Review of "Institutions and Economic Performance" edited by Elhanan Helpman, MIT Press, 2008, 610 pp.

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Elhanan Helpman has collected thirteen fascinating chapters which ask, from a variety of viewpoints and with a wealth of alternative approaches, what are the economic consequences of a society's institutional arrangements. What makes these chapters fascinating is the frequency with which they challenge accepted wisdom, or question evidence based on simple cross-sections. The wealth of approaches---from theory to historical analysis, to case studies and panel data econometrics--goes along with the variety of questions asked, which range from the time-honoured issue of the effects of inequality on growth, to more unusual topics such as why can small guerrilla movements be so stable and long-lived. Rather than providing a thorough review of the book—and not doing justice to many of the contributors--I shall entice the reader with a few examples of what this book offers.

Catholic countries, where the family lies at the centre of society, share a number of characteristics. Women participation in the labour market is relatively low, since the survival of families values requires women spending enough time at home. Labour mobility is also low because you can only benefit from your family if you live close to your relatives. Family firms are relatively frequent. The provision of welfare by the State or other public entities is limited since children, the elderly and those in poor health are looked after by various family members. Along with non-monetary transfers (e.g. daughters taking care of elderly parents and parents-in-law) monetary transfers within the extended family are also frequent and explain why a spell of unemployment in a Catholic country affects individual consumption less than elsewhere (Bentolilla and Ichino, 2007). The organization of

[1] I thank Alberto Giovannini for insightful comments.

Catholic societies helps understand why groups that are ethnically homogeneous and rich in social ties find it less necessary to rely on formal institution, such as a government-run welfare program. But why are Catholic countries also laggards in growth? What are the drawbacks of a society built around the family?

Siwan Anderson and Patrick Francois in their contribution to the book argue that the problem with groups organized around kinship is that such ties make it difficult to punish transgressors. Formal rules, instead, help enforcing punishments by taking some of the authority in decision making out of the hands of group members. This conjecture helps understand a peculiar finding from an experiment run in a large slum in Nairobi, inhabited by a variety of social groups. Contrary to the hypothesis that ethnic homogeneity makes formalization less necessary—Anderson and Francois find that groups formed along ethnic lines are more likely to adopt formal procedures. The difficulty an ethnic group faces in punishing transgressors would seem to offer an argument for the view that family firms underperform competitors run by professional managers and owned by outside investors—a view which runs against David Landes' thesis in his book Dynasties. So, why do Catholic societies remain family-based and keep underperforming? Why, differently from the groups in the Kenyan slum, are they reluctant to adopt more formal procedures? This is the fascinating question this chapter raises.

The empirical and theoretical findings on the effects of inequality on growth are mostly inconclusive. Daron Acemoglu and his co-authors, in their chapter in the volume, explain that this is because most studies fail to distinguish between economic and political inequality. The effects of economic inequality on growth depend on the degree of political inequality and on thus on the quality of a country's institutions. When institutions are weak—such as in Colombia in the nineteenth century, the case they study—economic inequality helps because it provides a counterbalance for rapacious politicians. The interest of this "inverted U" hypothesis goes beyond the growth literature. It challenges the time-honoured view of Latin American underdevelopment which attributes the diverging paths of North and South America to their different levels of economic inequality. It is also consistent with earlier work on Africa (Bates, 1981): greater land inequality (in Kenya) was conducive to better outcomes because large farm owners had the power to check politicians. In Ghana a large number of small farmers were unable to solve their collective action problem and failed to restrain politicians from engaging in highly distortionary policies.

Why is the discovery of a natural resource (oil in Norway, or silver in Spain-controlled Peru in the sixteenth century) a curse for some countries but not for others? Starting from this observation Auricio Drelicham and Hans-Joachim Voth analyze the reasons why Spain, after having become the richest country in the world, declined so rapidly. The simple answer is that resources are a curse where institutions are weak. But the case of Spain is more challenging because by the time of the Conquista, in the late fifteenth century, Spain had developed reasonably good institutions with a balance of power between parliament (the Cortes) and the king. So why didn't these institutions prevent silver turning into a curse? What happened is that the flow of silver enriched the Spanish kings and weakened the Cortes because parliament lost its main instrument to control the sovereign: denying the fiscal resource for his military adventures. While in Britain the warring instincts of Henry VIII's were constantly reined in by the state of his finances, the belligerence of Charles V and Philip II's was encouraged by the sheer size of the financial resources at their disposal. Through its effect on institutions the windfall from American silver eventually sentenced Spain to a centuries' long decline.

Returning to growth in the Americas, another fallacy the book exposes is the view, associated with the work of Engerman and Sokoloff (2005), according to which the different paths followed by various countries in the Continent can be traced back to different factor endowments which resulted in differences in the use of production based on slave labour. Countries which had a comparative advantage in crops produced by slaves in large plantations (such as sugarcane) had extreme economic inequality. This hampered the evolution of those institutions that are necessary for sustained growth--for instance voting rights and the provision of public schooling.   Nathan Nunn, in his contribution to the volume, confirms the finding of a negative association between past slave use and current economic performance. But he finds no evidence that large plantations, and thus large-scale slavery, was more detrimental for growth than other forms of slavery. In fact small-scale plantation slavery seems to have been more harmful for growth. This finding debunking the view that differences in factor endowments explain the growth experience across the Americas.

How can guerrilla movements remain so small and still last so long and impose such deadly outcomes? What makes guerrilla warfare—and the associated problem of organizing a counter-insurgency—so different from conventional military confrontations? James Fearon suggests that the answer lies in the information externality associated with insurgencies. Counter-insurgency works by gathering intelligence about who and where the active rebels are. This means that the larger the insurgency movement the higher the risks of infiltration, betrayal and detection. These diminishing returns to guerrilla warfare explain why this kind of conflicts tend to remain small, stable and deadly. Fearon, however, is less convincing in his attempt to explain why guerrilla warfare is more likely in poor countries. He starts debunking the conventional view that poverty makes for civil war because in poor countries there are more poor, underemployed people who find rebellion attractive as a “job”. If this was the case, in rich countries guerrilla warfare should be even more frequent, because higher per-capita income means that there is more wealth to tax or appropriate. But after this smart observation, Fearon is left with the only option of assuming that risk aversion rises with the level of income, a hypothesis for which the evidence is not compelling. A more plausible explanation might be that, as income rises, the effectiveness of counter-insurgency improves faster than the ability of guerrillas.

Avner Greif, in an intriguing chapter, discusses the constraints an administration imposes upon elected politicians. This is an important and mostly overlooked issue (an exception is Alesina and Tabellni, 2008). Politicians though entrusted with a mandate from the electorate, can only govern through an administration. This gives administrators the power to control politicians. One of the major effects of constitutions—and possibly the main reason constitutions seem to affect prosperity--is, according to Greif, the constraint they impose upon administrators. Readers who have spent some time in government will find this obvious. But Greif is among the first to point out this important role of constitutions.

Discussing the institutional origins of the industrial revolution, Joel Mokyr has contributed what in my view is the most forward looking chapter in the volume. Mokyr argues that the traditional emphasis on the role of British formal institutions in making the industrial revolution possible has been overemphasized: the role of formal institution has been less crucial than North's interpretation has suggested. What has been overlooked is the role of a "culture" which created an environment in which inventors and entrepreneurs could operate and cooperate freely. Mokyr identifies these cultural traits in the British gentlemanly, which meant that a "gentleman" could be trusted: gentlemanly, more than formal institutions, provided the shared code that made possible the rise of capitalism.

The relationship between culture and institutions, to which Mokyr hints at in his contribution, is at the centre of some of the most interesting research developments of the past few years. Some authors have worked on trying to identify the role of culture in affecting both institutional arrangements and economic outcomes—a task which faces a formidable identification problem. If, as suggested by Guiso, Sapienza and Zingales (2006) culture are "*those customary beliefs and values that ethnic, religious, and social groups transmit fairly unchanged from generation to generation*", then culture is a time-invariant characteristic of a society. Thus it cannot be separated from other time-invariant characteristics, such a geography, or the origin of the colonizing power in case of developing countries (see e.g. Tabellini, 2009 and Giavazzi et al., 2009 for attempts at solving the identification problem). Others (Guiso, Sapienza and Zingales 2008), following Putnam, trace a country's current culture back to its institutions many centuries ago. The feedbacks between culture and institutions are a fascinating and yet unresolved research question.

In his introduction to the book Helpman observes that "the rapid transformation of this area of scientific enquiry has been achieved thanks to the dismantling of disciplinary barriers". It is a sign of this dismantling that the most forward looking chapter in the volume has been written by Joel Mokyr, an historian.

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