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Income inequality and colonialism

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Abstract

This paper proposes that colonialism is a major explanation behind today's differences in income inequality across countries. We argue that income inequality has been higher in the colonies where the percentage of European settlers to total population was higher, as long as Europeans remained a minority. The countries where Europeans became the majority of the population did not suffer from high inequality. These initial differences continue to hold today. The empirical evidence we provide strongly supports our thesis.

JEL classification: O15; O13; N90

Keywords: Colonialism; Inequality; Income distribution

1. Introduction

In the last few years a considerable number of papers have increased our understanding of the way the colonial experience of today's developing countries has influenced their subsequent economic evolution. While the analysis of many short term issues might be safely done without considering the historical context of each country, such approach would be questionable for long term problems like differences in income levels between rich and poor nations.

It is precisely the careful consideration of history in general, and of colonial history in particular, that sets papers like Acemoglu et al. (2001, 2002) or Engerman and Sokoloff (2002) aside among those addressing the question of why southern countries have not

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attained the economic well-being of the world's industrial countries. Acemoglu et al. (2001) argue that the pattern of European settlement in the colonies determined the type of institutions that these countries developed and that these institutions are a major factor behind their economic backwardness. In those regions where few Europeans settled, Europeans created "extractive states" and the resulting institutions "...did not introduce much protection for private property, nor did they provide checks and balances against government expropriation." On the other hand, the authors also propose that the countries that received a large number of settlers "tried to replicate European institutions" and therefore created the right set of rules encouraging future economic growth. European migration to a given region was largely determined by the mortality rates that future settlers would face. This provided the authors with an instrument to test the effect of institutions on the level of GDP per capita, namely the mortality rates of European settlers in colonial times.

Engerman and Sokoloff (2002) provide us with a convincing account of how many of the differences in economic outcomes between the northern and the southern part of the American Continent are rooted in colonial times. The authors identify as the initial cause of this divergence the differences in factor endowments that Europeans found in the New World. The southern part of the continent, with its aptitude for sugar production and mining, started with a much more pyramidal society than the northern one, with its family-size agricultural units. Engerman and Sokoloff "document—through comparative studies of suffrage, public land and schooling policies—systematic patterns by which societies in the Americas that began with more extreme inequality or heterogeneity in the population were more likely to develop institutional structures that greatly advantaged members of the elite classes (...) by providing them with more political influence and access to economic opportunities."

The present paper places itself in the same line as the two aforementioned ones. Like them, it studies a long run distinction between developed and developing countries in the light of the colonial past. The object of our study is the large differences in income inequality that exist among countries. Using the most popular measure of inequality, namely the Gini coefficient, we can observe that the countries of Latin America and sub-Saharan Africa have much higher levels of inequality than those prevailing in Europe or Asia. The average value of the Gini coefficient is 51.80 for Latin America and 46.85 for sub-Saharan Africa while for Western Europe and South and East Asia the values are 31.83 and 37.71, respectively.[1]

The only explanation for these important differences that has ever gained wide approval among the economics profession is the "Kuznets' hypothesis". Proposed by Kuznets (1955), it asserts that inequality should evolve following an "inverted U" pattern as countries develop. Although initial tests of Kuznets' hypothesis gave contrasting results,[2] the issue could finally be settled once comprehensive time series data on inequality became available for a large number of countries. This took place in the mid-nineties thanks to the

[1]Calculated using the latest available data for each country. Note that these numbers are given for illustrative purpose only since we have not taken into account differences in income and income recipient definitions.

[2]For instance, Ahluwalia (1976) found support for the inverted U hypothesis but this was proved not to be robust by Anand and Kanbur (1993).