INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE
THE POLITICAL ECONOMY OF INSTITUTIONS
AND DECISIONS

editors
James Alt, Harvard University
Douglas North, Washington University in St. Louis

Other books in the series
Yoram Barzel, Economic Analysis of Property Rights
Robert H. Bates, Beyond the Miracle of the Market: The Political Economy of Agrarian Development in Kenya
Gary Libecap, Contracting for Property Rights
Matthew D. McCubbins and Terry Sullivan, eds., Congress: Structure and Policy
Charles Stewart III, Budget Reform Politics: The Design of the Appropriations Process in the House of Representatives, 1865–1921
INSTITUTIONS,
INSTITUTIONAL CHANGE
AND ECONOMIC
PERFORMANCE

DOUGLASS C. NORTH
Contents

Series editor’s preface  
Preface  
Part I Institutions  
1 An introduction to institutions and institutional change  
2 Cooperation: the theoretical problem  
3 The behavioral assumptions in a theory of institutions  
4 A transaction cost theory of exchange  
5 Informal constraints  
6 Formal constraints  
7 Enforcement  
8 Institutions and transaction and transformation costs  
Part II Institutional change  
9 Organizations, learning, and institutional change  
10 Stability and institutional change  
11 The path of institutional change  
Part III Economic performance  
12 Institutions, economic theory, and economic performance  
13 Stability and change in economic history  
14 Incorporating institutional analysis into economic history: prospects and puzzles  
References  
Index  

v
Series editor's preface

The Cambridge Series in the Political Economy of Institutions and Decisions is built around attempts to answer two central questions: How do institutions evolve in response to individual incentives, strategies, and choices, and how do institutions affect the performance of political and economic systems? The scope of the series is comparative and historical rather than international or specifically American, and the focus is positive rather than normative.

In this challenging theoretical work, Douglass North examines how to explain the vastly different performances of economies over long periods of time. Asking "What combination of institutions best permits capturing the gains from trade?", he offers a broad perspective on how institutions persist and change, superseding his own earlier work on incentives toward efficient institutions. Now his focus is on the interaction of institutions, defined as any constraint humans devise to shape their interactions, and organizations, created to take advantage of the opportunities presented by institutions in shaping the development of economies. The importance of institutions arises from the costliness of measuring what is valuable, protecting rights, and policing and enforcing agreements. Once created, institutions determine the costs of acting in various ways in political and economic contexts. North applies his theories of the interplay between institutional evolution and political and economic organization to a range of historical examples, including the development of management structures, law merchants, insurance, and financial markets. The synthesis he achieves will be equally valuable to students of economics, history, and politics.
Preface

History matters. It matters not just because we can learn from the past, but because the present and the future are connected to the past by the continuity of a society’s institutions. Today’s and tomorrow’s choices are shaped by the past. And the past can only be made intelligible as a story of institutional evolution. Integrating institutions into economic theory and economic history is an essential step in improving that theory and history.

This study provides the outline of a theory of institutions and institutional change. Although it builds on the earlier studies of institutions that have been the focus of my attention for the past twenty years, it delves much more deeply than the earlier studies into the nature of political and economic institutions and how they change. The specification of exactly what institutions are, how they differ from organizations, and how they influence transaction and production costs is the key to much of the analysis.

The central focus is on the problem of human cooperation — specifically the cooperation that permits economies to capture the gains from trade that were the key to Adam Smith’s Wealth of Nations. The evolution of institutions that create an hospitable environment for cooperative solutions to complex exchange provides for economic growth. Not all human cooperation is socially productive, of course; indeed, this study is concerned as much with explaining the evolution of institutional frameworks that induce economic stagnation and decline as with accounting for the successes.

My primary objective is to construct a way of approaching the issues — a necessary first step in evolving a theory of institutional change. Therefore, much of the book is devoted to developing the analytical framework. The history I include is illustrative, designed to show the promise of the approach, but far from providing for the kind of hypothesis testing that must ultimately be done. Although my primary message is to economists
Preface

and economic historians, I believe the argument will be equally interesting to other social scientists. With this in mind, I have attempted to keep the economic terminology to a minimum and make the analysis clear to the noneconomist.

So many people have played a role in the development of the ideas presented here that it is difficult to know where to begin in acknowledging them. The first draft of this manuscript was written while I was a fellow at the Center for Advanced Study in the Behavioral Sciences supported by Grant # BNS 8700864 of the National Science Foundation. Gardner Lindzey, Bob Scott, and the staff established a wonderfully hospitable environment for this enterprise. I owe a particular debt to Carol Baxter, who patiently indoctrinated me into enough of the mysteries of the computer to alter fundamentally (for the better) my way of writing. Robert Keohane, Steven Krasner, Mark Machina, and Ken Sokoloff, fellows at the Center that year, all contributed to the development of this study.

I owe special debts to Barry Weingast and John Nye, with whom I have discussed many of the ideas developed herein and who read and commented extensively on several drafts of this study.

While I was writing this manuscript, I was reading drafts of Thrainn Eggertsson’s excellent survey of neoinstitutional economics, Economic Behavior and Institutions (Cambridge University Press, 1990). His study clarified my thinking on many issues and contributed to shaping the direction of my own work.

Other colleagues at Washington University – Lee Benham, Art Denzau, John Drobak, Gary Miller, and Norman Schofield – all read an earlier draft and offered valuable suggestions. Others who read an earlier draft and provided valuable comments were James Alt, Robert Bates, Robert Ellickson, Stanley Engerman, Philip Hoffman, and Margaret Levi. However, my debts go far beyond those who read the manuscript. I have presented parts of this study at conferences and university colloquia over the past half dozen years and received many valuable suggestions that have shaped my research agenda.

Ruey Hua Liu, and particularly Werner Troesken and Brad Hansen have been diligent and trustworthy research assistants. Annette Milford has labored long and hard over drafts of this manuscript.

Last but certainly not least, Elisabeth Case has translated my inelegant prose into the English language. More than that, she has borne with me through dejection and inspiration as this study has evolved.

Benzonia, Michigan
January 1990