
Douglass C. North

The Restless Innovator

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JOHN V. C. NYE

By the time Douglass North passed away at the age of ninety-five, he had become one of the most widely read and most highly cited economists in all the social sciences. I stress the social sciences because North’s work has influenced research not just in economic history—his specialty—but also in political science, sociology, and anthropology as well as in law and philosophy. Moreover, his ideas are an illustration of how radical notions become received wisdom. His most influential claim—that institutions are critical to the process of economic growth—went from being ignored or derided to being critiqued for its oversimplifications to becoming so commonplace a notion that modern-day readers are likely to say, “Didn’t we always know that?”

Yet, odd as it may sound, there was a time when the mainstream view of economic development was that institutions were of minor importance in modern industrialization. That technological innovation as an independent force, coupled to applied science and industry within a nation that had the right mix of capital and labor and working under the guidance of Keynesian monetary and fiscal policy, was the prime or even the sole determinant of growth and prosperity. As one professor told me more than three decades ago, “Markets account for only static gains in income. Growth is all about technological change, and there, government policy is often more effective than market prices.”

I am not going to rehash the stories about the common wisdom of the 1960s that overrated the growth prospects of the Soviet bloc vis-à-vis the West or the way

John V. C. Nye holds the Bastiat Chair in Political Economy at the Mercatus Center and is professor of economics at George Mason University as well as international adviser and research director at the Higher School of Economics, Moscow.

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that the International Monetary Fund and the World Bank arranged their funding and support to align with this consensus. I simply note that whenever someone today writes that one sector of the economy is clearly more deserving of support than another, that managed growth always beats spontaneous investment, that increased public spending is the proper route to development, or that sufficient numbers of engineers and scientists can propel the economy of an otherwise moribund nation, that person is in essence channeling the anti-institutional spirit of pre-Northian ideas.

So let us examine more closely what North meant by institutions and just what his contributions were. For North, institutions were the so-called rules of the game—the set of formal and informal laws and norms that constrained and directed people’s behavior in both business and politics. Unlike the more informal use of the word *institutions*, he saw entities such as the World Bank and the university as organizations, not institutions. They were actors within a given institutional framework and not institutions themselves.

His particular insights about institutions’ importance evolved over time. His earliest work in the 1950s up to the publication of his book *The Economic Growth of the United States, 1790–1860* (1961) can be seen as traditional neoclassical analysis applied to economic history. But even this early research was pioneering in that it helped contribute to the movement known variously as Cliometrics or the New Economic History, which involved the straightforward application of economic theory and statistical techniques to the history of development. As a coeditor of the *Journal of Economic History* in the 1960s, North also moved Cliometrics into the mainstream by promoting articles in that vein in the journal, including the early work of a brilliant scholar who would later come to share the Nobel Prize in economics with him—Robert Fogel.

When North became chairman of the Department of Economics at the University of Washington in Seattle, he helped attract a number of scholars who were heavily influenced by the work of Ronald Coase, most notably Stephen Cheung and Yoram Barzel. This gathering of scholars led to the “property-rights” school of economic analysis, which saw well-structured property rights, properly enforced, as necessary and sufficient conditions for growth and development. One could chart the success or failure of different societies by studying the nature and quality of their property-rights structures, and this view was prominent in the books North wrote with Lance Davis and Robert Paul Thomas: *Institutional Change and American Economic Growth* (1971) and *The Rise of the Western World* (1973), respectively. Although the property-rights framework continues to be a valuable and useful contribution to the methodology of institutional analysis, North eventually came to believe that this earlier work was too tied to a narrow form of neoclassical theory that mostly ignored politics, culture, and social norms. It was too optimistic and often tended to assume that when potential gains from trade existed, efficient property rights would evolve to allow people to benefit. Yet North clearly saw that most of the world was not “efficient” except in the most uninformative and tautological sense of the word.

North began to think more deeply about the ways that the state mattered and how it functioned—developing ideas that were different from but complementary to the work of James Buchanan and Gordon Tullock’s public-choice school and those that were based on Mancur Olson’s theory of collective action. At the core of the Northian vision was the dual insight that the state is like a firm which is a hierarchy that can be analyzed with many of Coase and Oliver Williamson’s tools that were being used to characterize the modern firm. At the same time, the state was not like the firm in that it had access to force and made claims to having a monopoly on the legitimate use of force, and could therefore shape the very rules and rights that the neoclassical view of the economy often takes as a given.

In my own work, I have chosen to call this dual insight the “Hobbes versus Smith paradox”: voluntary trade in a competitive market is mutually beneficial, but any third party capable of enforcing the rules so as to limit coercive exchange is capable of abusing its force for its own gain. In my view, this treatment of the state in economic history, which was most directly derived from North’s work in the literature, continues to be the dominant idea embedded in much of the work classified under the rubric “New Institutional Economics.” The earliest version of this treatment, in which North tried to combine and revise his ideas from *The Rise of the Western World* (North and Thomas 1973) with new thoughts about the role of social norms and ideology, appeared in *Structure and Change in Economic History* (North 1981).

When North left Seattle in 1983 to move to Washington University in St. Louis (a move that has caused endless headaches for scholars in languages where the name “University of Washington” is given the same translation as “Washington University”), he continued to mine his new insights and, by adding insights from the literature on path dependence and the new work in rational-choice political theory, to elaborate his ideas about why nations find it hard to develop structures that systematically promote growth. This work culminated in his book *Institutions, Institutional Change, and Economic Performance* (1990). In particular, he developed the idea that because institutional structures—including informal social constraints—were especially prone to path dependence, nations could become “locked in” to rules and rights that were obviously dysfunctional from afar but extremely resistant to change.

At Washington University in St. Louis, he also applied some of his insights on institutions to specific historical cases, and the paper that came out of this application—“Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England” (1989), coauthored with Barry Weingast—has become highly cited in both the economic literature and the political science literature for its claim that the Glorious Revolution allowed a system with a constrained monarchy and more secure property rights to develop that ultimately propelled Britain into becoming the preeminent financial and military power in Europe.

By this time, North’s work was increasingly receiving more favorable attention, and his star had risen high. He liked to laughingly claim that before the book was

published in 1990, none of his work had received generally positive reviews. Of course, the final evidence that his views were more fully accepted was the awarding of the Nobel Prize to him (jointly with Fogel) in 1993, just two years after Ronald Coase had also received it.

However, his increased interest in ideas from psychology, philosophy, and cognitive science, which had begun in the late 1980s, led him to move in a different direction. And his musings in this area eventually led to his book *Understanding the Process of Economic Change* (2005). Though this book is in some ways the most tentative and inconclusive of North's works, both it and the one that preceded it point to his role as a pioneer in both behavioral economics and the treatment of culture as an important variable—previously ignored if not outright scorned—in mainstream economic analysis.

North continued to grapple with the problem of how the state solves the problem of constraining violent coercion and promoting growth, and so in collaboration with John Wallis and Barry Weingast he produced *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (2009). This work's importance cannot be underestimated because North had finally come directly to grips with the Hobbesian problem. The need to produce a stable order is of paramount importance in human social history, and the compromises arrived at to produce the various societies the world has seen limited mankind's capacity to also promote growth and development. In my view, this book explains better than any other work in economics why most nations find it almost impossible to sustainably adopt growth-promoting free-market institutions without finding a viable substitute for the social and institutional relations that currently promote order. It is a curiosity that many economists who understand full well the problems with assuming away the problems of human knowledge in the economics of exchange can blithely promote reforms in developing nations' economic policies that also assume away the problems of political order. *Violence and Social Orders* makes clear why imperfect states have mostly been unavoidable and points us to the conditions that would allow us to better understand how to reform them.

If North has often leaped into the void without first working out the safe path down, his constant questioning of received wisdom and the creative answers he has proposed have provided plenty of work for future scholars to exploit or to critique in the decades ahead. He has produced a uniquely innovative and diverse body of work that will endure and continue to inspire social scientists throughout the world.

As North often said, the only question that really should matter in economics remains, "Why are some nations rich, and some poor?"

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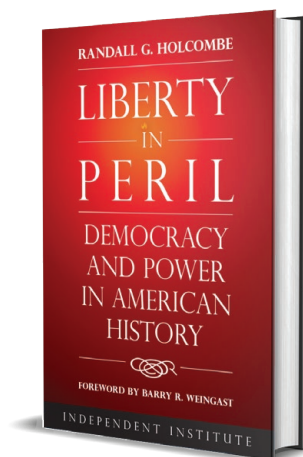
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