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Economics

The big questions
Douglass North, a pioneer in institutional economics, has died

Nov 25th 2015, 11:17 by R.A. | LONDON

ON MONDAY Douglass North died at the age of 95. Mr North was an American economic historian, who shared the Nobel prize (http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1993/) in economic science with Robert Fogel (http://www.economist.com/blogs/freeexchange/2013/06/economic-history) , another economic historian, in 1993. (Fogel died in 2013.)

Mr North's work tended to focus on the biggest questions in economics, namely, how it is that some countries in some places became rich while others remained poor. His research came to emphasise the role of institutions in shaping long-run economic outcomes. While the fact that institutions might matter in some ways was not previously lost on economists, Mr North brought a newly rigourous analysis to the study of institutional dynamics. He was a pioneer in the use of "cliometrics": that is, in the use of statistical analysis in economic history work (Clio is the muse of history). He is also considered a co-founder, with Ronald Coase (http://www.economist.com/news/finance-and-economics/21584966-ronald-coase-economist-who-explained-why-firms-exist-died-september-2nd) , of the New Institutional Economics school of thought.

Economics has long struggled to explain the persistence of poor economic performance in some parts of the world, and the neoclassical economic frameworks in use in the mid-20th century simply could not generate the desired result. As Mr North wrote (http://web.cenet.org.cn/upfile/100466.pdf) in 1971:

> The tools that the new economic historian inherited from the economist were not intended to deal with long-run economic change...The economist not only accepted tastes, technology, and population as given, but also he accepted equally the current basic ground rules within which both market and non-market decisions were made. For that matter, the theory did not recognise the possibility of making economic decisions via the political process. Information was assumed to be perfect and costless.

Mr North set about to construct a new way of thinking about economic interactions that *could* explain long-run economic divergence. Like his contemporary Coase, Mr North understood that the transaction costs and frictions of the real world ruled out ideal solutions. He then set about exploring the ways in which societies created institutions to help ameliorate the problems created by these imperfections. As trade expanded in the Middle Ages, traders found themselves in need of ways to overcome all sorts of market shortcomings: to determine who was creditworthy, whose goods were of high or poor quality, which merchants were good partners for risky trade voyages, and so on. Different societies developed different institutional approaches to managing these problems: like common merchant codes and repositories of records tracking traders (https://afinetheorem.wordpress.com/2015/11/24/douglass-north-an-economists-historian/) who ran afoul of it. Mr North studied the conditions under which such solutions might arise and be sustained (or lead to defections and collapse).

Institutions are persistent, he noted. Institutions developed as a response to one set of historical circumstances could inhibit development later on. Or encourage it; Mr North emphasised the role of Britain's Glorious Revolution (http://www.economist.com/blogs/freeexchange/2013/12/institutional-economics) in supporting British economic development. When Parliament conspired to replace King James II with William of Orange, that demonstrated the enhanced power of the legislature relative to the monarch, which in turn sent a credible signal that the monarch could be prevented in future from exproporiating private wealth in a time of fiscal need. That constraint, he reckoned, was crucial in asserting the rule of law and the security of private property, clearing the way for Britain's economic revolution.

Mr North's work did not lead to an outbreak of unanimity on the nature of long-run gaps in economic performance. That debate still rages. It did change the argument, however, to allow for the inclusion of hugely importance features of economic and political life. Our understanding of the way economies work is much richer for it.