Introduction

Why isn't the whole world developed? How can we explain the great variability in economic and political performances across countries? Finding answers to these questions is one of the enduring challenges in social science. While a small number of countries have reached high levels of economic prosperity and political openness, most have experienced short bursts of growth followed by economic and political volatility, often involving violence. The explanation for this uneven development provided by Institutional and Organizational Analysis (IOA) emphasizes the role of institutions and norms as fundamental determinants of economic and political development. Institutions are rules that recognized authorities create and enforce. Norms are long-standing patterns of behavior, shared by a subset of people in a society or organization. These factors play a role in all organizations, including governments, firms, churches, universities, gangs, and even families. In this book, we present an overarching framework and a set of concepts for institutional and organizational analysis, the tools used to analyze the evolution and effects of institutions, and a set of case studies drawn from economic, legal, and political history.[1]

[1] This book is not an overview of the entire literature on institutional and organizational analysis, which is now far too big to summarize in a single volume, but is our attempt at defining the major concepts at play in the literature and integrating them into a unified framework. For broad contributions and surveys to institutional analysis, see Acemoglu and Robinson (2006); Alston, Eggertsson, and North (1996); Brousseau and Glachant (2002, 2008); Drobak and Nye (1997); Eggertsson (1990); Engerman and Sokoloff (2012); Furubotn and Richter (1991, 2005); Galiani and Sened (2014); Gibbons and Roberts (2013); Greif (2006); Hodgson (1988, 2003); Klein and Sykuta (2010); Ménard and Shirley (2005); North (1990, 2005); North and Thomas (1973); North, Wallis, and Weingast (2009); Parisi and Fon (2009); Posner and Parisi (1997); Richter (2015); and Williamson (1985, 1996).

The book is in three parts, each presenting a different level of institutional analysis. In Part I, we analyze how the institutions and norms of society determine property rights, which provide the incentives for organizations and contracts and ultimately shape economic performance. In Part II, we analyze the determinants and impact of the laws of society and their enforcement, which overall determine political performance. In Part II, we take constitutional-level rules as fixed, treating them as the umbrella under which organizations and actors interact to shape and enforce laws. Taken together, Parts I and II analyze the normal operation of the economic and political systems and the interaction among institutions, property rights, technology, and economic performance. The system is not static; there are new technologies and growth, but the underlying belief system and political system remain unaffected. In Part III, we analyze broader explanations of the divergent development trajectories of nations around the world. We consider in detail the circumstances under which beliefs become malleable and change and how those changes, frequently orchestrated by leadership, can lead to transitions to different economic and political trajectories. At this scale, we analyze longer stretches of time, allowing for differences in fundamental core beliefs that in turn can transform the development path of a society. In Part III, we also analyze the determinants of constitutions that emerge through a process in which beliefs shape constitutions and, under some circumstances, the constitutional-making process shapes beliefs.

Examples of Institutional and Organizational Analysis

The interpretation and implementation of institutions is dynamic, shaped by other institutions, norms, individuals, and organizations. This means that the effect of institutions and norms on behavior is difficult to generalize and often requires a more granular consideration of the behavior within a given social group that a rule is trying to influence. In order to familiarize the reader with the benefits of a mode of analysis that focuses on the specific rules in play in a given context, we provide a series of illustrative examples in this section. Each example can be situated in one of the parts of our book, emphasizing the analytical toolkit that we develop throughout.

The Decline of Littering in the United States

Casual disposal of one's refuse became widely recognized as a social problem in the period following World War II, although some jurisdictions note laws reaching as far back as 1897 (Frisman, 2008). Nonetheless, the effect of the institutions prohibiting littering is not clear, because the practice of littering persisted for decades after the enactment of such laws. Why might legal enforcement be ineffective in restraining a practice like littering? Careful consideration of the different ways in which institutions and norms incentivize behavior provides a compelling explanation for the eventual decline in littering in the United States.

In first considering institutions as a potential solution to the problem of littering, it is important to remember that institutions depend upon a recognized authority for their enforcement. In the case of laws (or ordinances) prohibiting littering, the enforcement authority is the police. In order to enforce the consequences for littering, police must either witness the act of littering, engage in an investigation to determine the identity of the litterer after the fact, or rely on the testimony of eyewitnesses who saw the littering occur.[2] Each of these possible means of enforcement fails to provide a cost-effective deterrent to the practice for obvious reasons. Littering laws are difficult to enforce because it is hard to catch someone in the act of littering and hard, after the fact, to determine who did the littering. Thus, the deficiencies of enforcement of the minor crime of littering suggest that laws prohibiting littering are unlikely to affect the behavior of individuals inclined to do so.

Absent such an analysis, one could look at the decline in littering subsequent to the enactment of laws prohibiting the behavior, and infer that the laws caused the eventual decline in the practice. However, given the preceding analysis, it is unlikely that laws whose enforcement costs outweighed the marginal social benefit of deterring individual acts of littering had their intended effect. Instead, while the decline in the practice of littering in the United States has been quite substantial (a 61 percent decrease between 1969 and 2009 by one estimate

[2] In today's world, cameras that capture many acts like littering are increasingly found in cities like London, where nearly every aspect of public behavior is recorded, often from multiple angles. Our example of littering sets aside the case of technological shocks to enforcement costs, because the change in practices surrounding littering in the United States occurred well before such public surveillance was affordable for common law enforcement purposes.

[Schultz and Stein, 2009]), this change has occurred gradually. As importantly, this change occurred over the same period when public attitudes regarding the importance of a healthy environment increased significantly. While many states passed laws explicitly designed to address the problem of littering from the 1950s to the 1970s, it is more likely that these laws were an expression of the underlying change in beliefs regarding the environment. These same beliefs led to a change in norms; where littering was previously quite commonplace, the increased social costs of littering had two important implications for individual behavior. Individuals likely held the underlying belief regarding the value of a clean environment. Even if some individuals did not hold such a belief, the likelihood that members of their social group did hold such a belief increased significantly, which meant an individual who littered in view of anyone was more likely to bear costs such as ostracism or direct criticism of their behavior. Over time, this increased likelihood of either individually valuing the environment more than the convenience of littering, or one's social group doing so, led to more and more individuals adopting the norm against littering, regardless of the legal penalties associated with the action. The example of littering displays how careful analysis of the incentives created by different rules, and the comparative costs of the enforcement of rules (both individually and in comparison to other rules in society), provides a deeper understanding of an important social change than a cursory analysis of legal change and subsequent behaviors.

Land Reform in Brazil

Rural conflict and the struggle for land permeate Brazilian history. In the nineteenth century, slavery and the coffee boom consolidated the ownership of land in the hands of a small elite, and the highly concentrated pattern of land ownership has persisted to the present day. The coexistence of unproductive *latifundia* with large numbers of landless peasants has resulted in recurring violence, conflict, and deforestation, promoting economic uncertainty and social disruption. As Brazil returned to democracy in the mid-1980s after decades of authoritarian rule (1964–1984), the level of rural violence and unrest further increased, as landless peasants organized and initiated systematic invasions of underused properties. The new

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government adopted land redistribution as a flagship policy and symbol of the return to democratic ideals. The redistribution consisted of the compensated yet forced expropriation of unproductive farms and the creation of settlement projects. The Brazilian government gave land, credit, and technical support to landless peasants. Despite the prominence of land reform policies in the political agenda, landowners resisted politically and physically. The upshot was a steady increase in the number and severity of rural conflicts throughout the 1990s and 2000s. The number and audacity of the invasions, and the ruthlessness of the reaction by landowners and police, kept land reform as a constant fixture in the media and in political and electoral debate. Although each new instance of rural violence prompted renewed promises of greater government action, the violence and conflicts just seem to get worse every year.

Critics maintained that the government's land reform effort was insufficient and the solution was to invest more resources and redistribute enough land to diffuse the source of the conflicts. Nevertheless, as each new president upped the ante and adopted higher targets for the number of families settled and higher land reform budgets, the level of tension and number of invasions just seemed to get worse.

The problem with this way of looking at the issue of rural conflicts in Brazil is that it focuses on the upfront manifestations of the actions of players, but does not consider the institutional foundations that determine the players' incentives and constraints. Conflicts should not be understood as a game played in physical space, where the player that grabs the land and defends it most successfully is the winner (Alston, Libecap, and Mueller, 1999a, 1999b, 2000). Instead, it is a game played in institutional space, where the players engage in violence, not for its direct effect on the opponent, but strategically, for the indirect effect that results from the institutional rules that mediate land reform in Brazil. The key insight to understand rural violence is that Brazilian society (public opinion and the majority of voters) is strongly in favor of redressing historical wealth inequalities through redistributive land reform. This has become a valence issue in Brazilian politics despite the fact that Brazil is overwhelmingly urban and few voters are directly affected. Politicians, especially the office of the president, which is directly in charge of land reform, understand these preferences and respond accordingly, promising to further the cause. There are, however, organized interests that oppose the reforms, especially landowners and agricultural producers. They strive in Congress, in the courts, and in the field to undermine land reform efforts. The upshot is a balance where neither side has overwhelming influence, so that the struggle continues.

In the 1980s and early 1990s, very little land got effectively redistributed because politicians responded to the pressure for redistribution by creating the structure for land reform (a program, ambitious targets, and political visibility), yet did not allocate sufficient funding. Formally, landless peasants should register with the land reform agency and wait to be called when land became available. The agency would seek out land that fit the legal criteria for being expropriable according to the constitution (unproductive and/or bad title) and would then proceed through the process of taking the land and establishing settlement projects. Because this process turned out to be woefully slow, organized landless peasants realized that rather than waiting their turn, they could expedite things by preemptively invading land. Landless peasants did not invade randomly, but rather, they targeted properties, which the peasants knew fit the criteria for land reform redistribution. The landless did not intend to grab the land for keeps; rather, the strategy was to create a commotion that the media noticed and would have the effect of embarrassing and pressuring the land reform agency and politicians to prioritize that specific case. Every time this strategy succeeded, it had a demonstration effect that led to further invasions. Very soon, invasions became the main route for land redistribution.

Although the invasions were not strictly legal, they worked because of a constitutional provision that land must fulfill its social function, that is, the function of being productive. In a way, all the invasions did was to expedite something that the government should be doing anyway. If this recognition of the legitimacy of the invasions was the only claim to legality, then it would be hopeless for landowners to resist, and redistribution would proceed quickly and with little violence. However, landowners also had a legal recourse in the case of invasion. They could appeal to their local courts asking for a reintegration of possession, which often involved a warrant for the police to remove the interlopers. The courts might be aware of the land reform aspects of the invasion, but this was not in their jurisdiction, as land reform is a federal matter. Instead, they treated the issue as any other case of wrongful appropriation: if the plaintiff could prove rightful ownership, the judge would usually grant the eviction of the squatters.

With conflicting institutions legitimizing the opposing claims from each side, and without a clear rule of which institution should trump the other, the result was uncertainty and ultimately conflict and violence. The example illustrates the importance of institutional and organizational analysis. Under the standard diagnostic that conflicts arise out of insufficient political will to pursue land reform, the obvious solution would be to simply invest more resources and more effort to settle more families. The application of more resources escalated violence. An institutionally driven analysis, on the other hand, would have suggested a focus on resolving the legal contradictions that prompted each side to persist in the pursuit of land through violence. This might not fully resolve an issue that reflects deep historical cleavages in Brazilian society, but it would have resulted in less conflict, suffering, and waste.

Beliefs and Empire: Understanding the Decline of Portugal in the Sixteenth Century

The rise and fall of the Portuguese Empire in Asia during the fifteenth and sixteenth centuries illustrates the importance of beliefs and their interaction with institutions in affecting economic performance, a major theme we address in Part III of this book. During the fifteenth century, the Portuguese achieved considerable technological breakthroughs in nautical technologies and gradually managed to extend their reach down the coast of Africa and sail around the Cape of Good Hope to reach India in 1498. The Dutch and the English would only manage to follow suit almost one hundred years later. During this time, the Portuguese were poised to dominate the lucrative trade that supplied spices and other Asian goods to Europe satisfied by a dispersed caravan trade that ferried the goods by land and sea to the Middle East, where they traded with Mediterranean merchants. However, although the Portuguese had such a huge head start, they never quite managed to make the most of the new trade opportunities. Throughout the one hundred years prior to the Dutch and the English, the caravans remained the main suppliers of Asian goods to Europe. When the

Dutch and English finally arrived, they almost immediately displaced the Portuguese, who thereafter were minor players in an area where they once seemed set to reign supreme.

What explains the success of the Portuguese during the fifteenth century in tackling the myriad intricacies and impediments to developing the technology, knowledge, and organization required to brave the unknown and establish a route that no nation had sailed before? And, given this success, why did they not capitalize on the opportunities that these accomplishments had set at their feet? It seems clear that the proximate cause of the failure to reap the potential gains from the sea route to Asia was the decision to base their strategy on violence (redistribution) instead of commerce. Rather than using their maritime and military superiority to arbitrage the price differential of goods in Asia and Europe and drive the caravans out of business, they chose instead to prioritize the charging of duties, tolls, taxes, rights of transits, and other forms of veiled or outright extortion, leaving commerce as a secondary consideration. Previously, a variety of local bosses, princes, and caliphates charged fees and the Portuguese simply used their naval might to usurp many of these sources of revenue, especially on sea routes to the Persian Gulf. Correspondingly, during the reign of the Portuguese, caravans continued to carry the bulk of Asian supply to Europe, while the arrival of the Dutch and the English in the seventeenth century practically drove the caravans to a halt.

Many historians have ascribed the failure of the Portuguese to a culture and religion that was not conducive to trade and commerce (Hall, 1985; Jones, 1981; Landes, 1998). A different interpretation came from economic historians who faulted instead the “structures” of trade by the Portuguese. We can interpret the structures as institutions. This view, often associated with Steensgaard (1974), argued that the *Estado da India* – the Portuguese enterprise in Asia, manned by a viceroy, captains, diplomats, priests, down to the lowest soldiers – captured the rents and did not effectively pursue the king’s interest as mandated.

In Part III of this book, we focus on the interaction of beliefs and institutions. Beliefs, as defined here, are a derivative of culture and refer to the agents’ understanding of how institutions affect outcomes. Under this definition, it makes no sense to discuss whether beliefs *or* institutions were responsible for the rise and fall of the Portuguese

Empire; the Portuguese chose institutions consistent with their beliefs, the two go hand-in-glove. Those with power chose institutions purposefully to accomplish desired ends, given their beliefs of how the world works. If the expected outcomes materialize, this reinforces the beliefs. If they do not, then the belief becomes fragile and is displaced. There is thus a coevolution of beliefs and institutions.

Coevolution of beliefs, institutions, and organizations best explains the rise and fall of the Portuguese in the fifteenth and sixteenth centuries (Mueller and Leite, 2016). Mueller and Leite single out two specific dimensions of Portuguese medieval beliefs to explain the sequence of events.[3] The first, *patrimonialism*, is the belief that it is the state and not the individual or private sector that is the engine of wealth and progress. If something is to be accomplished, it is the state that will be the driving force. Consequently, the path for individual advancement is through capture and rent-seeking. A characteristic of this belief is thus a blurred boundary between public and private interests. The second dimension is a belief in the dishonor of manual labor, prudence and commerce, and the virtue of chivalry, just war, crusades, and violence. This was a common belief in many European medieval societies and was especially strong in Portugal, where the aristocrat or *fidalgo* (translated as "son of somebody") perceived themselves as born warriors and even the king would go off to the crusades.

It is straightforward to see how these beliefs and the institutions they spawned can make sense of both the rise and the fall of the Portuguese Empire. Portuguese success in developing and employing the technology and organization that enabled their unprecedented expansion was the result of a long process financed and managed by the state. While most nations were financially impoverished by the wars of the fifteenth century, Portugal experienced a level of centralization and financial solvency that allowed the state to lead the way, for example, through the leadership of Prince Henry the Navigator and the School of Sagres. For these accomplishments, a belief in the predominance of the state and the centralized institutions that

3 It is common for scholars who analyze the interaction of beliefs and institutions to try to single out main dimensions or traits that characterize the beliefs, although beliefs are typically quite complex and nuanced. See Alesina and Giuliano (2015) for an extensive review of this literature and for several examples of the beliefs identified in different historical circumstances.

accompanied the process, were appropriate and successful. Similarly, a belief that prioritizes the virtue of crusades, war, and conquest also contributed towards that success. Both patrimonialism and a belief in violence were conducive to institutions that promoted the crusades and the voyages of expansion. In contrast, the Dutch and the English reached Asia many decades later, spurred by very different beliefs and institutions. Their enterprise was primarily commercial, and the institutions and organizations that they developed, such as the trading companies and their rules, had different incentives with different outcomes.

While patrimonialism and violence had served the Portuguese well in the fifteenth century, as they sought to develop the knowledge and organization to conquer their enemies and nature, these beliefs were not as beneficial in the new setting that the Portuguese encountered in the sixteenth century. In Asia, those beliefs proved to be poor guides for how to best capitalize on the opportunities that their earlier achievements had made possible. The choice of violence instead of commerce as the defining strategy of the Portuguese enterprise in Asia paid off handsomely in the first couple of decades of Portuguese presence. It gave the Portuguese a dispersed foothold in the region and much wealth in the form of plunder and taxes. Gradually, violence ran into decreasing returns as the local people and organizations learned how to avoid or minimize Portuguese exploitation. As this happened, and the proceeds from the enterprise systematically failed to live up to the Portuguese king's expectations, the Crown made many attempts to reform the *Estado da India* and the rules that sought to incentivize its agents and restrain their opportunism. Portuguese historian Vitorino Godinho (1965) describes this period as one of shifting beliefs, marked by the tensions and contradictions of the incomplete transition from the medieval to the modern era in Portugal. That is, there was a perception that a new world order held opportunities that necessitated different beliefs and institutions, but the attempted conversion was always incomplete and insufficient. The Portuguese state never quite managed to develop a commercial enterprise or to give room for a strong mercantile class to arise. Similarly, the aristocrat never fully became a merchant, adopting thrift and prudence, nor did the merchant avoid becoming a warrior (Godinho, 1965: 62, vol. I). So, although the Portuguese navigated the passage to Asia, they never navigated the passage from a medieval