF THE LAND

THE FOCUS OF our book is on explaining world inequality and also some of the easily visible broad patterns that nest within it. The first country to experience sustained economic growth was England—or Great Britain, usually just Britain, as the union of England, Wales, and Scotland after 1707 is known. Growth emerged slowly in the second half of the eighteenth century as the Industrial Revolution, based on major technological breakthroughs and their application in industry, took root. Industrialization in England was soon followed by industrialization in most of Western Europe and the United States. English prosperity also spread rapidly to Britain's "settler colonies" of Canada, Australia, and New Zealand. A list of the thirty richest countries today would include them, plus Japan, Singapore, and South Korea. The prosperity of these latter three is in turn part of a broader pattern in which many East Asian nations, including Taiwan and subsequently China, have experienced recent rapid growth.

The bottom of the world income distribution paints as sharp and as distinctive a picture as the top. If you instead make a list of the poorest thirty countries in the world today, you will find almost all of them in sub-Saharan Africa. They are joined by countries such as Afghanistan, Haiti, and Nepal, which, though not in Africa, all share something critical with African nations, as we'll explain. If you went back fifty years, the countries in the top and bottom thirty wouldn't be greatly different. Singapore and South Korea would not be among the richest countries, and there would be several different countries