

Douglass North's Theory of Politics

Margaret Levi and Barry R. Weingast
Stanford University

March 2018

(Forthcoming, *PS: Political Science*)

Abstract

Few social scientists have equaled the impact on political science of Douglass C. North, co-winner of the Nobel Memorial Prize in Economics in 1993. His extraordinary influence emanated from his ideas but also as a result of his vast social network of collaborators, students, and friendly critics. North was at the forefront of four revolutions in economics and political economy.

1. The New Economic History;
2. The "property rights" revolution;
3. The New Institutional Economics; and
4. Cognitive science and behavioral economics.

North explicitly brought issues of political science into the second through fourth revolutions. He became a major leader in historical and comparative political science and in the study of institutions more generally. His work proved particularly relevant for those interested in questions of state-building, state variation, development, and long-term secular change.

Introduction

Few social scientists have equaled the impact on political science of Douglass C. North, co-winner of the Nobel Memorial Prize in Economics in 1993. His extraordinary influence emanated from his ideas but also as a result of his vast social network of collaborators, students, and friendly critics.

North was at the forefront of four revolutions in economics and political

economy.¹

1. The New Economic History (NEH)
2. The “property rights” revolution
3. The New Institutional Economics
4. Cognitive science.

Even so, this list understates his influence. Doug began his career as an economist, and his first book, *The Economic Growth of the United States, 1790-1860* (North 1961), helped launch the NEH revolution. This book is among the first to bring massive amounts of data to questions of history. Doug’s subsequent works all involved understanding the choices made by states, most of which failed to produce growth while a very small number did produce growth.

Doug became a major leader in historical and comparative political science, and in the study of institutions more generally. His work proved particularly relevant for those interested in questions of state-building, state variation, development, and long-term secular change.

Doug’s curiosity about issues of politics and governments began early, but it became salient with the publication of *The Rise of the Western World* (North and Thomas 1973) and was fully realized in *Structure and Change* (North 1981), arguably his most important work. Doug’s involvement with political scientists began with the conception and writing of this book: teaching a seminar with Levi for many years at the University of Washington, Seattle, and then moving to Washington University, St. Louis, in 1983 where he engaged with Jim Alt, Jean Ensminger, Jack Knight, Bill Marshall, Norman Schofield, Ken Shepsle, Barry Weingast, among others.

¹ We expand on this point in Levi and Weingast (2015).

North and Political Science

Doug's interest in political science reflected the same motivation that led him, earlier, to explorations of analyses of property rights and transaction costs and, later, of cognitive science. He had a puzzle, and to complete it he needed more pieces than traditional economics provided. John Wallis (2016), in his *EHR* review of Doug's work and life, captures this exactly when he argues that, after mightily trying to stay within the confines of neo-classical economic theory to account for long term institutional change in the books with Robert P. Thomas (North and Thomas 1973) and Lance E. Davis, *Institutional Change and American Economic Growth* (Davis and North 1971), Doug recognized the need to search for complements to and revisions of standard premises. That search led him back to Marx, then on to political science, and then to Margaret Levi.

Almost all of his closest friends and collaborators have a story to tell of their initial interactions with Doug. Margaret's began when she received a phone call as a new assistant professor at the University of Washington. Doug, who—again, as Wallis notes and to which we both attest—had a reputation as a curmudgeon, called Margaret to ask her to lunch. The economist Sam Bowles had told him that Margaret knew something about Marxism, which offered perhaps a way to begin thinking about the problems he sought to contemplate. Doug had studied Marx at Berkeley years earlier but needed a refresher. His conversations with Margaret soon morphed into their teaching a joint undergraduate seminar annually for almost a decade. Among the results were

Structure and Change in Economic History by Doug (North 1981) and *Of Rule and Revenue* by Margaret (Levi 1981, 1988).

Simultaneously, Doug was gleaning all he could from economics colleagues about new ideas in industrial organization, contracting, property rights, and transaction costs, especially from Yoram Barzel and Steve Cheung, among others. Indeed, one of Doug's hallmarks was to value a university environment for what it offered in ideas. He spent his academic career at places where he could best gather new tools and new concepts. The emblems of status – such as parking spaces, offices, or money – were far from his highest priority. When he recognized his need for new tools and ideas, he left the University of Washington and moved to Washington University in St. Louis where the political scientists offered the possibility of the ideas he needed as he continued, tirelessly, to search for the pieces for his puzzles. Doug's defining characteristics included his ability to focus on asking the big questions and his willingness to explore multiple disciplines to help him find clues to their solutions; this focus made him one of the most exciting intellects of his day.

Of equal importance was his extraordinary capacity as an organizer and a galvanizer. He built teams, groups of scholars with whom he interacted, learned from, and inspired. These teams promoted participant's work as well as his own; he got others excited about ideas he was exploring and made them recognize the value of their contributions to solving key puzzles. Doug was also a great friend, solicitous, caring, and kind. He combined the two sides of his personality in his team-building. He believed all team members, and not least he, would

benefit from the knowledge shared and the arguments about what we really know (or even can know). He asked questions, he challenged, he spared no feelings, but in the end all became smarter. These teams also improved everyone's work.

Elisabeth Case

Understanding Doug's success, especially in the second half of his career, requires an understanding of the important role of Elisabeth Case, his second wife and partner until he died. They married in 1972.

In partnership with Elisabeth, Doug grew as a person and a scholar. Elisabeth had been an editor at Michigan University Press and then at Cambridge University Press, which is where they met. As a result of her influence, indeed direct intervention, Doug's writing improved significantly. So, too, did his team-building skills. She enhanced his emotional intelligence, and she intervened when he became too curmudgeonly. He came to understand how teams did better when the partners were cooperative. Perhaps, as significantly, Elisabeth made Doug realize the importance of norms and ideology in understanding human behavior.

Modeling economic and political development

Doug was, for most of his research life, concerned with understanding the sources of economic growth and development, and he increasingly became interested in political development as well. With each book and project, he discovered new pieces of the puzzle—and discovered as well the pieces he once thought fit that really did not.

The theory of the state

“The existence of the state is essential for economic growth; the state, however, is the source of manmade economic failure” (1981, 20). North, unlike most economists, recognized that government had a positive influence on human interactions. He accepted that rules and regulations could at times represent a dead weight loss for society, but he wanted to know how often, under what conditions, and in what kinds of context that was true.² The economists’ myth of the invisible hand proved insufficient to understand the state³: one had to do more than assume a set of institutions that provided property rights and security. A satisfactory explanation of the variation—in place and time—of the wealth of nations required an actual theory of the state.

Doug’s first effort was “a neo-classical theory of the state” (North 1981, ch. 3), which focused on the state as the provider and enforcer of property rights. The state North described maximized revenue; it was predatory but bloodless. He recognized that maintaining rule was often costly and involved coercion, especially against those groups who use violence to enhance bargaining power, the only form of power North acknowledged at this point. Later, in *Institutions, Institutional Change, and Economic Performance*, he introduced a more nuanced view, “...if the state has coercive force, then those who run the state will use that force in their own interest at the expense of the rest of the society” (North 1990,

² Along with his coauthor, John Wallis, North pioneered the measurement of transactions cost (Wallis and North 1986).

³ Economists since Friedman (1976) and Samuelson (1949) associate the invisible hand metaphor with Adam Smith who used it once in three of his works. Today, many Smith scholars argue that Smith’s use of this metaphor was far narrower than idea associated with it by most modern economists. See, for example, Kennedy (2017, ch. 5) and Liu (2018, ch 4).

59).⁴ Nor were violence, ideas, and class conflict featured in his explanation of institutional change. The principal exogenous variables remained changes in relative prices, including technological and demographic factors.

Not until his book with Wallis and Weingast (NWW), *Violence and Social Orders* (North et al. 2009), did North resolve the contradiction inherent in *Structure and Change*: the state is simultaneously the propagator and the subject of violence, a topic to which we return below.

North learned—as he always did. The limits of the neoclassical approach to the state became apparent to Doug even as he wrote the book. While he had touched on norms, beliefs, and culture in *Structure and Change* and introduced a first stab at the concept of ideology that might resolve free rider problems, he began to seek a framework that would encompass all those elements. That led him in several directions in the 1990s: first to refine his model of institutions, the next book (North 1990), and then to cognitive science as a way to understand the sources of knowledge, beliefs, and ideology (Denzau and North 1994; North 1996 [1993], 2005).

Doug also began focusing on dynamics: how and why polities and economies change over time. In the mid-1990s, Doug set out his agenda by proposing “five propositions of institutional change” (North 1995):

1. The continuous interaction between institutions and organizations in the economic setting of scarcity and hence competition is the key to institutional change.

2. Competition forces organizations to continually invest in skills and knowledge to survive. The kinds of skills and knowledge individuals and their

⁴ For a critique of North’s view of power, especially in his earlier works, see Moe 2005.

organizations acquire will shape evolving perceptions about opportunities and hence choices that will incrementally alter institutions.

3. The institutional framework provides the incentives that dictate the kinds of skills and knowledge perceived to have the maximum pay-off.

4. Perceptions are derived from the mental constructs of the players.

5. The economies of scope, complementarities, and network externalities of an institutional matrix make institutional change overwhelmingly incremental and path dependent.

In this work, Doug sought to integrate organizations, institutions, competition, incentives, mental models of the players, and change over time. As Doug recognized, the five propositions point the direction of an understanding of economic and political change, but they do not add up to a satisfactory theory.

Doug reported that after he got the Nobel Prize, governments would invite him to “play God,” as he called it; that is, to tell these governments how they could introduce new policies and institutions to create economic growth. He would advocate institutional improvements but also make clear that institutions require a set of supportive norms and beliefs. And that process was not a matter of a simple tweak or regulatory shift; a generation and its norms might have to die off. Another feature of these conversations, as Doug reported them, is that rulers and officials of the countries would invariably explain why Doug’s recommendations could not be implemented in their country!

The Glorious Revolution: Constitutionalism in 17th Century England

In the 1970s and 1980s, in part due to the dominance of the Public Choice School, most rational choice models of politics focused on inefficiency (see, for example, Brennan and Buchanan 1980, Stigler 1971, Tollison 1981, Tullock

1976). Interest groups and rent-seeking biased public policy away from efficient outcomes toward inefficient ones. This approach raises a major problem. If politics produced inefficient outcomes, how did markets arise in the first place so that politics could slowly but ineffably erode them? No one knew. Indeed, almost no one raised this question (but see Wittman 1986).

North, in collaboration with Weingast, proposed an answer. To foster markets and prevent government predation, the state had to make credible commitments to restrict its behavior, honoring both the procedures of government (such as a separation of powers system in which Parliament had exclusive control over taxation) and citizen rights (such as the right of *Habeas Corpus*).

Throughout the 17th century, the Stuart kings made a series of unilateral decisions without consulting Parliament, including raising taxes and ignoring laws passed by Parliament. Government predation was a major problem. When King James II ignored laws involving parliamentary elections (and his wife bore him a Catholic son) a large portion of the political nation rose against him, forcing him out in the Glorious Revolution of 1688-89. As part of the revolution, Parliament announced a set of rules that, if violated by the King, would cause another revolution. These rules included honoring laws of Parliament and not imposing new taxes without the consent of Parliament. North and Weingast argued that these small changes in the de facto rules had massive implications.

To see this, consider sovereign debt. Prior to the Glorious Revolution, loans were personal to the king. He could unilaterally alter the terms, and lenders

had no recourse to courts. Being rationally wary, lenders were reluctant to supply loans to the king; hence the king was credit-constrained.

After the Glorious Revolution, this changed. Loans became acts of Parliament, implying that the terms could be revised only by another act of Parliament. A king who attempted to alter the terms of a loan unilaterally would violate parliamentary legislation and, by the terms of the Revolution, risk a coup.⁵ This risk prevented kings after the Glorious Revolution from violating laws of Parliament. The government could now credibly commit to honoring loan agreements; no longer could the king unilaterally alter laws and debt agreements.⁶

The new ability to credibly commit produced striking results. Government debt rose by nearly an order of magnitude in nine years, from approximately £1 million at the Revolution to £16.7 million. Clearly, lenders believed their funds were far more secure following the Glorious Revolution than before.

Cognitive factors

As Doug brought political and normative factors to bear, he began to recognize the existence of earlier unnoted incentives and cognitions that sometimes inhibited change and sometimes facilitated it. Institutional and structural change reflected not only changes in relative prices, as economists

⁵ Locke, Montesquieu, and Adam Smith called this the “right of resistance”; the American founders built this principle into the Declaration of Independence: People are endowed “by their Creator with certain unalienable rights ... That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed, --That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government.”

⁶ Pincus and Robinson (2014) observe that these rules were always official; hence they were not new per se. Reflecting the new credible commitment, their holding in practice was new.

had conceived them. These changes were also an effect of embedded relationships that gave some greater bargaining power than others. Also important were worldviews or “mental models,” as Doug and Arthur Denzau called them. As people’s experience changed, so too did their mental models (Denzau and North 1994), in turn having the power to make new options viable and some older options no longer viable. So, Doug became obsessed with the conditions that made certain incentives, norms, and cognitions salient and with the relationships that subsequently enabled successful reorganization of societies. This work culminated in North’s, *Understanding the Process of Economic Change* (2005).

Dynamics of regime transformation: “Violence and Social Orders”

The question of what leads to regime change was a focus of *Structure and Change* (with seeds in earlier work) but culminated in his work with Wallis and Weingast (North et al. 2009).

Returning to the questions, why are so many countries poor, and why is development so difficult, North and his coauthors built a new approach based on the concept of violence. Violence is one of the biggest factors missing from economic development; although political scientists study violence, they tend to do so in specific contexts, such as coups, ethnic conflict, or civil wars, and do not generalize the implications of the different types of violence to a general theory of violence. An important aspect of violence, in NWW’s view, is that developing countries have multiple sources of violence.

All societies must solve the problem of violence in order to prosper. NWW theorize that most developing countries address violence in a particular manner; they create rents and dispense privileges to those individuals and groups with violence potential in a way that makes these groups better off than fighting. Failing to do so risks violence. But rents and privileges require manipulating the economy in a way that inhibits markets. In particular, rents require limits on access to organizations, hence limits on competition in both economics and politics. NWW therefore call these states *limited access orders*. NWW show that distributed violence potential accounts for many problems of development, such as the inability to maintain competitive markets or a legal system with the rule of law. This conclusion follows because, in developing societies, the state has to make those with violence potential better off than fighting; and doing so requires creating and distributing rents and privileges.

Economists studying limited access orders qua developing countries correctly observe the symptoms: manipulation of markets to create rents, creation of monopolies and other privileges, and, generally, “market-intervention.” Economists miss-diagnose the problem, however. The problem is not unproductive political intervention in markets that makes everyone worse off. Instead, the problem is violence; and rents and privileges serve a useful purpose, reducing violence. Missing the margin of violence, the so-called market-reform offered by economists and aid agencies typically fails because this reform necessarily involves dismantling the policies and institutions that prevent violence.

Because disorder is much worse than a stagnant developing country, most people resist economic reform. The path to development lies elsewhere.

Development, NWW argue, involves movement to what they call the “doorstep conditions” and then into the transition from a limited access order to an “open access order,” a state that allows every citizen access to organizations.⁷

Conclusion

Property rights, Transaction costs, institutions, credible commitments, beliefs, and cognitive illusions are all part of the solution to Doug’s puzzle about development, but he knew he was still missing an important piece. This came with the recognition of violence (and the power struggles on which it rests—although not a terminology he would use) as a problem successful states and economies must resolve. Doug was never satisfied with his existing framework; he restlessly searched for better and fuller explanations that would encompass the issues raised by his latest attempt. He wanted the next insight. Nonetheless, the big question was always the same, the one Adam Smith introduced in *The Wealth of Nations* (Smith 1993 [1976]): Why are some countries rich while most are poor?

Douglass North will long remain famous for his contributions to the new economic institutionalism, but here we emphasize his equally important contributions to understanding the dynamics of political change. In the process,

⁷ NWW explore these topics in chapters 4-6.

North transformed our thinking of how norms, beliefs, and violence sustain the privileges, advantages—and power—of some groups over others. He led the way in pointing to the forces and factors that produce new political, social, and economic relationships.

References

- Davis, Lance E., and Douglass C. North. 1971. *Institutional change and American economic growth*. Cambridge England: University Press.
- Denzau, Arthur T., and Douglass C. North. 1994. "Shared Mental Models: Ideologies and Institutions." *Kyklos* 47 (1):3-31.
- Friedman, Milton. 1977. "Adam Smith's Relevance for Today," *Challenge* 20, no. 1 (March 1, 1977).
- Kennedy, Gavin. 2017. *An Authentic Account of Adam Smith*. Palgrave, Macmillan.
- Levi, Margaret. 1988. *Of Rule and Revenue*. Berkeley: The University of California Press.
- Levi, Margaret, and Barry R. Weingast. 2015. "Douglass North Was a Visionary," *Monkey Cage, Washington Post*, December 9. <https://www.washingtonpost.com/news/monkey-cage/wp/2015/12/09/douglass-north-was-a-visionary/> Accessed, September 14, 2016.
- Liu, Glory M. 2017. *Inventing the Invisible Hand: Adam Smith in American Thought and Politics, 1780 – Present*. Unpublished Ph.D. Dissertation, Department of Political Science, Stanford University.
- Moe, Terry. 2005. "Power and Political Institutions." *Perspectives on Politics* 3 (2):219-33.
- North, Douglass C. 1961. *The Economic Growth of the United States, 1790-1860*. New York: W.W. Norton.
- . 1981. *Structure and Change in Economic History*. New York: Norton.
- . 1990. *Institutions, Institutional Change, and Economic Performance*. New York: Cambridge University Press.
- . 1995. "Five Propositions about Institutional Change" in Jack Knight and Itai Sened, eds., *Explaining Social Institutions*. Ann Arbor, Mich.: University of Michigan Press.
- . 1996 [1993]. "Economic Performance Through Time." In *Empirical Studies in Institutional Change*, ed. L. J. Alston, T. Eggertsson and D. C. North. New York: Cambridge University Press.
- . 2005. *Understanding the Process of Economic Change*. Princeton: Princeton Univ. Press.
- North, Douglass C., William Summerhill, and Barry R. Weingast. 2000. "Order, Disorder and Economic Change: Latin America vs. North America." In *Governing for*

- Prosperity*, ed. B. Bueno de Mesquita and H. Root. New Haven: Yale University Press.
- North, Douglass C., and Robert Paul Thomas. 1973. *The Rise and Decline of the Western World*. New York: Cambridge University Press.
- North, Douglass C., John Wallis, and Barry R. Weingast. 2009. *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History*. New York: Cambridge University Press.
- North, Douglass C., and Barry R. Weingast. 1989. "Constitutions and Commitment: " *Journal of Economic History*. 49(4): 803-32.
- Samuelson, Paul. 1948. *Economics: An Introductory Analysis*. New York: McGraw-Hill.
- Smith, Adam. 1976[1776]. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Indianapolis: Liberty Fund.
- Wallis, John Joseph. 2016. "The New Economic History and Beyond: the Scholarship of Douglass C. North," *Journal of Economic History* (forthcoming).
- Wallis, John Joseph and Douglass C. North, 1986. "Measuring the Transaction Sector in the American Economy, 1870-1970." In Stanley Engerman and Robert Gallman, eds., *Long Term Factors in American Economic Growth*, Studies in Income and Wealth, vol. 51, University of Chicago Press.