

# Douglass North's Theory of Politics

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## ABSTRACT

Douglass C. North, co-winner of the Nobel Memorial Prize in Economics in 1993, 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.

**F**ew 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 the following four revolutions in economics and political economy:

- the new economic history
- the “property rights” revolution
- the new institutional economics
- cognitive science and behavioral economics

Even so, this list understates his influence. North began his career as an economist, and his first book, *The Economic Growth of the United States, 1790–1860* (North 1961), helped to launch the new economic history revolution. This book was among the first to bring massive amounts of data to questions of history. All of North's subsequent works involved understanding the choices made by states, most of which failed to produce growth.

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North's curiosity about 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 in Economic History* (North 1981), arguably his most important work. North's involvement with political scientists began with the conception and writing of this book. It led him to teach a seminar with Margaret Levi for many years at the University of Washington, Seattle. His move in 1983 to Washington

University, St. Louis, was partially motivated by his desire to engage further with political and other social scientists, including James Alt, Jean Ensminger, Jack Knight, Norman Schofield, Ken Shepsle, and Barry Weingast.

## NORTH AND POLITICAL SCIENCE

North's interest in political science reflected the same motivation that earlier led him to explorations of analyses of property rights and transaction costs and, later, cognitive science. He had a puzzle and to complete it, he needed more pieces than traditional economics provided. In his *Journal of Economic History* review of North's work and life, Wallis (2016) captured this exactly. He argued that, after mightily trying to stay within the confines of neoclassical economic theory to account for long-term institutional change in the books with Thomas (North and Thomas 1973) and Davis (Davis and North 1971), North 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 ultimately to Margaret Levi.

Almost all of his closest friends and collaborators have a story to tell of their initial interactions with North. Levi's began when she received a phone call as a new assistant professor at the University of Washington. North, who—again, as Wallis noted and to which we both attest—had a reputation as a curmudgeon, called to ask her to lunch. The economist Sam Bowles had told him that Levi knew something about Marxism, which offered perhaps a way to begin thinking about the problems he sought to contemplate. North had studied Marx at Berkeley years earlier but needed a refresher. His conversations with Levi 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 North (1981) and *Of Rule and Revenue* by Levi (1988; also see Levi 1981).

Simultaneously, North was gleaming 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 North'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—parking spaces, offices, and money—were far from his

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highest priority. When he recognized his need for new tools and ideas, he left the University of Washington and moved to Washington University, where the political scientists offered the possibility of the ideas he needed as he continued, tirelessly, to search for his puzzle pieces. North'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.

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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 participants' 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. North was also a great friend: solicitous, caring, and kind. He combined the two sides of his personality in his team building. He believed that all team members—and not least himself—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 North'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 Case, North grew as a person and a scholar. She had been an editor at University of Michigan Press and then at Cambridge University Press, which is where they met. As a result of her influence—indeed, direct intervention—North's writing improved significantly. So, too, did his team-building skills. She enhanced his emotional intelligence and intervened when he became too curmudgeonly. He came to understand how teams did better when the partners were cooperative. Perhaps as significant, Case made North realize the importance of norms and ideology in understanding human behavior.

#### MODELING ECONOMIC AND POLITICAL DEVELOPMENT

For most of his research life, North was 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 also discovered the pieces he once thought fit that really did not.

#### THE THEORY OF THE STATE

In his seminal *Structure and Change in Economic History* (North 1981), he recognized, unlike most economists, that government had a positive influence on human interactions. He accepted that rules and regulations could sometimes represent a dead-weight

loss for society, but he wanted to know how often, under what conditions, and in what kinds of context that this was true.<sup>1</sup> The economists' myth of the "invisible hand" proved insufficient to understand the state<sup>2</sup>: 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.

North's first effort was "a neo-classical theory of the state" (1981, ch. 3), which focused on the state as the provider and enforcer of

property rights. However, North went beyond the property-rights formulation in his earlier book with Thomas (North and Thomas 1973). He emphasized the importance of transaction costs such as bargaining, measurement, and monitoring. When transaction costs are high, efficient and welfare-enhancing outcomes can be achieved only with the aid of institutions. This is where the state comes in; it holds the potential to reduce transaction costs by coordinating interests. Simultaneously, however, it also can raise transaction costs by imposing new forms of regulation and non-compliance that demand detection and enforcement. North famously claimed (North 1981, 20) that "The existence of the state is essential for economic growth; the state, however, is the source of manmade economic failure."

The state that 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 used violence to enhance bargaining power—the only form of power that 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, 59).<sup>3</sup> Violence, ideas, and class conflict were inadequately attended to in his explanation of institutional change. The principal exogenous variables remained changes in relative prices, including technological and demographic factors.

However, it is not until his book with Wallis and Weingast (NWW), *Violence and Social Orders* (North, Wallis, and Weingast 2009), that North resolved the contradiction inherent in *Structure and Change* (North 1981): the state is simultaneously the propagator and the subject of violence. NWW's approach to violence is discussed further below.

North learned—as he always did. The limits of the neoclassical approach to the state became apparent to him even as he wrote the book. Although he had touched on norms, beliefs, and culture in *Structure and Change* (North 1981) 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 of those elements. That led him in several directions in the 1990s: first to refine his model of institutions in *Institutions, Institutional Change, and Economic Performance* (1990), and then to cognitive science as a way to understand the sources of knowledge, beliefs, and ideology (Denzau and North 1994; North [1993] 1996, 2005).

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

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

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3. The institutional framework provides the incentives that dictate the kinds of skills and knowledge perceived to have the maximum payoff.
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 (North 1995).

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

North reported that after he received the Nobel Prize, governments invited 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 advocated institutional improvements but also made 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 North reported them, was that rulers and officials of the countries invariably explained why North’s recommendations could not be implemented in their country!

#### **THE GLORIOUS REVOLUTION: CONSTITUTIONALISM IN SEVENTEENTH-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 (Brennan and Buchanan 1980; Stigler 1970; Ekelund and Tollison 1981; Tullock 1986). 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 ineffectually erode them? No one knew. Indeed, almost no one raised this question (but see Wittman 2006).

North, in collaboration with Weingast (North and Weingast 1989), 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 (e.g., a separation of powers system in which Parliament had exclusive control over taxation) and citizen rights (e.g., the right of *habeas corpus*).

Throughout the seventeenth 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), much 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 new 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 its consent. North and Weingast argued that these small changes in the de facto rules had massive implications.

To understand this, consider sovereign debt. Before 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 Glorious Revolution, risk a coup.<sup>4</sup> This risk prevented kings after the revolution from violating laws of Parliament. The government now could credibly commit to honoring loan agreements; no longer could the king unilaterally alter laws and debt agreements.<sup>5</sup>

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 beginning of the Glorious Revolution to £16.7 million. Clearly, lenders believed their funds were far more secure following the Glorious Revolution than before.

#### **COGNITIVE FACTORS**

As North 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 had conceived them, but also were an effect of embedded relationships that gave some individuals and groups greater bargaining power than others. Also important were worldviews or “mental models,” as Denzau and North (1994) called them. As people’s experience changed, so too did their mental models, in turn having the power to make new options viable and some older options no longer viable. So, North 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 2005 *Understanding the Process of Economic Change*.

#### 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 North's work with Wallis and Weingast (North, Wallis, and Weingast 2009).

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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 (e.g., coups, ethnic conflict, and civil wars) and do not generalize the implications of the different types to a general theory of violence that explains its economic implications. 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 to prosper. NWW theorized 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 those groups better off than fighting. Failing to do so risks violence. However, rents and privileges require manipulating the economy in a way that inhibits markets. In particular, they require limits on access to organizations and, therefore, limits on competition in both economics and politics. Hence, NWW called these states *limited-access orders*. NWW showed 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 misdiagnose 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 productive 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 argued, involves movement to what they called the "doorstep conditions" and then into the transition from

a limited-access order to an "open-access order"—that is, a state that allows every citizen access to organizations.<sup>6</sup>

#### CONCLUSION

Property rights, transaction costs, institutions, credible commitments, beliefs, and cognitive illusions are all part of the solution to North'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. North 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 *An Inquiry into the Nature and Causes of the Wealth of Nations* (Smith [1776] 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 this article emphasizes his equally important contributions to understanding the dynamics of political change. In the process, 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. ■

#### NOTES

1. Along with his coauthor, John Wallis, North pioneered the measurement of transactions cost (Wallis and North 1986).
2. Economists since Friedman (1977) and Samuelson (1948) associate the "invisible hand" metaphor with Adam Smith, who used it once in three of his works. Today, many Smith scholars argue that his use of this metaphor was far narrower than ideas associated with it by most modern economists. See, for example, Kennedy (2017, ch. 5) and Liu (2017 ch. 4).
3. For a critique of North's view of power, especially in his earlier works, see Moe (2005).
4. 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."
5. Pincus and Robinson (2014) observed that these rules were always official; hence, they were not new per se. Reflecting the new credible commitment, their holding in practice was new.
6. NWW (2009) explored these topics in chapters 4–6.

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