

Mike Fitzhugh
March 13, 2008
CNISS seminar

Historians and the New Institutional Social Sciences

For too long now, most historians have seen their theoretical choices as limited to either the postmodernism associated with the rise of the new cultural history during the 1980s and 90s, or to nothing. However, there is an excellent alternative in what is being called the "new institutional social sciences." Spearheaded by Nobel Laureate Douglass C. North, the new institutional approach to the social sciences takes neoclassical economics as its core but refuses to fall prey to the reductive predictions that beset the mechanical application of Adam Smith's ideas. Outside economics, it has garnered widespread support in political science and is attracting followers in anthropology and sociology as well. It offers an especially attractive theoretical route to the historian because it emphasizes history as a crucial component.

[THE FOLLOWING PARAGRAPH IS BASED ON VAGUE MEMORIES FROM MY SUMMER CNISS SEMINARS OF TWO YEARS AGO -- I NEED HELP REFINING IT:]

Non-economists are fond of dismissing economics as pretentious and unable to live up to its claims, but the fact is that under certain conditions, it yields not merely powerful explanations but also accurate predictions. [I NEED REAL-WORLD EXAMPLES, NOT THEORETICAL ONES. CITATIONS?] It remains the only body of well developed social-science theory that practitioners have been able to validate with game-theoretical experiments involving real actors.

[AGAIN, I NEED EXAMPLES OR CITATIONS.]

It is odd, to say the least, that English-speaking historians should have assiduously paid court to French philosophers during the very decades in which a home-grown Nobel laureate has been sweeping the boards in economics and political science with theoretical work explicitly

invoking history as a major component. The first theoretically sophisticated book North wrote that should have appealed to a wide swath of historians was 1981's *Structure and Change in Economic History*, which was followed by *Institutions, Institutional Change and Economic Performance* (1990) and *Understanding the Process of Economic Change* (2005). The "economic" label in these titles is not inaccurate but is misleadingly narrow; the books lay out nothing less than the broad outlines of a general theory of sociopolitical change, including within its scope "the political and economic institutions, technology, demography, and etiology of a society" (3). The name of North's work in progress, forthcoming in 2009 with two co-authors, is more revealing and should make historians take notice: *A Conceptual Framework for Interpreting Human History*. To his sometimes ahistorical colleagues in the social sciences North proclaims, "History matters" (*Institutions* VII). Under his prompting, social scientists involved in the institutionalist movement are increasingly using historical arguments and examples; should not historians be on hand to correct the inevitable mistakes of the non-specialist? We are the scholars best qualified to disqualify political and economic arguments based on overly schematic understandings of historical trends and events.

A convenient entrance into North's work is his model of the state, which incorporates important insights from traditional economics but supersedes those to offer a schema conducive to explaining change -- the major task of the historian but for which received economic theory is ill-suited (this is surely part of the reason for which economic history has become a backwater of our profession). "[T]he long path of historical research is strewn with the bones of theories of the state developed by historians and political scientists," North notes before offering his own (*Structure* 20). It is not an auspicious beginning, especially when those very historians have mostly turned their backs on the economic ideas forming the heart of North's

work, but in the two subsequent decades a great number of political scientists as well as economists have accepted his ideas as a fruitful starting point [NEED EXAMPLES -- HELP?] Historians might profitably follow suit.

For North, "a state is an organization with a comparative advantage in violence, extending over a geographic area whose boundaries are determined by its power to tax constituents." Following from this definition is the implication, usually ignored in "the literature of political science, sociology, and anthropology," that the state uses its power "to gain control over resources." Of crucial importance in this analysis is an emphasis on property rights, "the rights individuals [strive to] appropriate over their own labor and the goods and services they possess." A ruler, with initial control over resources, "is in the position to specify and enforce property rights" (Structure 21). Rulers negotiate bargains with different groups of constituents, allocating resources differentially according to the bargaining power of the various groups. A ruler may be somewhat constrained, however, by what economists call the "opportunity cost" of constituents: if people have a better opportunity (however defined), such as an alternative choice of ruler, they pay a high metaphorical price to live under the current ruler. If that price becomes so high that they are willing to undergo substantial risks to alter their circumstances, the ruler in turn faces risk. Or the reverse may obtain: if the ruler's "violence potential" increases and the constituents lack other political opportunities close to hand, the ruler's risk decreases. In either situation, or others like them, the initial specification of property rights is likely to change as a result of renegotiation (Institutions 48-9, Structure 22-30).

North goes so far as to insist, "One cannot develop a useful analysis of the state divorced from property rights" (Structure 21). This may seem extreme to historians trained to avoid absolute assertions, but it has found wide acceptance in political science, the discipline whose

very domain is the state. In addition, no historian can afford to ignore North's argument that "the mix between the formal protection of rights and individual attempts to capture rights varies enormously. We have only to compare property rights in Beirut in the 1980s with those of a modern small-town US community to cover the spectrum." Whether they are nonexistent, enforced effectively, or anywhere between those two poles, the effect of property rights on human life wherever it exists, and thus on human history in all its manifestations -- intellectual, cultural, and artistic as well as the more obviously sociopolitical -- is likely to be profound and, indeed, fundamental. And historians weaned on the new cultural history's attention to the margins should find quite congenial North's observation that "the essence of property rights is the right to exclude" (Structure 21).

By no means does this equate to a reductive Marxian-style economic analysis of base and superstructure. Property rights, under North's definition, exist even in more politically egalitarian hunter-gatherer societies, although they are usually not economically efficient because of what economists call "transaction costs." These are burdens not apparent in traditional economic analyses based on formal prices for goods; the concept of transaction costs is fairly recent, dating from the 1970s. Transaction costs account for two major factors in economic exchange that had previously been ignored: first, the fact of imperfect information and the effort required to obtain what information does happen to be available (i.e. measurement), and second, the effort required to enforce property rights (Institutions 24, Structure 18-19).

To establish the value of a commodity, it must be measured, but measurement is much more complicated than one might think. The service provided by doctors, for example, includes not just medical expertise but also "bedside manner and time spent waiting in their offices... It takes resources to measure these attributes and additional resources to define and measure the

rights that are transferred," and measurement is in fact "too costly to be comprehensive or fully accurate" even when complete information is available -- and it usually isn't. Most of the time "there are asymmetries of information among the [parties]"; there is currently no standard of professional measurement whatsoever for a doctor's bedside manner or office waiting time, and even though the medical license on the wall testifies to a certain amount of competence, doctors know a great deal more about their individual -- and varying -- levels of skill than even their longtime patients. Aside from the word of the AMA, word of mouth is usually the only measurement technique available to prospective patients -- and word of mouth, while often helpful, is far from perfect. In many transactions the case is even worse, since not only does one participant no more than the other, but "he or she may stand to gain by concealing that information. According to a strictly wealth-maximizing behavioral assumption, a party to exchange will cheat, steal, or lie when the payoff to such activity exceeds the value of alternative opportunities available to the party" (Institutions 29-30).

Because of the difficulties of measuring in a world of asymmetrical information, enforcement becomes a tricky business: if you cannot measure accurately in the first place, cheating or stealing can only be identified imperfectly. Thus, there are significant risks associated with economic exchange, and "the transaction cost will reflect the uncertainty by including a risk premium." Such premiums decrease as accurate information increases, but "throughout history the size of this premium has largely foreclosed complex exchange and therefore limited the possibilities of economic growth."

These concepts are not limited to the sphere of economics. They apply just as well to politics, to the negotiation and a renegotiation of bargains over resources between rulers and constituent groups, as political scientist Itai Sened has recently argued (The Political Institution

of Private Property 4). [ANY IDEAS ON HOW TO BEEF UP THIS POINT? MORE POLITICAL-SCIENCE CITATIONS?]

However, while he goes beyond the traditional economist's attitude toward the state, North admits that his model remains deficient because it retains consistency with neoclassical economics by assuming a kind of institutional Darwinism: competition dictates that ineffective political systems should perish, ultimately leaving only "the efficient institution, policy, or individual action," no matter what people believe about the world around them. "False' theories that lead to inefficient consequences would lead to the demise of those groups relative to [other groups] with theories that produced more efficient results." It is patently clear, however, that "[economically] inefficient forms of political structure do persist for long periods of time.... human culture produces diverse, conflicting, and in efficient solutions." This makes it important for economists to study beliefs after all, since scholars can assume that peoples' "different perceptions of reality [and] different theories to account for the world around them" are what result in the "different and conflicting policies they pursue" (Structure 7).

Another shortcoming of the neoclassically-based model is the inability to resolve the "free-rider dilemma" (Structure 32). If people act solely in their own individual self-interest, then no individual worker should strike or riot; he or she "would sit back and let someone else do it.... In essence, rational individuals will not incur the costs of participating in large group action when the individual benefits can still be received by being a free rider." This result does obtain in many well-documented cases. Nevertheless, there are also "an immense number of cases where large group action does occur and is a fundamental force for change...which...is simply inexplicable in neoclassical terms" (10). Anti-government riots do occur; people do volunteer to work in soup kitchens. To help resolve this puzzle, North turns to ideology -- long the province

of historians proper. Noting that in a world operating wholly by the principles of neoclassical economics "no society would be viable" (11), he asserts that ideologies usually justify or challenge the status quo; either way, the purpose of an ideology is to persuade individuals to ignore their more fundamental "calculus of costs and benefits" and instead act in ways encouraged by the ideology (53-4). Ideologies are especially effective, North postulates, when the cost of acting upon their prescriptions is low (for example, in the absence of extreme penalties such as prison or execution), but since examples abound of people risking such penalties by undertaking ideologically-based activities, the force of belief is clearly not limited to what might be thought of as cost-effective scenarios (56-7, 54).

North proposes integrating beliefs with his modified economic ideas by examining what he calls "institutions." He does not mean organizations but instead much of what anthropologists mean by "culture": "the rules of the game in a society," "the humanly devised constraints that shape human interaction." Institutions act to solve the problem posed by the asymmetry of information, "reduc[ing] uncertainty by providing a structure to everyday life" (Institutions 3). Institutions can be formalized in the rules or laws, or remain in formal "conventions and codes of behavior" (4); either way, they are instantiations of ideologies and even the broader psychological frameworks that the Annales historians called "mentalities." In political and social terms, institutions greatly influence both the kind of organizations (political and otherwise) that emerge in a society and how those organizations develop; in turn, organizations also influence how institutions evolve. Organizations are deliberately created in response to "the opportunity set resulting from the existing set of constraints (institutional ones as well as the traditional ones of economic theory)." In their turn, as they struggle to achieve their goals, organizations also change institutions (Institutions 5).

But the old is as much a part of this picture as the new. Every historian knows that change is rooted in continuity and proceeds one stepping-stone after another across the stream of time; when we think we see radical discontinuities or utterly unprecedented phenomena, it is usually because we lack relevant data (rapid change does not at all necessitate the introduction of completely new elements; on this, see also *Institutions* 89-90). To account for continuity in change, North introduces the concept of "path dependence" (which incidentally allows him to better solve the problem of inefficient states and structures persisting for long periods of time). "The present and future are connected to the past by the continuity of a society's institutions," he insists (*Institutions* VII). Even organizations agitating for large-scale institutional change are embedded in the "interdependent web of an institutional matrix" which makes dramatic change difficult for various reasons: "large initial setup costs" have established the status quo and a similarly large outlay, in either economic resources or (in extreme cases) human blood, would be required; the free-rider problem militates against paying such costs. Similarly, most organizations will have learned to work within the current institutional framework and would have to reorient or even reinvent themselves in cases of massive change, arousing the very uncertainty that institutions exist to reduce. Even if an organization wishes to pay that price, other organizations will not, and to continue interacting with the latter, the former may be forced to continue using techniques, practices, behaviors, and so forth that they wish to leave behind (*Institutions* 95). No wonder continuity is a concomitant of change -- an aspect of history that the so-called "linguistic turn," with its general emphasis on radical otherness, has never confronted satisfactorily. In the institutional framework, "very imperfect feedback" and "ideology" -- in sum, "the historically derived perceptions of the actors" -- "will shape the path" followed by change.

And who better to trace such changes than historians? Some of us may shrug at these ideas, considering them self-evident; others may consider institutionalism too schematic (although this conclusion should emphatically not be reached merely on the basis of my an adequate description). But even if the theory seems merely truistic on the one hand or overly deterministic on the other, the object of the new institutional research program is neither. The economists and political scientists promoting it do so because they are trying to better understand human society in order to better the human condition, especially in developing countries; they are active as advisers and consultants to governments in Asia, Latin America, and Africa (by invitation, not because of imperialistic ambition). By making mistakes, they have learned that the effects of path dependence make it crucial for would-be advisers to understand a country's history. In addition, they see history as a mine of data with which to refine and sharpen institutionalist theory, and they realize that their own desultory reading in history is no substitute for the expertise of specifically trained historians (personal communication, a tight Senate, May 2006, and talk, North, "Interpreting Human History," November 2007). They would welcome our efforts should we choose to begin working alongside them. And we should not fear that their presentist concerns would contaminate our scholarship. The institutionalist concept of path dependence encourages as accurate a picture of the past as possible so as to reduce the asymmetry of information when offering advice to governments, advice that could cause a great deal of suffering instead of the intended amelioration.

In short, the new institutional social sciences are offering historians a chance to be relevant, to do work with direct policy ramifications but without distorting presentist pressure. We should not refuse. We can both benefit from and contribute to this research program. Interested historians need not worry that unfamiliarity with the bewildering mathematics now

prevalent in economics and political science is a bar to participation; I hope that this dissertation furnishes a modest example of how historians could use the rhetorical toolbox of cultural history alongside the new-institutional paradigm from the social sciences. At the same time, I also question some arguments made by North himself, attempting to help refine a few aspects of the new institutional framework. Historians can and should be full-fledged partners in the endeavors of the new institutional social sciences.