Breacher of the Peace

Simon Willson profiles

Daron Acemoglu

A NIGHT in jail first underscored to Daron Acemoglu the importance of regulation in the market system. The teenaged Acemoglu had been one of several unlicensed learner drivers careening around a deserted highway in Istanbul, Turkey, typically used for practice by such drivers. That day the city police decided to intervene. A swift and unpredictable roundup saw Acemoglu and several other drivers bundled into cells downtown pending a stern dressing down the next morning.

"Without regulations and predictable laws, markets won't work," Acemoglu, now older and wiser as Charles P. Kindleberger Professor of Applied Economics at the Massachusetts Institute of Technology (MIT), ruefully admits. A few hours' perusal of his cell's cement decor, and the administrative chastisement that followed, left a lasting recognition of the importance of impartially adjudicated rules, even in overtly free markets.

"Every single market we have in the world is regulated, it's just a question of degree," Acemoglu reflects while surveying through his office window the bleak and bleached vista of the frozen-over Charles River, which runs through Cambridge, Massachusetts. "When you have some judge who will enforce laws, that's regulation. This is much more palpable in developing economies, where markets don't work precisely because the necessary regulations and institutions are missing. Governments are often barriers to the functioning of markets, but if you really want markets to function you need governments to support them—with law and order, regulation, and public services."

Early exposure

Acemoglu's early personal exposure to the processes of law enforcement helped set him on course for a career that has latterly focused on why some states succeed as viable generators of wealth and fulfillment, and why others fail and stay failed. The circuitous route leading to this field of investigation took the Istanbul-born economist from starting out as a student of political science, to broadening his studies to include economics, and then to dropping politics altogether.

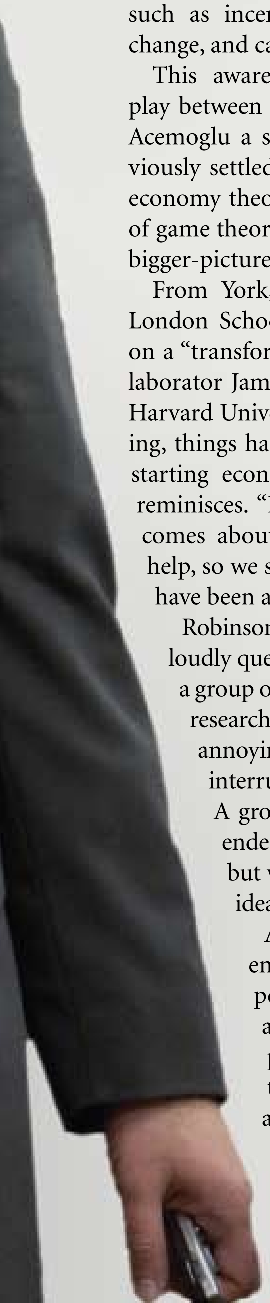
At the University of York in northern England in the mid-1980s, Acemoglu concentrated on macroeconomics, but increasingly found that macroeconomic trends were sourced in microeconomics. "If you want to fully understand the wider macro picture—growth, political economy, long-run issues—you have to understand underlying micro principles such as incentives, allocation of resources, technological change, and capital accumulation."

This awareness and exposition of overlap and interplay between the two major disciplines of economics made Acemoglu a singular hybrid who untidily disturbed a previously settled demarcation. "A lot of what I do is political economy theory, and much of that is essentially application of game theory, so you could say it's micro, but motivated by bigger-picture questions that macro also prides itself on."

From York, Acemoglu completed his doctorate at the London School of Economics (LSE), where he occasioned on a "transformative moment" in meeting his longtime collaborator James Robinson, now professor of government at Harvard University. When Acemoglu and Robinson got talking, things happened fast. "We agreed that the key factor in starting economic development is democracy," Acemoglu reminisces. "But there were no models of how democracy comes about, and the political science literature was no help, so we started working on it as a topic in 1995, and we have been at it ever since."

Robinson remembers a rumpled, gesticulating figure loudly questioning his methodology from the front row of a group of LSE seminar participants. "I was presenting my research at a seminar in early 1992 and there was a really annoying Ph.D. student right in front of me, continually interrupting and finding fault with my presentation. A group of us went out for dinner afterwards and I ended up seated next to the same irritating character, but we got talking and I found he had some original ideas that he put across very well. That was Daron."

Acemoglu seems to have systematically embarked on an argumentative auditioning of potential research partners at this time, because another future collaborator, LSE economics professor Steve Pischke, remembers receiving the same treatment. "I was giving a seminar talk at the LSE in 1991, and there was this obnoxious grad student in the front row querying my methods and demanding additional information," Pischke recollects. "And Daron had even more to say when we went out for a meal later."



Pooled research

By early 1993 Acemoglu and Robinson—who was then teaching in Australia—were exchanging ideas on research topics by a newfangled communications medium. "It was the first time I had ever used e-mail," Robinson recalls. "We started e-mailing our papers to each other, and we suddenly found that we had independently and separately written two almost identical papers on the same subject." Displaying the true economist's deep abhorrence of duplication and inefficiency, the two academics started pooling their research.

By the time his work with Robinson had shifted into high gear, Acemoglu had moved to "my first real job," starting as an assistant professor of economics at MIT in 1993. It did not take long for his characteristically untidy disregard for the established boundaries of his profession to cause a stir in the corridors alongside the Charles River. Fueled by the originality of Robinson's input, Acemoglu had continued to develop in Cambridge, Massachusetts, the hybrid macro-micro line of research on political economy theory he had first staked out in London.

"When I was up for promotion at MIT my faculty superiors said most of my work was good and interesting and had gotten good feedback. But they also said, 'You really should stop this work you're doing on political economy.' So I hid that part of my work for the next two years, until I got my tenure." By the time Acemoglu secured a tenured position at MIT in 1998, his political economy approach had become almost mainstream.

Notions of a complacent culture

Acemoglu joined other academic economists in looking inward at the profession (Acemoglu, 2009) for intellectual errors made in its heralding and handling of the global economic and financial crisis that hit in earnest in 2008. He believes three notions, in particular, stifled any sense of alarm.

First was a belief that business cycles had been conquered by a combination of astute policymaking and game-changing technological innovation. In fact, these two forces of evolution had increased economic interconnections to the point of creating potential domino effects among financial institutions, companies, and households.

Second, the institutional foundations of markets had been forgotten, and free markets had been equated with unregulated markets. Few would now argue that market monitoring is sufficient to guard against opportunistic behavior by unregulated, profit-seeking individuals taking risks from which they stand to benefit and others lose.

And third, the reputational capital of long-lived, large organizations was overestimated despite early warnings from the accounting scandals at Enron and WorldCom in the early 2000s. Trust in the self-monitoring capabilities of such organizations has now suffered a death blow, and future punishments for infractions will need to be punished severely and credibly.

Safely ensconced at MIT, Acemoglu in 2005 won the American Economic Association's John Bates Clark Medal, then awarded biennially to the most influential U.S. economist under the age of 40. He worked with Robinson—by then teaching at Berkeley and now at Harvard—on a book, *Economic Origins of Dictatorship and Democracy*, published in 2006. "I was really interested in issues of underdevelopment, so I started reading authors who had all worked on dependency theory about how the world was divided into poor and rich because the poor had been exploited by the rich. And I was fascinated by why Turkey had been poor and undemocratic."

In *Dictatorship and Democracy*, Acemoglu and Robinson started down a route they are still traveling. They ask why some countries are democracies—where there are regular and free elections and politicians are accountable to citizens—and why other countries are not. They investigate which factors determine whether a country becomes a democracy, and why democracy persists and consolidates in some countries but collapses in others. But, tracing Acemoglu's own career path, the book explains democracy from an economic rather than a political viewpoint, stressing that individual economic incentives determine political attitudes.

The book also highlights the fundamental importance of conflict in the political sphere, paralleling the role of competition in the economic sphere. Different societal groups or social classes have opposing (and usually rent-seeking) interests over political outcomes. These opposing interests translate into entrenched clashes over the form of the political institutions that determine the political outcomes.

Coauthoring the book gave Robinson further insights into the ever-widening scope of Acemoglu's research interests. "Most economists can be defined by their specialty or research focus, but not Daron. There is no category for him—he does everything, and he has a model for just about everything too. I don't know where he finds the energy for all his fields of interest. He is relentless." Could all that passion and drive ever get in the way of a more contemplative approach? Robinson concedes: "Daron can be obsessed with getting all the details right."

A paper written early in their collaboration had been submitted to a journal, and the response came in the mail while the two authors were huddled in Robinson's Los Angeles office. Rejection. "I was really downcast and depressed in reading the perfunctory referees' reports, and I was sitting there looking out of the window and wondering where we would go from there," Robinson recounts. "I turned to Daron and saw that he was already scribbling algebra on scrap paper. 'I'll just rework the model and we'll submit it somewhere else,' was his reaction."

Pischke acknowledges that Acemoglu may have spread his wide interests a little thin early in his career, but insists that his research partner quickly developed the analytical heft to support such voracious curiosity. "He has very wide-ranging interests and knowledge, and he does end up working in several different fields at the same time, but he has the capabilities to pull it off."

Applied contemplation

Acemoglu's applied contemplation of the economic origins of democracy led, through a series of journal papers, to a second book (Acemoglu, 2008), which looked at the timing and incidence of democracy. *Introduction to Modern Economic Growth*, a textbook of more than 1,000 pages based on the courses he teaches at MIT, moves on a step from the "Why democracy?" he asked in the first book to include—deep in the book—"When democracy?" Again, Acemoglu finds a central economic rationale.

"We have done a lot of empirical work that shows a very clear causal link between inclusive economic institutions—those that encourage participation by a broad cross section of society, enforce property rights, prevent expropriation—and economic growth," Acemoglu asserts. "The link to growth from democratic political institutions is not as clear."

Policies and institutions, the textbook states, are central to understanding the growth process over time. The book then uses this theoretical underpinning to explain two key "When democracy?" questions: Why did the world economy not experience sustained economic growth before 1800? And why did economic takeoff start around 1800 and in western Europe?

The textbook contends there was no sustained growth before 1800, first, because no society before that date had invested in human capital, allowed new firms to bring new

Movie mantra

In assembling his view of the causes of and cures for the global financial crisis that started in 2008, Acemoglu found himself echoing and adapting lines from a celebrated movie script. In the 1987 Oliver Stone film *Wall Street*, lead villain Gordon Gekko, played by Michael Douglas, famously intoned: "Greed—for lack of a better word—is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit."

In an early analysis of the global crisis (Acemoglu, 2009) Acemoglu states: "A deep and important contribution of the discipline of economics is the insight that greed is neither good nor bad in the abstract. When channeled into profit-maximizing, competitive, and innovative behavior under the auspices of sound laws and regulations, greed can act as the engine of innovation and economic growth. But when unchecked by the appropriate institutions and regulations, it will degenerate into rent-seeking, corruption, and crime."

Acemoglu saw the movie and did recall the Gekko monologue when he drafted his passage on greed. "Everybody responds to incentives. For the vast majority of people, there is a continuum between ambition and greed, and this is where institutions play a role. Institutions can put a stop to excess by functions such as the regulation of monopolies so that they don't crush the opposition. Greed is only bad if it is channeled into doing bad things. Institutions can channel greed into excellence."

But Acemoglu cautions that U.S. institutions that used to channel the greed of bankers and financiers into doing good in the 1980s and 1990s have been decommissioned. "We—the economics profession giving advice and the policymakers enacting the laws—dismantled the system that the institutions operated and did not replace it with any kind of checks on the behavior of the financial industry. That's how greed was allowed to be bad."

technology, and generally unleashed the powers of creative destruction; and second, because all societies before 1800 lived under authoritarian political regimes. And economic takeoff started in western Europe because international trade rose after the discovery of the New World and the opening of new sea routes. The trade uptick boosted commercial activity and vested more economic and political power in a new group of merchants, traders, and industrialists, who then began to operate independently from European monarchies.

Acemoglu acknowledges that economic growth can be generated by authoritarian regimes, but insists that it cannot be sustained. "It did happen for 300 to 400 years, on and off, in ancient Rome, and that's not a short period of time, but everything happened much more slowly then. And it has happened for the last 20 years—and probably for the next 20—in China, but there will be three obstacles to growth under authoritarian regimes: there are always incentives for such regimes to be even more authoritarian; these regimes tend to use their power to halt Schumpeterian creative destruction, which is key to sustaining growth; and there is always infighting for control of authoritarian regimes, which causes instability and uncertainty."

Acemoglu and Robinson are already working on their next book, *Why Do Nations Fail?* Following the "Why democracy?" of their first book and the "When democracy?" of Acemoglu's textbook, the third in what may be informally regarded as a trilogy will likely ask, "What if not democracy?"

Cure could be cause

Acemoglu sees cause for concern that the policies used to address the current global financial crisis may have planted the seeds for the next crisis. "Are we creating the background for the next crisis by the policies we have thrown at the problem? In my opinion, that's not an insubstantial risk.

"Once the crisis subsides, we'll be back to business as usual and we won't do anything about it. Before the crisis the United States had 20 or so large banks accounting for a large proportion of GDP [gross domestic product] and an even bigger part of total corporate profits and total financial sector employee compensation. Now we have five or six institutions playing that role, so it's a much more monopolized system. U.S. financial institutions saw that the clear narrative behind policies to address the crisis was 'You are too big to fail.' Well, they are 'too big to fail squared' right now.

"They expected that the U.S. government had the will and the political support to bail them out, one way or another. If you are the chairman of a large bank now, and you have a fiduciary duty to your shareholders to maximize profits, then it is your duty to take maximum advantage of all the things the government may give you in the current regulatory environment.

"If, on the other hand, we had the right regulations, the chairman's fiduciary duty to his shareholders would be to maximize profits by better financial intermediation, not by more proprietary trading—banks trading on their own behalf and not for clients. It's difficult to see how an efficient allocation of resources in a capitalist system could be such that a sizable portion of the profits in the U.S. economy are made from proprietary trading instead of financial intermediation or mergers and acquisitions."

"Dysfunctional societies degenerate into failed states," asserts Acemoglu, "but we can do something about it. We can build states with infrastructure and law and order in which people are confident and comfortable going into business and relying on public services, but there is no political will to do that. You would not need armies to implement such a scheme—just a functioning bureaucracy to lay down the institutional foundations of markets."

Reward structure

Acemoglu's look at failed states will aim to show why some countries reach economic takeoff and some do not. This will partly involve an account of how policies and institutions directly affect whether a society can embark on modern economic growth. These policies and institutions will determine the society's reward structure and whether investments are profitable; its contract enforcement, law and order, and infrastructure; its market formation and whether more efficient entities can replace those that are less efficient; and its openness to new technologies that may infringe on politically connected incumbents.

The conclusions are likely to revisit the contrast in *Dictatorship and Democracy* between the growth-promoting clusters of institutions nurtured under participatory regimes, and the growth-blocking extractive institutions established under authoritarian regimes.

What wider ambitions might such an ebullient, eclectic, and unpredictable academic still nurture within the confines of an MIT office and adjoining lobby unsteadily stacked with journals, periodicals, reference works, and dog-eared manuscripts? On a personal level, wife Asu is expecting the couple's first child in May, "so my biggest personal ambition is to turn out to be a decent father." Outlining his principal professional goal, Acemoglu projects his multifaceted academic interests onto a broader canvas. "There is a need for more interdisciplinary conversation and informed debate on important topics in the social sciences. In the United States, public intellectuals are seen as losers, but in the United Kingdom they take part in national dialogue. I would like to see that here and perhaps be part of it."

But a return to Turkey will not feature in Acemoglu's immediate plans. "I can't go back because I left without doing military service. I'd be arrested if I returned." The penalty: back to jail. ■

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