

Does politics explain the economic gap between the United States and Latin America?*

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Abstract

In 1700, and perhaps as late as in 1800, per capita incomes were about the same in Latin America and the United States. By 2000, Latin American per capita income was about one-fifth that of the United States. The gap was already visible by 1820 and it became large by 1870. Between 1870 and 1980, Latin America grew at about the same rate as the United States. But compounded at the same rate, the 1870 difference became enormous by 2000. Hence, Latin America fell behind during the wars of independence and the political turmoil that ensued in their aftermath. The difference in the effects of independence between the North and the South was a consequence of the breakdown of institutional continuity in Latin America: the disintegration of Spanish colonial administration left the continent without an institutional framework that could absorb and regulate economic and political conflicts. When stable institutions were finally established and where they permitted some political pluralism, Latin American economies grew. What mattered was not whether these institutions were egalitarian, but whether they channelled conflicts into a regulated framework. Inequality, however, led to political crises, and the recurrent political instability was costly to growth.

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1 Introduction

Our purpose is to examine whether and in what ways political institutions and events were responsible for the economic gap between the United States and Latin America.

To our surprise, we discovered that our effort is more pioneering than we expected. While dependency theory correctly emphasized the importance of political conflicts and the potential role of the state, in the end it found the key to economic retardation in the initial insertion of particular countries in the world economy. Yet, as Haggard (1990) argued, dependency is not a condition but a strategy.¹ Because of its incorrect view of economic openness, dependency theory failed to elucidate the political factors that may explain why Latin American countries stayed behind while the East Asian countries overtook them.

In turn, the "new institutionalism" is a mirror image of the dependency theory, only that the key to development are institutions (Przeworski 2004). The central claim of new institutionalism is that institutions are the "primary" cause of economic development, "deeper" than features of the natural environment, "geography," and deeper than the supply of factors and the technologies for their use.² In the light of recent research, the "quality" of institutions should have mattered for development. Yet while "quality" is a fashionable, it is also an impossibly vague, term. Institutions that matter may be those that protect property rights,³ but also those that mobilize savings and coordinate investment (Bardhan 2004, Bordo and Cortes Conde 2001), as well as those that subject the rulers to sanctions by the ruled (Keefer 2005). Yet institutionalist answers to the question "Why Latin America Fell Behind?" are often drowned in ritualistic invocations of the approach (Haber 1997 and 2000). In Haber's (2002) most recent collection, for example, the culprit is Latin American "Crony Capitalism," as if capitalism in the United States were not "crony."⁴

While the recent revival of the interest in Latin American retardation, evidenced by the essays in Prados de La Escosura and Amaral (1993), Coatsworth and Taylor (1998) and Haber (1997, 2000, 2002), provides several insightful case studies, our analysis is conducted at the cross-national level. Moreover, to the

¹See Gerchunoff and Fajgelbaum (No date) for an illuminating analysis of how two countries with similar endowments, Argentina and Australia, diverged in their economic strategies.

²The theoretical program has been laid out by North (1997: 224; italics supplied): "To make sense out of historical and contemporary evidence, we must rethink the whole process of economic growth.... The *primary source* of economic growth is the institutional/organizational structure of a political economy...." Specifically, we learn that "Third World countries are poor because the institutional constraints define a set of payoffs to political/economic activity that do not encourage productive activity." (1990: 110).

³For the importance of legal systems, see La Porta et al. (1998). Coatsworth and Tortella (2003) analyze the effect of the Spanish legal system for the development of Spain and Mexico in the early period.

⁴"Crony capitalism," Haber (2002: xii) defines, "is usually thought of as a system in which those close to the political authorities who make and enforce policies receive favors that have large economic value." He could have in mind the restrictions on sugar imports, or the Halliburton Iraq contracts, or the 14 billion dollar subsidy to the oil industry. But none of these are possible, because in the United States the government is "limited" (2002: xiii).

extent to which data limitations allow, we stick close to the facts. The caveats should be obvious: reconstructing historical data is a hazardous undertaking and the data are replete with errors and omissions.

Here is our story. Both the delay in independence with regard to the United States and the political turmoil that followed independence in Latin America were economically costly. While we can estimate the magnitude of their effects, we cannot tell why late independence retarded development. In turn, the long period of political turmoil in Latin America resulted from the breakdown of colonial institutions. As a result of the disintegration of the Spanish rule, Latin America was left without institutions that could absorb and regulate conflicts. These institutions could be established only either as a result of military victories of some political forces or as a result of an agreement between armed elites, and it took time for them to be constituted.

When they were finally founded, political institutions tended to be highly exclusionary, "oligarchical." Yet as long as the elites peacefully processed their conflicts – typically over centralization, tariffs, or the role of religion (*conservadores* vs. *liberales*, see Gargarella 2005) – Latin American economies developed. Political inequality, however, coexisted with increasing economic inequality. Inequality, in turn, recurrently undermined the stability of these institutions. Given the economic inequality, the problem of the political incorporation of the poor, urban workers as well as agricultural laborers and tenant farmers, could not be peacefully resolved. Even today, Latin American democracies find it difficult to absorb and process conflicts and Latin American economies remain exceptionally volatile (Machinea and Vera 2005). And political instability is economically costly.

In sum, contrary to Engerman and Sokoloff (2001) as well as Acemoglu, Johnson, and Robinson (2001), we believe that economies grow when political power protects economic power – this is what "security of property" means⁵ – as long as political institutions absorb conflicts and process them according rules. But unequal political institutions perpetuated economic inequality and generated conflicts – over land (or wages of agricultural workers) and over wages and conditions of work in industry – which were politically destabilizing and economically costly. Hence, while political inequality may be statically efficient, it is dynamically inefficient.

The rest of the paper consists of historical evidence. We begin in Section 2 showing that there is a gap to explain and analyzing its timing. Since the gap was visible already by 1820 and was enormous by 1870, we focus in Section 3 on independence and its aftermath. Once Latin American countries achieved

⁵This is not the place for theoretical discussions, but note that "security of property rights" is a notoriously fuzzy concept. For one, in a Schumpeterian world of creative destruction, property would be secure only if it were defended by barriers to entry (Acemoglu 2005). Secondly, property can be made secure not by right but by might: in Latin America, land was often protected by private militias (López-Alves 2000). Most importantly, however, property rights mean something different for those who possess it and for those who do not. In the presence of barriers to entry and credit constraints – both prevalent in Latin America – property rights are exclusionary.

some political stability, we can study political institutions and their impact on development. Following the arguments of Mariscal and Sokoloff (2000) and Sokoloff (2002), in Section 4 we examine the hypothesis that Latin America fell behind economically because it failed to extend political rights to a majority of its citizens. Then, in Section 5, we focus on political pluralism, political instability and their economic consequences. A brief conclusion closes the paper.

2 The Gap and Its Timing

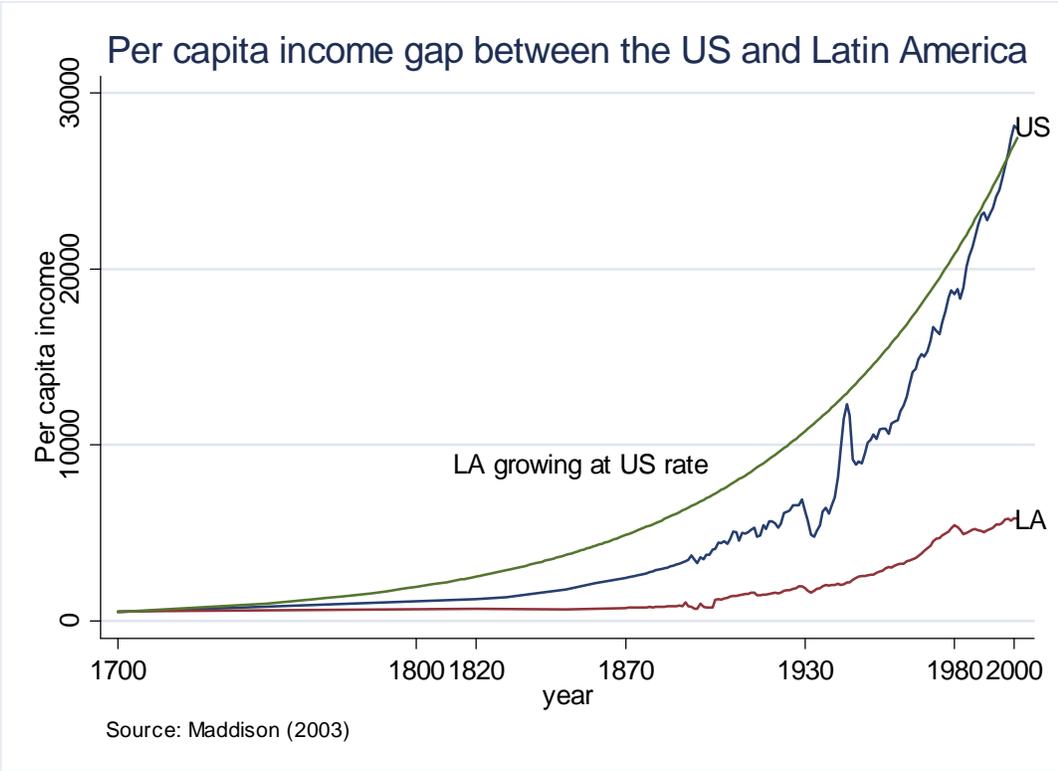
Obviously, the first question is whether there is a gap to explain. Given that in the year 2000 per capita income in the United States was \$28,129⁶ and in the nineteen Latin American countries it was \$5,844, the gap appears to be evident. But the issue is whether this gap is the result of something that happened in the independent lives of these countries or just of the conditions they inherited, either at the time of colonialization or at independence. Banerjee and Iyer (2002: 1) juxtapose these two possibilities: "In the new institutionalist view, history matters because history shapes institutions and institutions shape the economy. By contrast, in what one might call the 'increasing returns' view, historical accidents put one country ahead in terms of aggregate wealth or human capital ... and this turns into bigger and bigger differences over time because of the increasing returns." If the gap is just the result of countries growing at the same rate from different initial conditions, then politics could not have played a role in generating the gap.

Let us first look at the raw data. The irregular lines in Figure 1 show per capita income in the US and in Latin America between 1700 and 2000. In turn, the smooth line shows what *would have been* the income in Latin America had it grown at the same rate as the United States from the initial conditions in 1700. Since, at least according to Maddison (2003: 114), in 1700 the average per capita income in continental Latin America was \$521 and in the US it was \$527,⁷ if all incomes grew at the US rate, the gap in 2000 would have been only \$364. Hence, the gap in 2000 is almost entirely due to slower growth of Latin America, rather than of conditions as of 1700. There is something to be explained.

Another way to see the gap is by looking at the date when the US reached the per capita income that Latin American countries had in 2000. As shown in

⁶Unless noted otherwise, throughout the paper the dollars are G-K 1990 purchasing power parity dollars, from Maddison (2003). While this is the most comprehensive income series available, Maddison's figures are not universally accepted by economic historians. Indeed, at times they constitute only rough guesses.

⁷When Kuznets posed in 1969 the question whether Europe was wealthier than the rest of the world in 1750, his estimate was that the ratio of the lowest to the highest per capita income in the world was 1 to 2, perhaps even 1 to 2.5. Newer estimates reduce this difference. Bairoch (1994) claimed that contemporary less developed countries were not poorer than Europe. So does Pomeranz (2000). Maddison (2003) thinks the ratio was about 1 to 1.5.



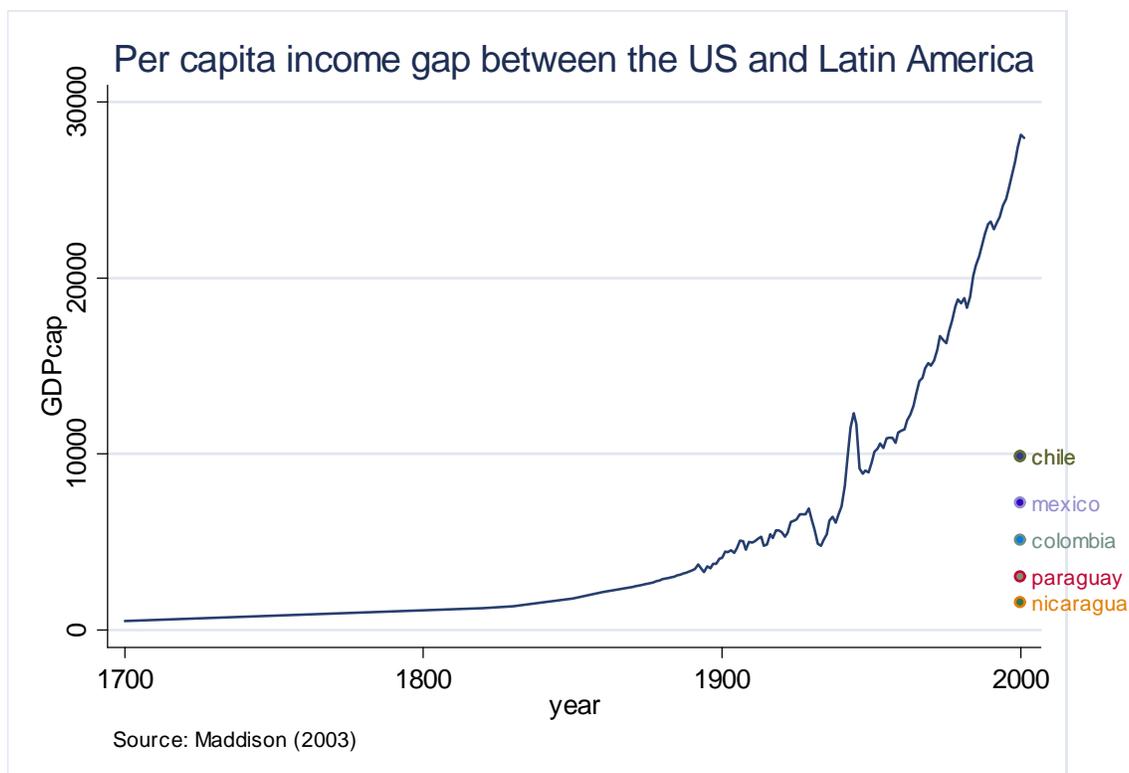


Figure 2, these dates are about 1950 for Chile, about 1900 for Colombia, and about 1850 for Paraguay.

This picture raises a methodological problem, which will appear throughout. By 2000 the most developed Latin American country, Chile, lagged 50 years behind the United States. Thus one can ask why *all* of Latin America fell behind. But such a formulation would give us two observations: the US (or North America, if we include Canada) and Latin America, and with two observations no causes could be identified. We can learn more by observing that all Latin American countries were not the same. While one cannot attend a Latin American meeting without hearing that "*En mi país, como en el resto de América Latina ...*," in fact Latin America always exhibited a large range of economic, cultural, and political characteristics. Coatsworth (1998: 26) observed that "the variation in the productivity of Latin American colonial economies in 1800 was almost as great as for the entire world." And as of 2000, per capita income of Chile was six times that of Nicaragua.

But exploiting the variations among Latin American countries does not take us off the hook. *All* of Latin America did fall behind, regardless of these vari-

ations. Perhaps the question is badly formulated: perhaps the correct question is why did the US develop faster than any other country in the world? After all, Latin America is not the only region that fell behind the US; so did the rest of the world, including Western Europe.⁸ Asking why I ride the bicycle slower than Lance Armstrong does not make much sense: he rides faster than anyone. In the end, the question becomes why some countries developed and others did not. But it turns out that even when we have all the data we need for the world as a whole, we cannot always identify the causes specific to Latin America. As Prados de la Escosura (2003: 11) observes, we must ask what are the feasible counterfactuals. All we can say now is that we will return to this problem each time it is relevant.

When did the gap appear? By 1820 it was already noticeable. And by 1870 it was enormous. Remarkably, between 1871 – the date after which continuous time series are available - and 1930, per capita incomes grew slightly faster in Latin America than in the US. By then, however, it was too late: compounded at the same rate, incomes diverged even more. And after 1930, growth of per capita incomes slowed down markedly in Latin America, while it accelerated in the US. Hence, by 2000 the average income in the US was 4.8 times higher than south of the Rio Grande.

Table 1: Per capita incomes 1700-2000

	1700	1820	1870	1930	2000
<i>Brazil</i>	459	646	713	1048	5556
<i>Mexico</i>	568	759	674	1618	7218
<i>LA^a</i>	521	701	756	1873	5844
<i>US</i>	527	1257	2445	6123	28129
<i>LA^a/USA</i>	0.99	0.56	0.31	0.31	0.21

Note: a Population weighted averages for countries for which data are available: seventeen countries in 1700 and 1820 (excluding Cuba and Dominican Republic), Brazil, Mexico, Argentina, Uruguay, and Venezuela in 1870, thirteen countries in 1930, eighteen in 2000. Source: Maddison (2003: 114) and Maddison (2003) data set.

Before we proceed to explanations, it is enlightening to decompose the evolution of per capita incomes into the growth of the total product and of the population. Note that the period 1820-1870 was disastrous for Latin America: Coatsworth (2005: 137) refers to "the catastrophic second quarter of the nineteenth century." In turn, between 1871 and 1980 the total GDP grew slightly

⁸One can ask the same question with regard to every region of the world and find some idiosyncratic reasons it fell behind. See, for example, Pomeranz (2000) on China or Kuran (2004) on the Middle East.

faster in Latin America than in the US.⁹ The faster growth of the total product in the US between 1700 and 1870 was accompanied by a much faster increase in population, due in large part to immigration.¹⁰ From 1930, population grew faster in Latin America, but productivity per worker must have remained low, so that the growth of per capita income was slower than in the United States.¹¹

Table 2: Rates of growth of total GDP, population, and per capita GDP, by period

	<i>GDP</i> <i>LA</i>	<i>GDP</i> <i>US</i>	<i>POP</i> <i>LA</i>	<i>POP</i> <i>US</i>	<i>GDPcap</i> <i>LA</i>	<i>GDPcap</i> <i>US</i>
1700 – 1870	0.84	3.12	0.68	2.20	0.14	0.92
1700 – 1820	0.77	2.67	0.55	1.94	0.22	0.73
1820 – 1870	1.02	4.21	1.07	2.83	-0.05	1.38
1871 – 2000	3.76	3.52	2.22	1.51	1.54	2.02
1871 – 1929	3.91	3.77	1.89	1.90	2.02	1.87
1930 – 2000	3.73	3.32	2.31	1.18	1.42	2.14
1930 – 1980	4.34	3.43	2.45	1.23	1.89	2.20
1981 – 2000	2.34	3.06	1.99	1.07	0.36	1.98

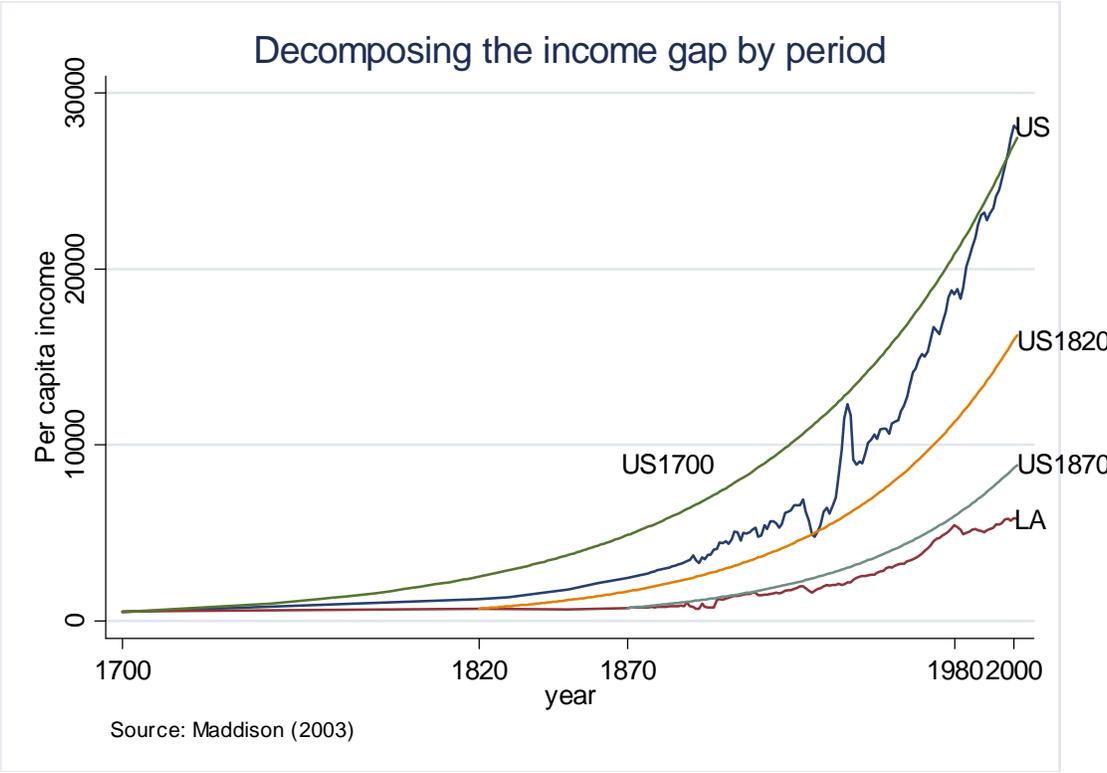
Note: Until 1870 exponential rates of growth of population weighted averages. After 1870 unweighted averages of country growth rates. Source: Maddison (2003: 114) and Maddison (2003) data set.

To summarize these patterns, it is useful to think in terms of three periods. Already by 1820, the difference between the US and Latin America was sufficiently large that even if they had grown at the same rate since then, the gap in 2000 would have been large. Between 1820 and 1870, the gap increased further because total output grew very slowly in Latin America. After 1870, the total output in Latin American grew somewhat faster than in the US, but so did population. Finally, growth of total output slowed down sharply after 1980, but we will not delve into this period.

⁹Coatsworth (1993: 10) argues that "all of the significant obstacles to economic growth in nearly all of the countries of Latin America had disappeared by the late nineteenth century."

¹⁰According to Cortes Conde (2003: 143), the growth of the US between 1774 and 1905 was due mainly to the increase of productive factors, rather than of productivity.

¹¹Cole, Ohanian, and Schmitz (2004) also attribute the retardation of Latin America after 1950 to stagnant labor productivity.



To decompose the gap as of 2000, examine Figure 3, in which the smooth lines represent the counterfactual per capita incomes of Latin America, where the counterfactual is that they would have grown at the same rates as the US from the initial conditions at different dates.¹² The upper irregular line is the actual income path of the US, while the lower is the average per capita income in Latin America.¹³ If you look vertically in 2000, the last year represented, you can interpret the distance between the actual income of Latin America and the smooth lines originating in 1700, 1820, and 1870 as the income gap due exclusively to growth rates falling behind those of the US after these dates. As we see, the gap in relation to 1700 is very large: the difference between the income Latin America would have had it grown at the same rate as the US since 1700 and the actual income it had in 2000 is \$23,123. The 2000 gap relative to the initial conditions in 1820 is already smaller, \$10,040 but still very large. In turn, the gap relative to the conditions in 1870 is small, \$2,780. Indeed, the post-1870 gap is due almost exclusively to the slowdown of growth in Latin America after 1980.¹⁴ Hence, while Latin America fell further and further behind in each period, it is clear that the current gap is due mainly to the period before 1870, and particularly before 1820, with a downward twist after 1980.

3 Independence and Its Aftermath

There are very few systematic data for the early period and this paucity makes it difficult to date the origin of the gap with more precision. As seen in Table 1, according to Maddison (2003: 114) the income of the US in 1700 was only slightly higher than that of Latin America, with the income of Mexico higher and of Brazil lower than of the US. Coatsworth (1998) gives the income of Mexico in 1700 as 89 percent of that of the US; he does not have data for Brazil, but shows Cuba to have been much wealthier than the US. In a more recent paper, Coatsworth (2005: 128) concludes that "the areas of Latin America under effective Spanish and Portuguese control probably enjoyed per capita incomes on a par with Western Europe and at least equal to the British colonies that became the United States well into the eighteenth century."

It is difficult to tell whether the gap opened up during the eighteenth century or only during the Latin American wars of independence. Bulmer-Thomas (2003: 27) cites estimates according to which per capita income of Latin America was at least as high as that of the US still in 1800. Coatsworth (1998), however, finds these Latin American estimates exaggerated, giving the ratio of unweighted average of Latin American countries to the income of the US as 66

¹²There is nothing special about using the same rate of growth as a yardstick. Indeed, in the light of convergence theories (see, for example, Lucas 2000), one would expect countries that lag behind the technological leader to grow faster. We use the same rate of growth merely as an accounting device.

¹³Remember that this is not quite accurate, since data for different countries are available at different dates.

¹⁴In 1980, this gap was \$528; by 2000, it was \$2858.

percent in 1800.¹⁵ If incomes were identical in 1700, this ratio would imply that the US grew at the rate of 0.4 of one percent, while Latin America stagnated throughout the century. In fact, standard estimates of the growth of per capita income in the US during the eighteenth century range from 0.3 to 0.6 of one percent. However, Mancall and Weiss (1999) estimate that between 1700 and 1800 the incomes of the colonists and their slaves grew only at the rate of 0.04 of one percent, so that the growth of the average income in the US was due to the fact that Native Americans, who had lower incomes, were becoming a smaller part of the total population. In turn, Bulmer-Thomas (2003: 27) claims that the Bourbon reforms generated growth in Latin America in the second half of the eighteenth century. Hence, it is not apparent why incomes would have diverged during the eighteenth century.

It is clear, however, that the wars of independence and their aftermath were costly to growth. Per capita income in the US fell by about 7 percent between 1775 and 1800, mainly because of the decline of agricultural exports (Mancall and Weiss 1999: Table 2). In turn, Bulmer-Thomas (2003: 27) concluded that "The economic difficulties encountered in the first two decades of the nineteenth century can safely be assumed to have reduced real income per head in Latin America considerably," again due to the disruption of trade but also to the decline of mining. Prados de la Escosura (2003: 4), in turn, observed that "independence was followed by a marked decline in economic activity: per capita income did not return to colonial levels until the mid-nineteenth century."

We can examine how the timing of independence and the duration of the subsequent turmoil affected the gap of incomes in 2000. As the date of independence, we take the year when the last metropolitan soldier left a territory. In turn, we measure the duration of the subsequent political turmoil as the length of the period between effective independence and the first completion of a constitutionally specified term by a chief executive. When the date of independence is combined with the duration of political turmoil, both reduce the 2000 incomes: each year of delay in independence costs \$165 ($t = -3.05; p = 0.007$) in 2000 and each year of turmoil an additional \$70 ($t = -1.89, p = 0.076$).¹⁶ Given these numbers, one can calculate that waiting for independence for one additional year had an opportunity cost of \$4.50 this year, while waiting for political conflicts to settle had a cost of \$6.61.¹⁷ As these costs became compounded,

¹⁵Coatsworth provides ratios of per capita incomes of some Latin American countries to that of the US. Assuming the income in the US to have been \$1,000 (extrapolation from 1820-1830 Maddison's numbers) and using these ratios, the income of Argentina in 1800 would have been \$1020, of Brazil \$360 (Maddison's figure for 1820 is \$646), of Chile \$460, of Cuba \$1120, of Mexico \$500 (Maddison's 1820 figure is \$759), and of Peru \$410.

¹⁶These results are based on regression that includes the nineteen Latin American countries and the United States. If we drop the United States, both numbers become smaller, but the estimates are still statistically significant. Hence, these relations held within Latin America.

¹⁷Here is how we reason. Regression shows that the 2000 cost of postponing independence one year is \$170. Hence, it must be true that $y_t(1+r)^{2000-t} - y_{t+1}(1+r)^{2000-(t+1)} = 170$. Solving yields $y_{t+1} - y_t = ry_t - 170(1+r)^{-(2000-(t+1))}$. Letting $t = 1820$, using the US growth rate for r , and assuming $y_{1820} = 700$ yields the numbers in the text. Analogously for turmoil.

Bolivia, independent in 1825 and waiting 59 years before the completion of the first term, suffered a loss of \$11,225 in relation to the United States, effectively independent in 1782 and with first term completed by 1793. The impact of these dates on the 2000 incomes is shown in Table 3.

*** Table 3 here ***

Given the available information, it is not possible to determine why postponing independence was costly. One possibility is that colonial control retarded growth, mainly by restrictions on trade. The alternative hypothesis entails the timing of independence. The United States reached independence exactly in time to reap the fruit of the technological revolution that shook England after 1750, while continental Latin American countries became independent some 35 to 50 years later.¹⁸ Hence, the gap that emerged by 1820 could be due to the fact that the US was quietly growing, at the rate of 0.3 of one percent between 1800 and 1820, while Latin Americans fought for independence. Perhaps if the wars of independence had occurred in Latin America forty years earlier, there would have been no gap by 1820. Note that according to Maddison (2003) Canada, which remained a British colony had an income of \$430 in 1700 and of \$904 in 1820, thus passing Mexico. In turn, according to Coatsworth (1998: 25), Cuba, which remained a Spanish colony had income higher than that of the US until 1830.

Unfortunately, this is as far as we can go in analyzing the impact of the early period. Moreover, the timing of independence may be endogenous with regard to the possibilities of development¹⁹ or it may have been related to some unobserved country characteristics that also influenced development. Hence, one should treat these findings with a grain of salt. Yet they are quite impressive. It is clear that the gap was present by the time wars of independence ended on the continent. Compounded over about 180 years, the differences at the time of independence explain a large part of the gap in 2000.

Why did the effects of independence differ so drastically between the United States and Latin America? One answer may be the effect of independence on intra-regional trade. Although there was little trade between the South and the North in the United States, independence removed all barriers to internal trade. In contrast, in Latin America independence destroyed what was de facto a customs union during the colonial period (Bulmer-Thomas 2003).

From the political point view, the startling difference is the length of time it took Latin American countries to settle their boundaries and to establish state institutions. The period after independence was not completely peaceful

¹⁸On the costs of waiting for independence, see Coatsworth (1993: 16), who estimates that had Mexico gained independent in 1800 instead of 1821, its GDP would have been 7.2 percent higher.

¹⁹Amaral (1993: 202-3), for example, argues that Argentine independence resulted from local pressure on institutions that could not satisfy the needs of trade and production.

in the United States and the election of 1800 brought the country to the edge of violence (Dunn 2005; Weisberger 2005). As we have seen, per capita income declined during this period. But the political unrest in the United States pales in comparisons to that in most Latin American countries, where the wars of independence were to large extent civil wars and where these wars continued well after independence had been achieved. Explanations abound (López-Alves 2000) but systematic tests are few.²⁰

One story is that conflicts were more acute in Latin America, either because inequality generated more pressure toward redistribution or because of the contest between *peninsulares* and *creoles* for the rents accruing to political power.²¹ Note, however, that the question whether and to what extent the wars of independence resulted in social transformations is also well familiar to students of the United States (Beard vs Jameson). But even if both economic and political conflicts were equally intense, there was a crucial institutional difference. The fact that the British North American colonies had self-governing institutions is crucial, since it permitted the US to gain independence without a break of institutional continuity. Colonies became states of the Union, with the same boundaries,²² and the newly founded federal institutions emanated from self-government institutions established under the British rule. In turn, the Spanish colonial administration was much more direct and much more centralized, leaving little space for self-government. No one born in the colonies, a *creole*, could hold higher posts in the Spanish colonial administration. The only institution that entailed some modicum of self-government in Spanish America – *the cabildo* – was an estate body, with offices that could be purchased and kept in perpetuity after 1556 and only few elective posts, subject to the confirmation by the Crown and elected under highly restricted suffrage. The fiscal powers of the *cabildo* were minimal. These institutions functioned so badly that in 1789 *intendentes* appointed by the Crown took over most of their functions. Summarizing its evolution, Haring (1947: 165) concluded that “the *cabildo* had virtually disappeared at the end of the colonial era.”

Hence, when the Spanish colonial administration disintegrated – and it collapsed not because of pressure for independence in the Americas but because of events in Europe – the ensuing conflicts, whether among territorial units or between landowners and peasants over land or between *creoles* and *peninsulares* over political power or just among different militias over nothing, could not be resolved within a pre-existing institutional framework. Until one of the forces established its military domination or the opposing forces agreed to process conflicts according to some rules, conflicts could only take violent forms. And it took time before any kind of stable institutions were established.

²⁰For an explanation of the difficulties to reach national unity in Argentina, in contrast to the US, see Saguir (1999).

²¹On the controversies whether and to what extent the Latin American wars of independence were social revolutions, see the essays in Hanke (1967: pages 1-59).

²²Territorial consolidation in Latin America entailed some failed projects (Cundinamarca, Gran Colombia, Central American Republic) as well as attempts of some provinces to become independent on their own. Inter-state wars, however, were rare in Latin America.

4 Post-consolidation Period

Once countries became independent, they could and eventually did develop political institutions. We examine first the arguments that unequal political institutions, those that restrict political rights and limit political participation, retard development and perpetuate economic inequality. We do not find support for either of these hypotheses in Latin America but observe that, through mechanisms that remain opaque to us, inequality was highly persistent. In turn, we find that political pluralism – situations in which those who enjoyed political rights processed their conflicts peacefully according to some, even highly biased, rules – was conducive to growth. Yet, we believe, persistent inequality generated recurrent political instability, which was economically costly.

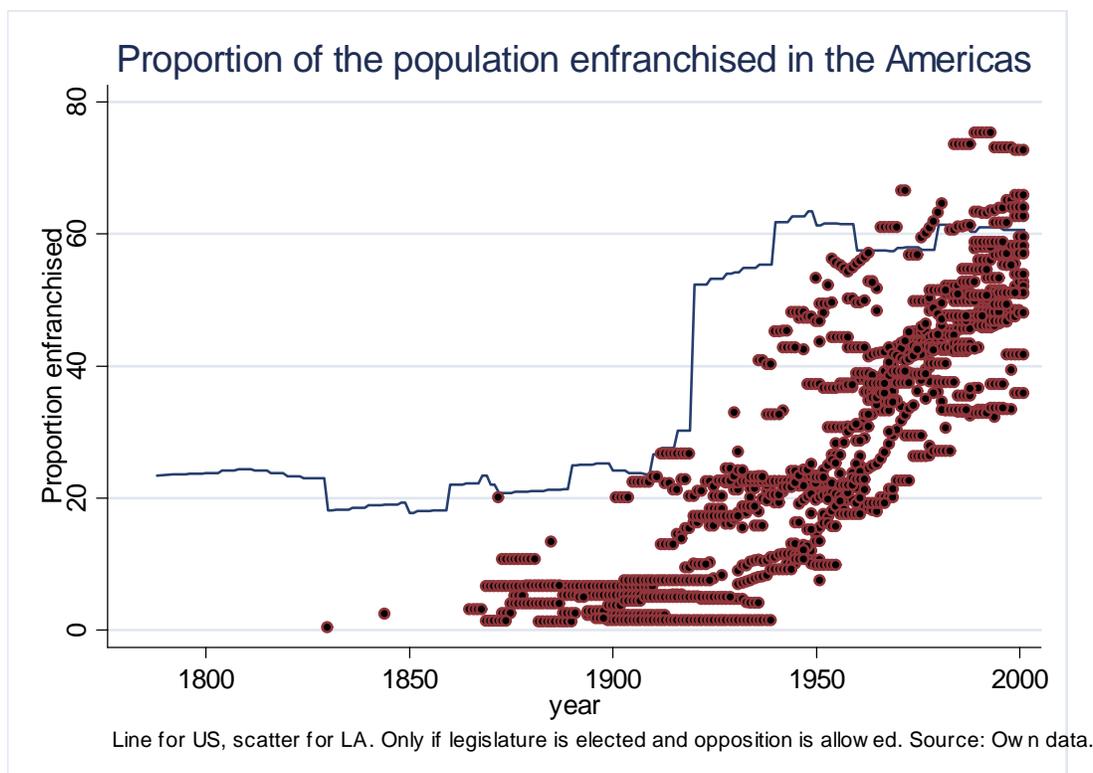
4.1 Political Rights, Development, and Inequality

Many argue that political rights in the form of suffrage promote development, either by protecting property rights and thus inducing investment (North and Weingast 1989, Acemoglu, Johnson, and Robinson 2001) or by stimulating the demand for public goods, including public productive goods (Lizzeri and Persico 2004). Yet the effect of political rights on economic development is subject to sharply divergent beliefs. In a view dominant during the first half of the nineteenth century and represented in contemporary economics by the median voter model (Meltzer and Richards 1971), extensions of suffrage, by lowering the relative income of the decisive voter, should lead to increased demand for redistribution, higher taxes, and lower growth. Sokoloff (2002: 76) entertains both possibilities:

Where an economic elite wields highly disproportionate political power ..., a broadening of political influence through an extension of the franchise might diminish the returns to members of the elite and dampen their rates of investment. On the other hand, there could well be advantages for growth to having a more equal distribution of political influence. Many would expect, for example, more substantial support of infrastructure and other public goods and services ..., a reduction in the levels of corruption, and perhaps more competition throughout the economy....

Since both views may be correct, we may be observing only net effects, and they can be positive or negative.

Suffrage restrictions were prevalent both in the US and Latin America. The formal restrictions for free males were gradually removed in the US around 1830 and former slaves were legally enfranchised as of 1869, but since the regulation of elections was the prerogative of state governments and since the US laws required voluntary registration, de facto restrictions were present throughout. Women, in turn, obtained the right to vote in 1919. In Latin America, male suffrage was typically restricted first by property or income requirements and

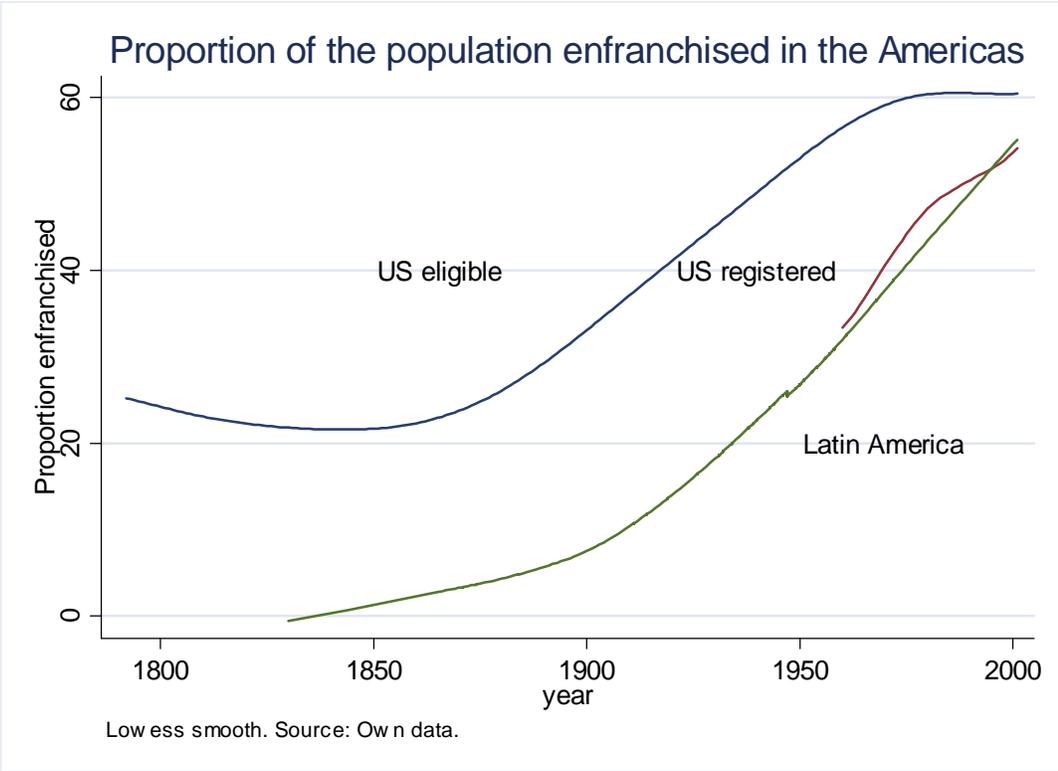


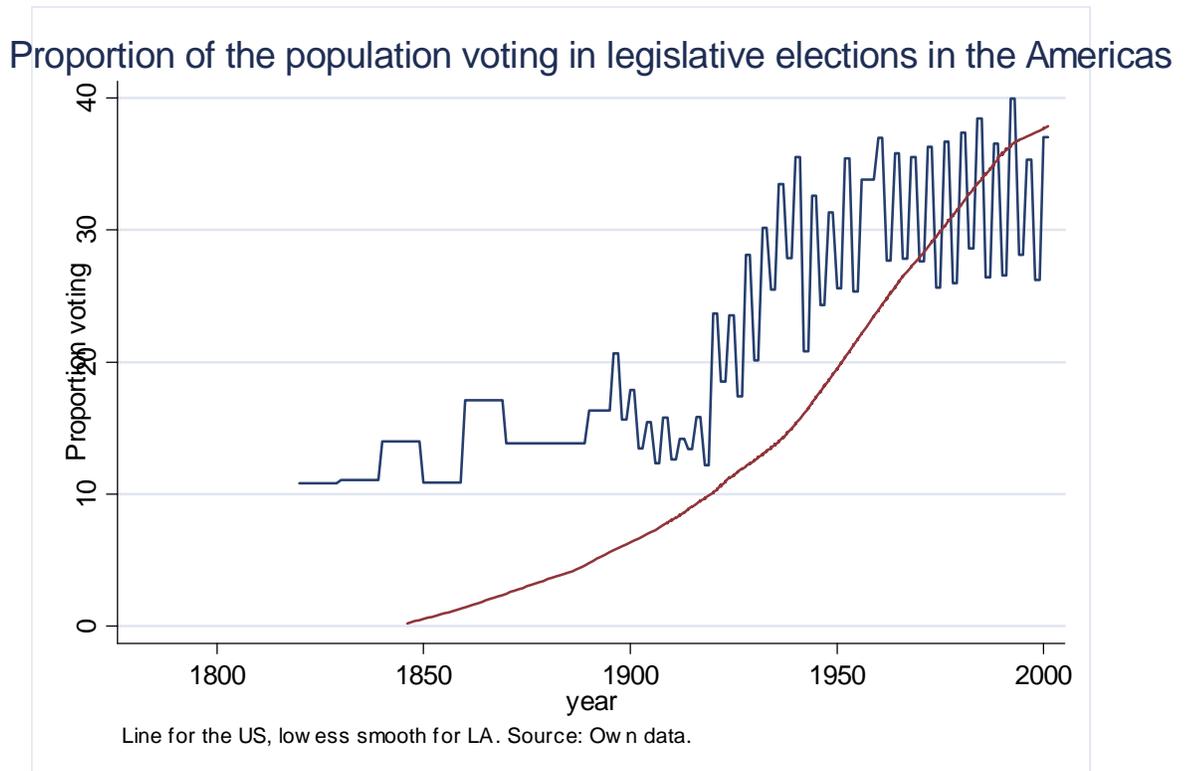
subsequently by literacy requirements, which were aimed specifically to exclude agricultural workers and tenant farmers. Female suffrage came late.

The proportion of the total population²³ that had the right to vote is shown in Figure 4.

The general trends can be seen more clearly in the next figure, in which the Latin American data are averaged and the series are smoothed. Note, however, that the US "eligible" series (from Rusk 2001) is for the proportion of the population qualified to vote given only requirements based on sex, age, and slavery, not the proportion that was registered to vote. The latter series is available only after 1960 and during this period it tracks closely the Latin American series that mixes eligibles and registered (it is not always possible to tell what the numbers refer to). Hence, the gap may have been much smaller than the US eligible series indicates.

²³Note that the ratio of eligibles to the total population is sensitive to the age composition. Some of the upward trend of the data is due to the ageing of the populations and the difference between the US and Latin America in the recent period is due only to the age structure.



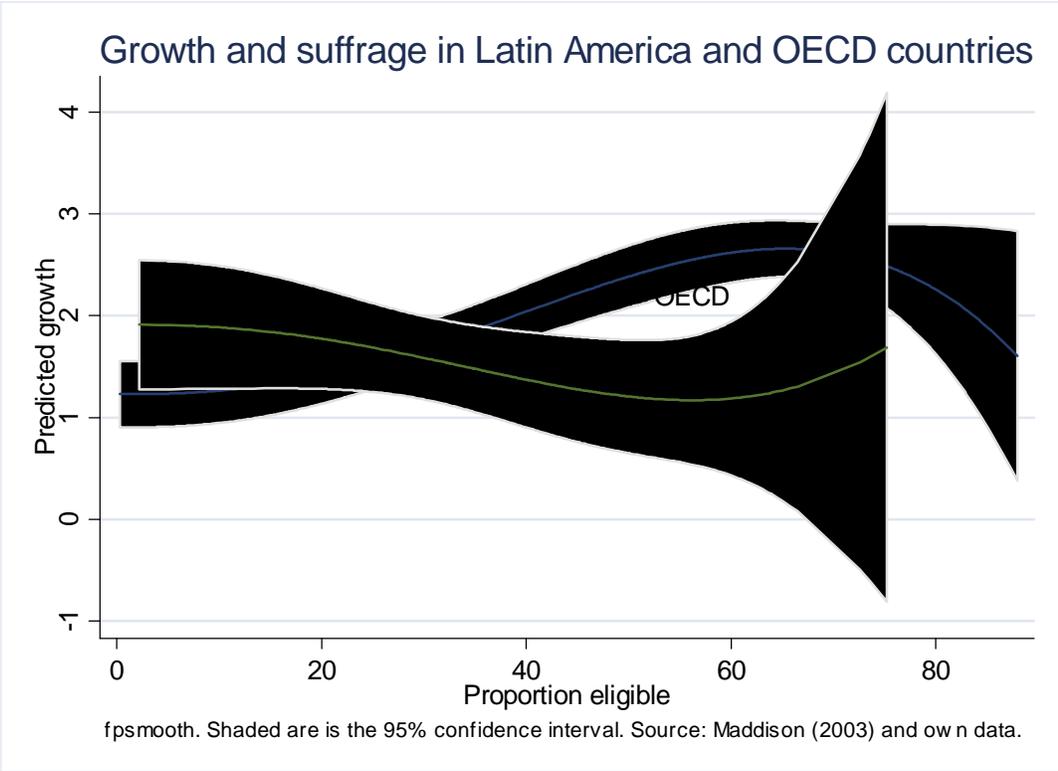


Having the right to vote, moreover, is not the same as actually voting. Since electoral turnout in the US tended to be low, particularly in the years without presidential election, the gap in electoral participation is smaller than in eligibility. But during most of the nineteenth century there was a gap.

With these descriptive preliminaries, we can approach the analytical question: Is the income gap explained by the gap in suffrage or in electoral participation? Here we face the methodological problem we announced earlier. In the OECD countries, more extensive suffrage and broader participation in legislative elections accelerated growth. Yet this was not true in Latin America, where broader suffrage and more extensive participation had almost no effect on growth.²⁴

Without delving further, one can only conclude that while in the currently developed countries the positive effects of suffrage dominated the negative ones,

²⁴The results about positive effect of suffrage on growth in the world and no effect in Latin America are robust to different estimators (2SLS with fixed effects, 3SLS, SURE) and different specifications of control variables. Results are almost identical for electoral participation.



in Latin America either they cancelled each other or the extent of suffrage was simply irrelevant. Halperin-Donghi (1973: 116), at least, argued that "The weakness of the vote made its nature irrelevant: since the voters were called upon above all to legitimize a preexisting situation and had already learned that it was expedient to do so, in the last resort it made no difference what part of the population held this dubious privilege"²⁵. Why would it be so, whether this is a matter of timing, the incomes at which suffrage was extended to particular groups, or something else, are fascinating questions that we must unfortunately leave aside. It is not obvious what is the appropriate counterfactual: should we be asking what would have happened had Latin American extended suffrage earlier in time, at higher income levels, at lower levels of inequality, or to different groups? All we know is that in Latin America the extent of suffrage and electoral participation did not affect growth.

Did restricted political rights perpetuate economic inequality? In a series of papers, Engerman and Sokoloff proposed the following explanation of Latin American underdevelopment: (1) The natural endowments found by European colonizers in Latin America could be operated only with unfree labor and, in turn, the legal inequality left a legacy of economic inequality even after it was abolished. According to Sokoloff (2000: 78-79), "Extreme inequality arose in the colonies of the Caribbean and in Brazil because their soils and climates gave them comparative advantage in growing sugar and other lucrative crops that were produced at lowest cost on large slave plantations.... Extreme inequality in wealth and human capital came to characterize much of Spanish America as well."²⁶ (2) Political institutions reproduced economic inequality: "Not only were certain fundamental characteristics of the New World economies and their factor endowments difficult to change, but government policies and other institutions tended to reproduce the conditions that gave rise to them" (Sokoloff 2000: 5). Among the instruments by which inequality was maintained was restricted suffrage. (3) Inequality was adverse to development, because the poor did not have the access to productive resources: "the greater inequality in wealth contributed to the evolution of institutions that commonly protected the privileges and restricted opportunities for the mass of the population to participate fully in the commercial economy even after the abolition of slavery" (Sokoloff 2000: 4). In turn, Engerman and Sokoloff (2001: 35), having in mind the US, maintain that "greater equality provides support, if not impetus, to self-sustaining processes whereby expanding markets induce, and in turn are induced by, more effective or intensified use of resources, the realization of scale economies, higher rates of inventive activity and other forms of human capital

²⁵ According to Halperin-Donghi (1973: 116), indirect elections favored the appointment of local dignitaries, so even when suffrage was extensive, the result was the same as if only the very rich could vote.

²⁶ Karl (2002: 7-8) echoes the prevailing view: "In Latin America from the very beginning, mineral and agricultural riches were a mixed blessing; in the context of a specific form of colonial rule they produced concentrated rents that centralized economic and political power and established the region's patterns of inequality."

accumulation, as well as increased specialization by factors of production.” In sum, political inequality led to the establishment of institutions that retarded development by perpetuating economic inequality and restricting productive opportunities for the large mass of the population.

Coatsworth (2005: 139-140) finds this story ”plausible [but] almost certainly wrong.” He maintains that ”landownership (and wealth more generally) was *not* more concentrated in Latin America than in the thirteen British colonies (or the industrializing Britain itself),” pointing out that (1) most of the Spanish colonies were not slave economies, (2) throughout Mesoamerica and the Andes, the indigenous population occupied most of the arable land, (3) even where large estates existed, land was abundant and its value contributed little to concentrating wealth. Both Coatsworth (1998: 39, 2005: 30) and Prados de la Escosura (2003) maintain that inequality increased in Latin America only during the second part of the nineteenth century, when improved transport and expansion of trade made land more valuable. Williamson (2004: Table 7) shows that, with 1913 as 1.0, the ratio of real wages to land value declined from 6.9 in 1880-1884 to 0.7 in 1930 in Argentina and from 11.1 in 1870-1874 to 1.1 in 1930 in Uruguay.

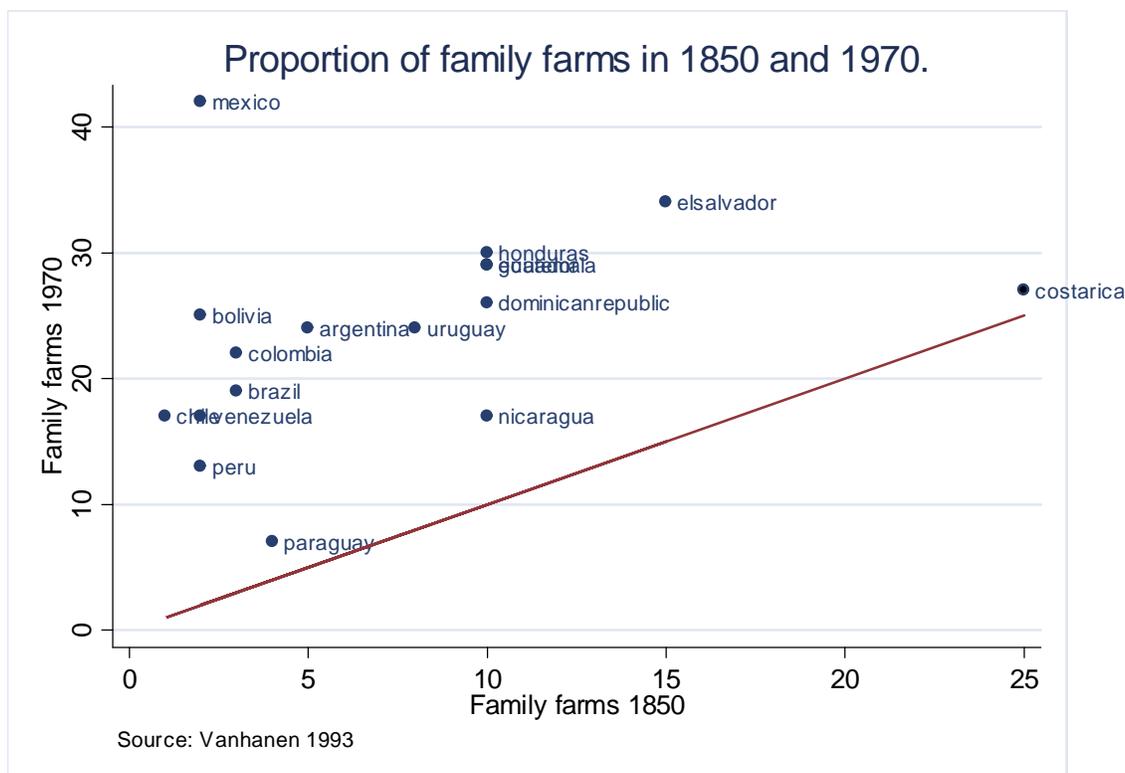
Hence, in the end it is not clear whether inequality was an original sin of Latin America or it was generated only when the continent embraced export-oriented development strategy during the second half of the nineteenth century. Here is what we can learn about inequality from the available data, which include the proportion of family farms between 1850 and 1970²⁷ and scattered information about household income distribution for the post-World War II period:

(1) In the light of Vanhanen’s (1997) numbers, as of 1850 the difference in land ownership between North and Latin America was startling. The average of family farms in Latin America was 7.2 percent, with a minimum of 1 and a maximum of 25. At the same time, in the United States 60 percent of farms were in family hands and in Canada seventeen years later 63 percent. It is not clear, however, whether land distribution was an important ingredient of total wealth distribution as of 1850.

(2) The proportion of family farms in 1970 does reflect the conditions as of 1850, but land distribution became more equal in all Latin America countries. Between 1850 and 1970, the proportion of family farms increased by 16.5 percent in an average Latin American country, with the range of 2 to 40 percent.

(3) Household income distribution during the 1960s and 1970s bear the traces of land distribution going back as far as 1850. Since the share of agriculture in national income was already low by the 1960s, what we see is the reproduction of inequality after 1850, rather than a contribution of land ownership to the current inequality of household incomes. Hence, it appears that inequality persisted even when the assets that give rise to it changed. Since the post-1930 Latin

²⁷Note that this variable is a highly imperfect indicator of income inequality since it does not take into account the changing relative value of land. In addition, we are not clear how Vanhanen treated communal lands.

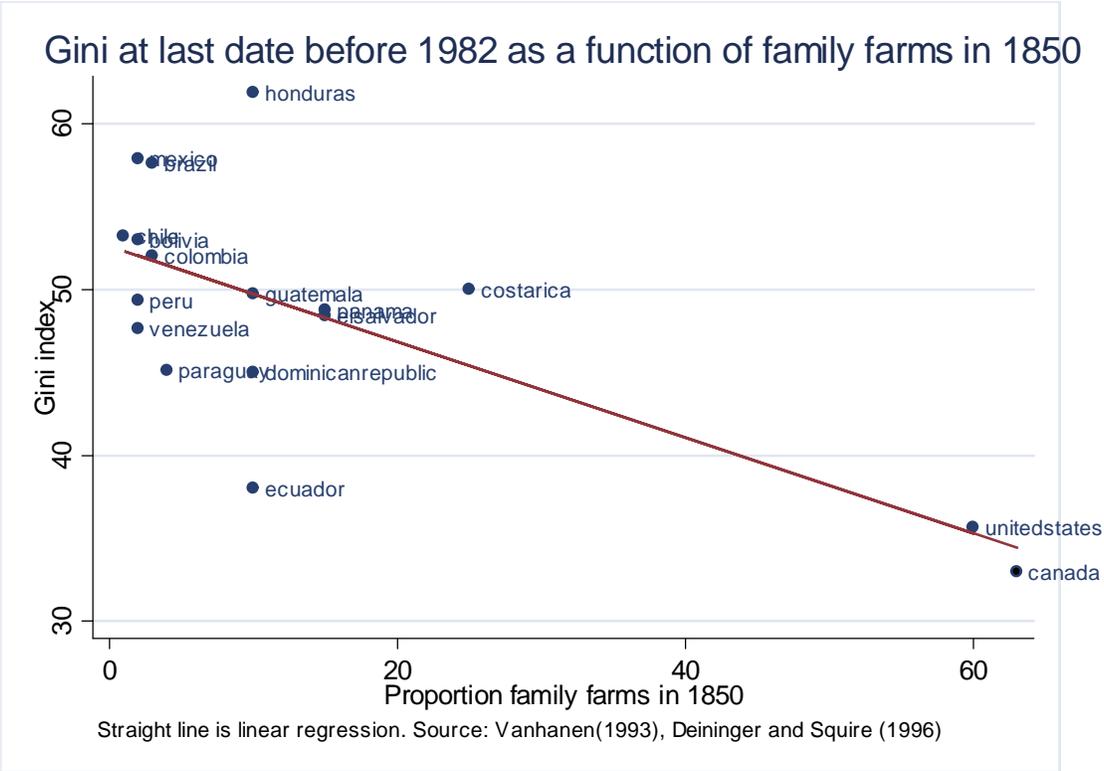


American growth was labor intensive and it entailed little improvement in labor productivity, this may be the reason inequality persisted.

Most importantly, to the extent that land redistribution did occur in Latin America, it was not because the poor acquired political rights and used them by voting: we find no relation between suffrage or participation and land redistribution. In turn, those Latin American countries which had more family farms in 1850 tended to redistribute more land.²⁸ Hence, the mechanisms by which the inequality was perpetuated remain obscure to us.

In conclusion, the inequality of political rights – the extent of suffrage and of voting participation – did not directly affect growth in Latin America. Moreover, there are grounds to doubt that restricted suffrage was the mechanism that perpetuated inequality, at least land inequality.

²⁸ Fixed effects regression with first-order autocorrelation and with the current proportion of family farms as control shows a negative effect of eligibility both in Latin America and the rest of the world. The persistence coefficient (on the current proportion) is, in turn, positive and high. Note, however, that these results are very sensitive to the choice of estimator.



4.2 Political Pluralism, Political Instability, and Development

Is inequality the culprit for the slow development of Latin America? The relation between inequality and growth is notoriously difficult to disentangle. Having asked the question "Inequality and Growth: What Can the Data Say?," Banerjee and Dufflo (2003) could only say "Not much." The crux of the question concerns the mechanisms through which inequality affects development. Engerman and Sokoloff repeatedly argued that these mechanisms were institutional. Others emphasized the role of conflicts induced by inequality. To put the contrast sharply, we have two rival political hypotheses.²⁹ The neo-institutionalist story says that Latin America had "bad" institutions, that is, institutions that protected the power of the already powerful, by not educating the masses and by limiting political rights, preventing the masses from availing themselves of economic opportunities, keeping internal markets small, and as a consequence retarding growth as well as perpetuating inequality. The conflict story maintains that inequality intensifies conflicts over distribution, which divert resources from production to fighting (Banerjee and Iyer 2002) and impede collective actions oriented toward providing public goods (Bardhan 2005: Chapter 10). Moreover, prospects of future redistribution dampen current investment.

We have seen above that unequal political institutions did not prevent development. What mattered, we show below, is whether conflicts were processed according to rules, without violence, even if the institutions that processed them were inegalitarian and the rules were highly biased. The intra-elite conflicts in the nineteenth century Latin America concerned the territorial organization of the state, the role of religion or more broadly conservatism vs. liberalism, tariffs, and the location of state-financed infrastructure. As long as political institutions could absorb these conflicts and process them in relative peace, economies developed. Yet inequality persisted, and so did political instability. Instability, in turn, was costly in terms of development.

Regular elections, every four years for president and every two for the lower house of the legislature began in the US in 1788 and took place regularly ever since. In Latin America, the occurrence of elections was frequent³⁰ but much less regular and for varying periods after independence countries were ruled without elected chief executives or legislatures. Unfortunately, systematic data

²⁹There is also a theory that relies on market imperfections and credit constraints. See Banerjee and Newman (1994).

³⁰As Hartlyn and Valenzuela (1994: 108) remarked, "Liberal principles found a tenuous hold in Latin America before they took root in much of Europe." Annino (1995: 10) noted that local elections took place in many Latin American countries well before they occurred in Europe. A period of intense electioneering erupted between 1809 and 1814. According to Posada-Corbó (2000: 621), "most provinces lived through cycles of political agitation motivated by successive elections, including those for the juntas, the Spanish Cortes, for municipal offices and bodies, and provincial *diputaciones*." Note, however, that most of these elections were local, granting local governments legitimacy not enjoyed by national ones, and thus strengthening centrifugal tendencies (Annino 1995).

about the occurrence of elections is not yet available and difficult to compile.³¹ We can, however, judge whether politics were pluralistic once we observe the first completed constitutional term in a country.

By pluralistic politics, we mean something very weak: only that a legislature is elected and that there is some electoral opposition.³² Many elections that we consider pluralistic were manipulated, vote buying (*cohecho*) was widespread, and the results were frequently fraudulent.³³ Indeed, to our best knowledge, in the entire history of Latin America only one incumbent president who presented himself for reelection, Daniel Ortega in Nicaragua in 1990, ever lost.³⁴ As Halperin-Donghi (1973: 116) observed, "Among the many ways of overthrowing the government practiced in postrevolutionary Spanish America, defeat at the polls was conspicuously absent." Yet we do not exclude manipulation or fraud, thinking that they are *prima facie* evidence of political competition. Even when harassed, opposition was legally tolerated, allowed to win some seats in the legislature, and sometimes even a share of power. And these incentives were sufficient for the opposition to participate. Hence, intra-elite conflicts were processed according to rules and, even if not without sporadic rebellions, were peacefully resolved. Following Chile after 1831 (about which see Valenzuela 1995), several Latin American countries established stable systems of political competition in which the incumbent president, faithfully obeying term limits, chose his successor and through various devices assured his victory at the polls.³⁵ The stability of such systems of oligarchical competition – Chile between 1831 and 1925, Brazil between 1894 and 1930, Argentina between 1864 and 1916, or Mexico between 1934 and 2000 – was remarkable. Indeed, the last of such systems died in Mexico only in 2000.

As Figure 10 shows, when elections were instituted during the nineteenth century, they tended to be pluralistic. Yet in the twentieth century rulers learned that one can hold rituals called "elections" without allowing any opposition. Later on, when the military stepped into politics as an institution, most decided they do not need legislatures and elections at all. Only the post 1980 wave of democratization restored competitive elections in Latin America.

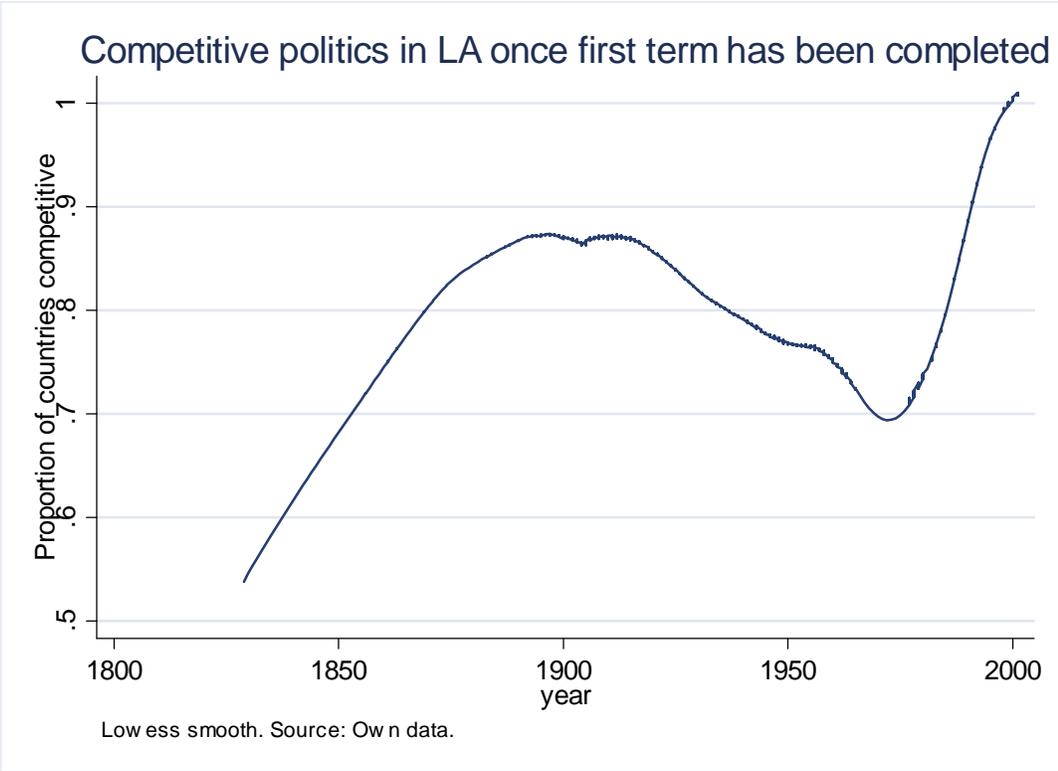
³¹We do know when some elections took place but cannot be certain that there were no elections during periods about which we have no information.

³²Specifically, politics is considered pluralistic if there exists an elected legislature and some, even minimal, legal opposition. Non-pluralistic years, therefore, are those without an elected legislature or those with only one party or those in which a party (or presidential candidate) run unopposed.

³³Electoral fraud is notoriously difficult to define. On the ambiguity of this concept in nineteenth century Latin America, see Annino (1995: 15-18).

³⁴There is also the case of the Costa Rican Braulio Carrillo, first elected in 1835 to complete the term of an incumbent who was forced to resign. Braulio Carrillo lost reelection in 1837 but one year later he overthrew the electoral winner and enacted a constitution that declared him president for life. He was deposed in turn in 1843.

³⁵For a summary of devices by which governments controlled results of elections, see Posada-Carbó (2000).



Thus defined pluralism of the political process had a positive effect on growth. Within Latin America, the average growth rate during 1219 years when politics were pluralistic was 1.67 percent, while during the 267 years when there were no legislatures or no opposition this rate was 0.52 per cent. Regression analyses lead us to believe that political pluralism had a positive effect on growth.³⁶

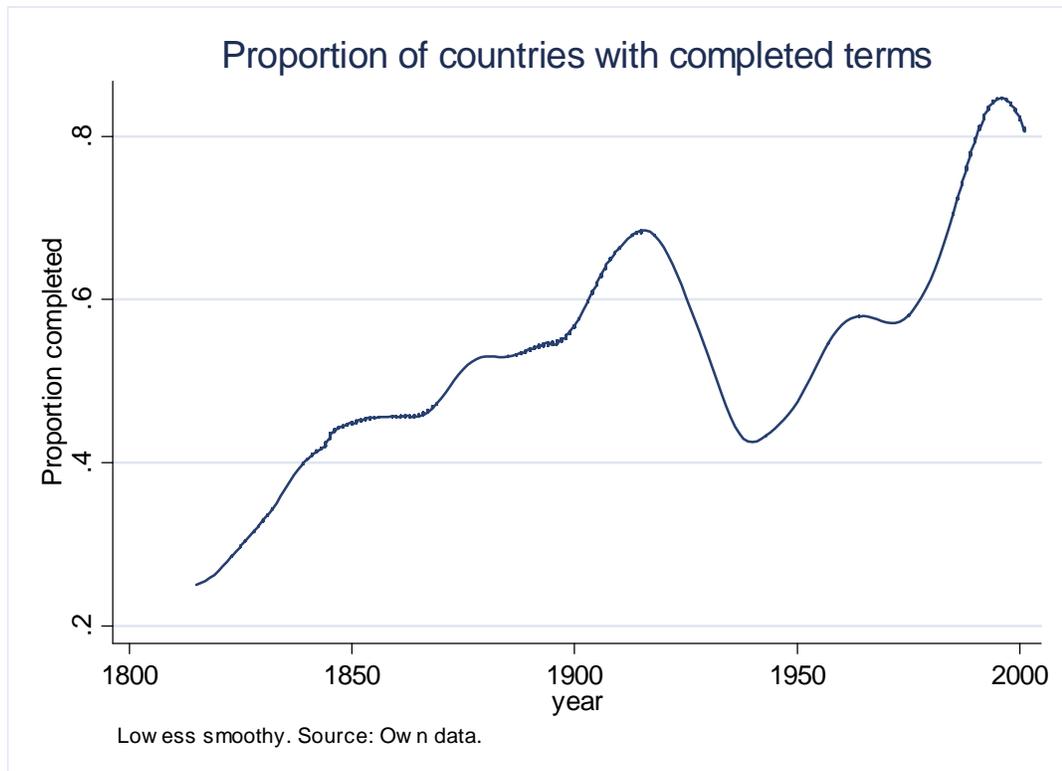
Peaceful processing of conflicts according to some rules, however, is possible only if the resulting distribution of incomes (or assets that generate them) is acceptable to all the political forces that have the military prowess to engage in conflicts aimed at establishing their political monopoly (Benhabib and Przeworski 2005, Przeworski 2005).³⁷ Whenever the degree of redistribution that results from processing conflicts according to rules is excessive for some or insufficient to others, they may attempt to establish their monopoly of power. The result is "political instability."

There are many ways to think about political instability, and we will try several. One is whether the chief executive completed a previously specified constitutional term, as distinct from periods when there was no effective constitution or the chief executive was deposed unconstitutionally or he made an *autogolpe* by extending his term. Another way to think about instability is to count the number of chief executives during a particular year or a moving average of this number over some number of years (we take five).³⁸ Yet another way to think of instability is to focus on the frequency of coups, irregular transfers of power. Perhaps the best way to summarize these measures is to count the number of consecutive years during which chief executives completed their constitutional terms. Given that there were 157 instances in which the chief executive changed when the term of his predecessor expired, for the total of 708 years (out of 1527 for which we have the requisite data) during which alternation in office continued according to constitutional rules, this measure indicates constitutional stability independent of the particular incumbent. To

³⁶We explain competitiveness by lagged per capita income, lagged military expenditures, proportion of family farms, and lagged unrest. The growth equation has only competitiveness, rate of growth of population, and the average rate of growth of GDPcap in the world in a particular year. The estimators we used include different forms of matching, Heckit, 2SLS with fixed effects, and fixed effects with AR1. Whenever the coefficient on competitiveness is significant, it hovers slightly above 1. The results do not depend on including the US.

³⁷Note that we are not saying that conflicts were processed peacefully when institutions succeeded in *imposing* order but when the politically relevant groups had incentives to accept outcomes that resulted from the institutional process. To put it differently, we view institutions as endogenous.

³⁸Note that if the constitutional term of the chief executive is for non-renewable four years and if this norm is always observed, then we would expect the five year moving average to be 1.25 heads per year, while with a six year term the five year moving average would be 1.1666. Protracted dictatorships or repeated reelections would generate lower numbers, while coups and other contests for power would be seen as more frequent turnovers. During the post-WWII period, the terms in Latin America ranged from four to six years, with an average of 4.64. We do not have systematic data for the earlier period, but there were some two-year terms. Term limits were ubiquitous and, surprisingly, whenever in place were almost always observed.



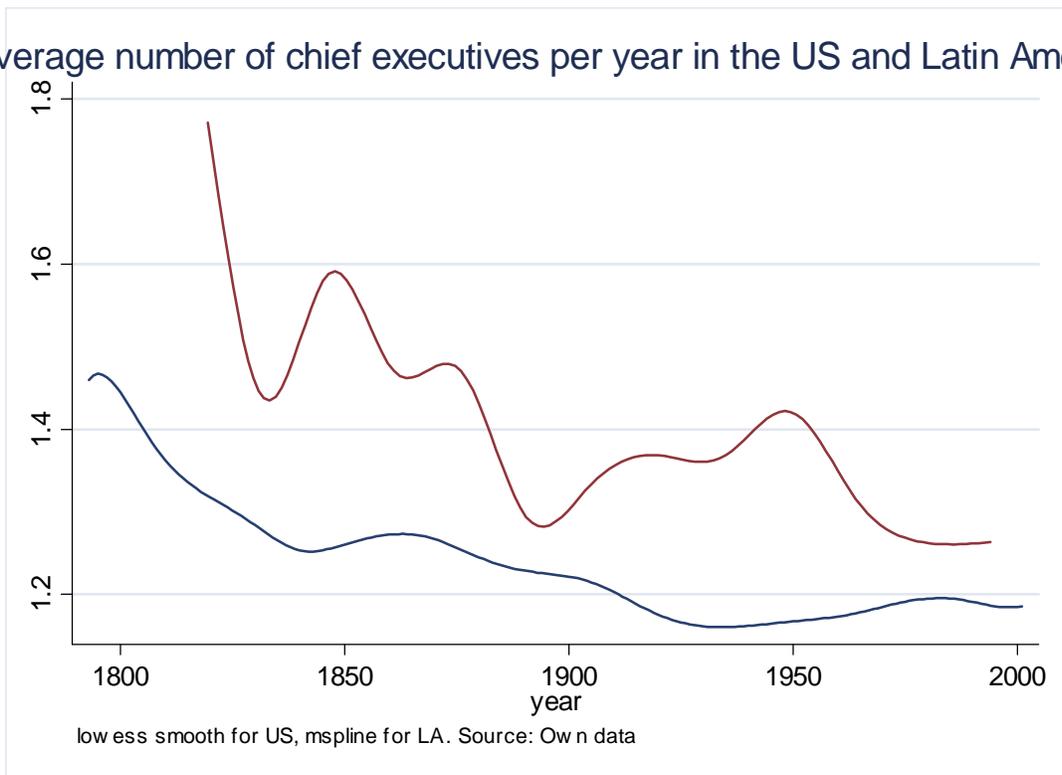
this extent, therefore, it indicates "the rule of law," even if the law was often manipulated in favor of the ruling oligarchy.

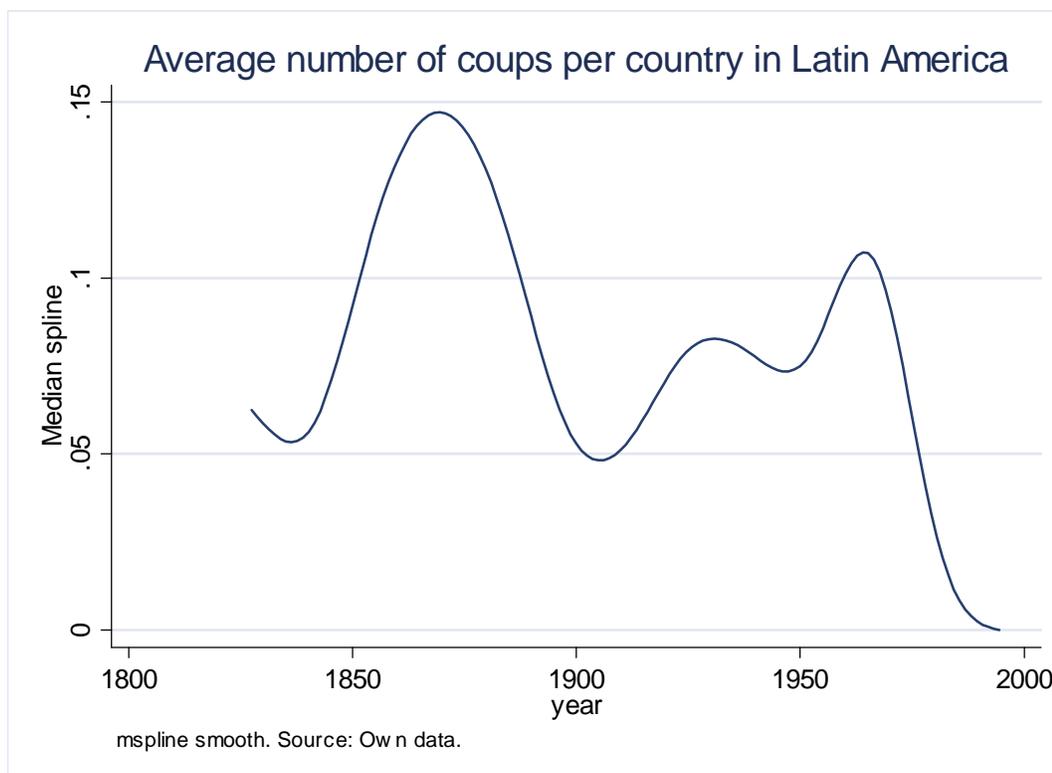
As the following figures show, the political dust of independence settled around 1870, and by the eve of World War I stability reigned. A new wave of destabilization, however, occurred after 1924, when several countries experienced the first military coups in their history.³⁹ Only after 1980 was political stability restored again, even if turnover of the chief executives accelerated again in the most recent years.⁴⁰

³⁹The first in a series of coups occurred in Chile in 1924. According to Rouquie (1994: 223), "Between February and December of 1930, the military were involved in the overthrow of governments in no fewer than six, widely differing Latin American nations - Argentina, Brazil, the Dominican Republic, Bolivia, Peru, and Guatemala. The same year also saw four unsuccessful attempts to seize power by force in other Latin American countries. Over the following years, Ecuador and El Salvador in 1931, and Chile in 1932, joined the list of countries in which military-provoked political shifts and unscheduled changes of the executive had taken place."

⁴⁰Eleven Latin American presidents left office precipitously in the last ten years. It is notable, however, that contrary to the past, in all cases succession occurred according to strict observance of constitutional rules.

Average number of chief executives per year in the US and Latin America





Note that while the above characterizes the general patterns for all of Latin America, particular countries experienced highly divergent trajectories. For example, executive turnover peaked during different periods and at different levels in Brazil, Chile, and Mexico.⁴¹ And again, the frequency of coups differed importantly among countries: by 2000, Venezuela had experienced three, while Bolivia twenty-nine.

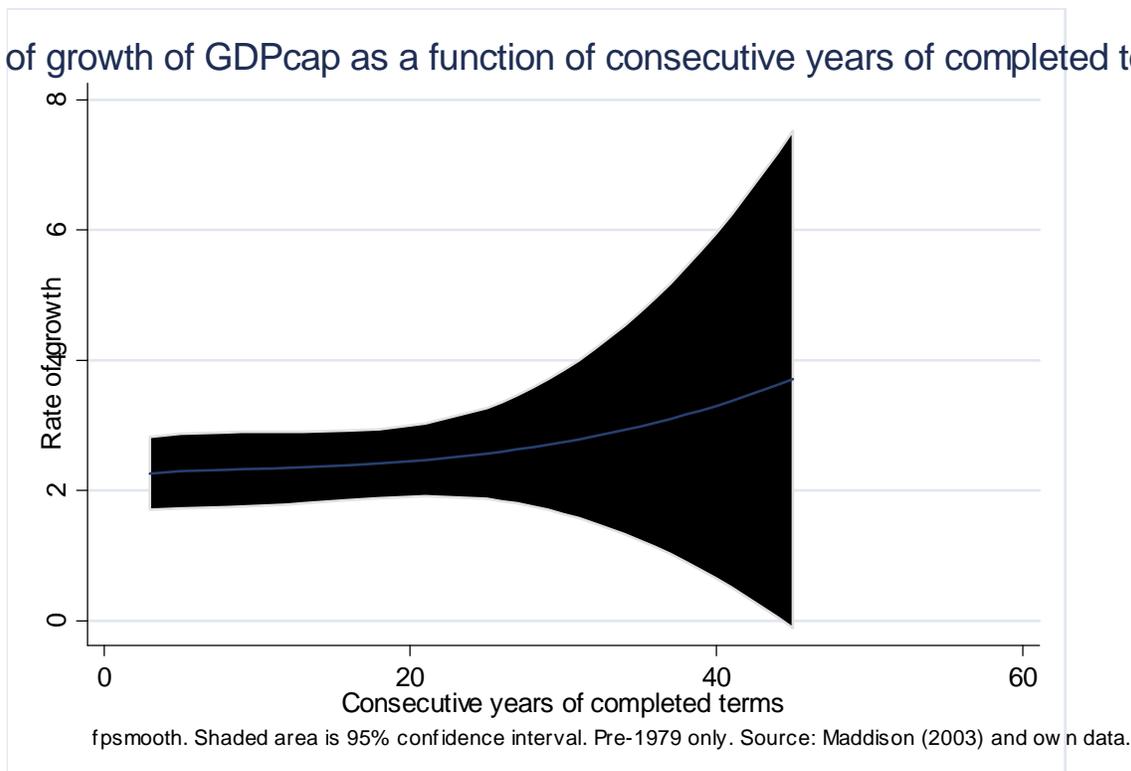
None of these ways captures fully the importance of instability, since what probably matters more for development are expectations of future conflicts, rather than the current disorders (Przeworski et al. 2003, Chapter 4). Yet current disorders divert resources from producing to fighting and impede collective actions designed to produce productive public goods. Hence, one should expect that even current political instability retards growth.

Does it? Prima facie numbers yield a positive answer. During the 997 years of completed terms, incomes grew at the average rate of 1.93, while during 631 years of interrupted terms they grew at the rate of 0.94.⁴² The average rate

⁴¹Coatsworth and Tortella (2003: 18) report, for example, that Mexico changed presidents 48 times between 1825 and 1855.

⁴²The positive effect of completed terms on growth defends itself in a fixed effects regression

Rate of growth of GDPcap as a function of consecutive years of completed terms



of growth during 1412 years when there was just one chief executive was 1.88; during 366 years when there were two it was 1.01; and during 96 years with more than two chief executives it was -0.55 . The average rate of growth during 1468 years without coups was 1.59, while during 95 years when at least one coup occurred it was 0.78. Our summary measure, the consecutive years of completed terms, shows again that thus defined political stability had a positive effect on the rates of growth.⁴³

Completed terms were more frequent at higher levels of suffrage, while executive turnover and coups were more frequent at lower levels: political inequality thus seems to have a direct impact on political instability. In turn, we cannot show statistically that political instability was caused by economic inequality.⁴⁴

with controls for growth rates as well as instrumental variables fixed effects estimation with the history of past coups and a moving average of past executive turnover as instruments.

⁴³Regression analyses (with country fixed effects), with several controls and a dummy variable for the post-1978 period, shows this effect to be sizeable and statistically significant. The same is true when we instrument years of completed terms.

⁴⁴While signs of family farms in regressions that take as the dependent variable the three indicators of instability as always correct, the coefficients are rarely significant.

The reason is perhaps that the only measure of inequality we have is the proportion of family farms, and this measure changes significance as assets other than land become important for income distribution. But there is ample historical evidence that destabilizing conflicts were distributional. The development of Latin America during the second half of the nineteenth century led to the emergence of two major distributional conflicts: over land (or wages in agriculture) and over wages and working conditions in industry.⁴⁵ Land distribution was a perennial issue in Latin America and continued to be so still in the second half of the twentieth century, when twelve Latin American countries instituted twenty-seven reforms that entailed some land redistribution.⁴⁶ In several countries, military regimes followed a breakdown of what used to be called "*pacto urbano*": a tacit consent to the urban bourgeoisie and industrial unions to exploitation of tenant farmers and agricultural workers by landowners. In turn, the rise of working class movements – union industrial militancy and the accompanying specter of communism – was a major factor in destabilizing political regimes. As Collier and Collier (1995: 8) report, "the incorporation [of the working class] experience produced a strong political reaction and in most countries this reaction culminated in the breakdown of the national political regime under which the incorporation policies had been implemented." Indeed, we believe that extensions of political rights were threatening not because they could or have generated redistribution via the fisc (taxes and transfers) but through the rights to organize and strike.

In sum, whenever political institutions could absorb conflicts and process them according to rules, economies developed. Yet unequal political institutions promoted political instability. Moreover, since income inequality persisted, distributional conflicts were destabilizing. And political instability recurrently interrupted development.

5 Conclusions

Here is then how we see the institutional dynamic in Latin America and its consequences for development. Latin American economies developed whenever conflicts were processed according to some rules that allowed political pluralism, even when suffrage was extremely narrow. What mattered was not whether institutions were broad or narrow, egalitarian or not, but whether they could structure and absorb conflicts as conflicts arose. The well entrenched "oligarchical republics," in which the masses were barred from participating in politics but the elites found some *modus vivendi*, were not inimical to development. Economies grew when political power protected economic power (For a formal argument to that effect, see Benabou 1996). Hence, we agree with Coatsworth (2005: 140) that "What Engerman and Sokoloff saw as obstacles to economic growth – elite power and economic inequality – actually facilitated the region's

⁴⁵According to the data collected by Godio (1972), the reason for strikes in Argentina became increasingly heterogeneous with time.

⁴⁶Based on data kindly provided by Anjali Thomas.

transition to sustained, if unstable, economic growth” Yet since development reproduced or perhaps even increased economic inequality, the prospects of political incorporation, particularly the right of workers and peasants to organize, threatened property. This threat was not that the newly enfranchised voters would demand redistribution through the fiscal system (as in Acemoglu and Robinson 2000, 2001), but that they would use their political rights to organize, strike, and thus redistribute private incomes or even productive assets. As a result, a new wave of violent conflicts ensued.

Political inequality, therefore, appears to be statically efficient. But since it perpetuates economic inequality, it renders foreboding the prospect of redistribution that may result from political incorporation of the masses. And since the prospects of political instability are economically costly – probably more costly than the occurrence of instability itself – political inequality is dynamically inefficient.

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