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From Property Rights and Institutions, to Beliefs and Social Orders: Revisiting Douglass North's Approach to Development

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ABSTRACT

Douglass North is a uniquely creative and inspiring social scientist. The impact of North's ideas in the area development cooperation can hardly be overstated. By stressing the role of institutions, this scholar has immensely influenced development thinking and practice, providing intellectual underpinnings to the dominant good governance paradigm. North's landmark *Institutions, Institutional Change and Economic Performance* is one of the most cited books in the social sciences. This paper contends, however, that North's ideas are widely cited, but not always properly understood. Moreover, some of his core arguments have been overlooked, ignored, or misrepresented, not least by the aid community. This paper provides a systematic assessment of the content and evolution of North's writings, from his pioneering works on property rights and institutions in the 1970s, to his recent scholarship on beliefs and political violence. The focus is on identifying the key analytical problems and remaining challenges of the institutional approach to development. The paper also takes issue with the inconsistencies and policy gaps of the good governance consensus. In doing so, it also reflects upon the future of the research program on institutions and development. Would the renewed emphasis on politics, conflict, inequality, and context lead to an improved governance agenda or to a shift towards a post-institutionalist paradigm?

RÉSUMÉ

Douglass North est un sociologue éminemment créatif et passionnant. L'impact de ses idées dans le domaine de la coopération au développement est sans pareil. En mettant l'accent sur le rôle des institutions, ce chercheur a considérablement influencé la pensée et les pratiques relatives au développement, et il a jeté les bases intellectuelles du paradigme de la bonne gouvernance, actuellement dominant. Le livre-événement de North, *Institutions, Institutional Change and Economic Performance*, est l'un des livres les plus cités en sciences sociales. Cependant, le présent texte soutient que les idées de North sont abondamment citées, mais pas toujours comprises correctement. En outre, certains de ses principaux arguments ont été négligés, ignorés ou déformés, en particulier par la communauté humanitaire. Le présent texte propose une évaluation systématique du contenu et de l'évolution des écrits de North, de ses œuvres pionnières des années 1970 sur les droits de propriété et les institutions à ses travaux de recherche récents sur les croyances et la violence politique. Nous insistons sur l'identification des problèmes analytiques cruciaux et des défis qui restent à relever dans l'approche institutionnelle du développement. Ce texte aborde également les incohérences théoriques et les failles dans la mise en œuvre du consensus sur la bonne gouvernance. Ce faisant, il développe également une réflexion sur l'avenir du programme de recherche sur les institutions et le développement. Le fait de mettre à nouveau l'accent sur la politique, les conflits, les inégalités et les contextes pourrait-il améliorer l'agenda de gouvernance ou entraînera-t-il un glissement vers un paradigme post-institutionnaliste ?

1. INTRODUCTION

'If I have seen further it is by standing on the shoulders of Giants' (Newton, 1675-6)

'Virtually every major development strategy of the last 50 years is associated with some pioneering research that provided its intellectual underpinnings' (Rodrik, 2010: 33)

Douglass North is one of the most creative and influential contemporary social scientists. The 1993 Nobel Prize for Economics is a unique thinker. Remarkably for an economist, his major works do not include formal assumptions and hypotheses, mathematical models, and quantitative tests.¹ Yet they are full of novel and inspiring ideas. Indeed, his ability to ask new questions, develop original insights, walk across disciplinary boundaries, and move forward the research frontier is second to none. North's ideas have had a massive influence in both economics and political science, contributing to the birth of the new economic history (Myhrman and Weingast, 1994), the rise of new institutional economics (Menard and Shirley, 2005), the reemergence of political economy (Ordeshook, 1990; Banks and Hanushek, 1995), and the economic turn in comparative politics (Levi, 2000).² By stressing the role of institutions, North has also made a substantive and lasting contribution to development studies. This scholar, together with Mancur Olson (1996), has provided the intellectual underpinnings of the dominant good governance agenda (Knack, 2003).

North's landmark *Institutions, Institutional Change and Economic Performance* is one of the most cited books in the social sciences. As of 18 October 2011, this book has more than twenty thousand Google Scholar citations (20,887). This astonishing figure speaks volumes about the diffusion of North's ideas. North's classic text has been more cited than other seminal works in the new institutional economics, including Ronald Coase's 'The Nature of the Firm' (18,506), Oliver Williamson's 'Markets and Hierarchies' (16,019), and Elinor Ostrom's *Governing the Commons* (9,953). It has been also consistently more cited than other classic works such as Smith's *Wealth of Nations* (11,201), Marx's *Eighteenth Brumaire of Louis Bonaparte* (2,529), Keynes's *General Theory* (14,926), Weber's *The Protestant Ethic* (12,043), and Schumpeter's *Capitalism, Socialism and Democracy* (14,950). In addition, North's *Institutions* has attracted more attention than other popular contemporary works such as Downs's *Economic Theory of Democracy* (16,420), Gramsci's *Prison's Notebooks* (10,980), Dahl's *Preface to Democratic Theory* (2,775), Putman's *Making Democracy Work* (15,507), Giddens' *Modernity and Self-Identity* (15,706), and Sen's *Development as Freedom* (11,788). Only books such as Mancur Olson's *The Logic of Collective Action* (20,498), Michel Foucault's *Discipline and Punish* (19,720), and Benedict Anderson's *Imagined Communities* (23,960) are in North's league. We are confident that any alternative citation analysis would confirm the wide diffusion of North's insights about institutions across the social sciences in general and development studies in particular.

The central contention of this article is, however, that North's ideas have been widely cited, but not always properly understood. In a recent review of the contributions of Douglass North to the new institutional economics, Claude Menard and Mary Shirley (2010: 21) suggested that in the process of acceptance and adaptation of Northean institutional analysis

[1] This statement does not apply to his early writings on American and European history, which indeed involved the application of economic models and methodologies to the study of economic history. See, for example, North's (1968) highly original account of productivity changes in ocean shipping.

[2] North's ideas have also impacted on anthropology, sociology, public policy, management (notably in the sub-field of industrial organization), and law (notably in the subfield of law and economics).

some of North's core tenants have been 'ignored, distorted, or misrepresented', most notably by the aid community. This may be an example of a broader pattern. As Dani Rodrik (2010) argued, every major development strategies in the last decades have been associated with some pivotal intellectual development, including the contemporary emphasis on improved governance, which has been heavily grounded in North's seminal works on institutions. But Rodrik also argued that there is always a significant gap between the original ideas of the founding fathers, on the one hand, and the caricatured versions of them proposed by applied economists and policy advisors, on the other.³ In Rodrik's (2010: 35, emphasis added) words:

"The original researchers who instigated each of these strategies were themselves quite aware...of the nuances of their arguments and the specificities of their policy proposals. The bigger surprise is that there is often only a tenuous relationship between these works and the caricatured message for which they often stand as a short cut reference".

In order to bridge the gap between North's original ideas and its caricatured version, this essay provides a critical assessment of both the content and trajectory of the Northean approach to economic development. The proposition that institutions, understood as the rules of the game constraining human interaction, do matter is often taken as uncontroversial. Yet the 'institutions rule' thesis should not be taken at face value. A closer inspection of North's writings reveals that the conceptualization of institutions, let alone its operationalisation and measurement, is more contested than commonly assumed. The relationship between institutions and outcomes is also problematic given the pervasive influence of informal constraints, imperfect enforcement and subjective mental models. In addition, the two main claims of new institutionalism (that institutions do matter and that institutions are endogenous) are difficult to reconcile (Przeworski, 2004). Moreover, we still lack a proper understanding of how the good institutions that would foster development emerge and evolve over time (Mantzavinos, 2001; Eggertsson, 2005). In light of these uncertainties, the policy lessons of neo-institutional economics are not obvious. As North himself recognizes in various works, institutional reforms do not always lead to better development outcomes; on the contrary, transplanting institutions can be a recipe for disaster (North, 2005).

Since the times of Adam Smith, political economists have sought to make sense of the overwhelming diversity in nations' economic fortunes. Despite some advances, there is still much we don't know about the 'mystery of economic growth' (Helpman, 2004). Why are some countries rich and others poor? What explains the huge variations in long-term economic performance across countries and within countries through time? Why have some countries managed to grow rapidly in the postwar era while others stagnated or shrunk? In the last decades, scholars have built upon the ideas of Douglass North to answer these ever-important questions.

To some extent, this research program has been successful. North has given scholars useful analytical tools for uncovering some of the institutional and political sources of poverty and prosperity. However, new institutional economics still confronts serious challenges. By systematically analyzing the evolution of North's thinking, this article points out the analytical, methodological and policy gaps of the institutional approach to development. In doing so, it offers a more nuanced account of the institutional and political underpinnings of peace and

[3] On the interesting but problematic relationship between academic research, development doctrine and actual policy, see Thorbecke (2006).

prosperity.

The paper is structured as follows. Section two outlines the evolution of North's ideas, from his pioneering writings on economic history to its recent collaborative research on violence. In section three we stress the key analytical lessons of the Northean approach that often remain unaccounted for. Section four focuses on empirical and methodological issues. The following section discusses some policy implications in relation to the dominant good governance paradigm. We conclude by reflecting on the future of the research program on institutions and development.

2. THE EVOLUTION OF NORTH'S IDEAS: A TOUR DE FORCE

'Doug is a walking, talking, Kuhnian scientific revolution' (Wallis, 2010)

North's intellectual trajectory has been motivated by one of the oldest but elusive research questions in political economy: What accounts for the significant variation in countries' performance characteristics, both cross-section and over time? In particular, North has sought to understand the process of economic change, including the persistence of highly divergent development and institutional paths.

In *The Rise of the Western World* (co-authored with Robert Thomas), published in 1973, North provided a new theoretical framework for understanding the sources of long-term economic prosperity and stagnation.⁴ The central claim of this 'new economic history' was that institutions were the fundamental determinant of economic success and divergent development paths. The bulk of North and Thomas' explanation was based on the way 'relative price changes' create opportunities for the development of 'efficient' institutions. Breaking with traditional modes of analysis, the focus was not on objective conditions or factor endowments, but on rulers' incentives. In some countries (notably Britain and the Netherlands), a particular configuration of relative prices created incentives for the development of productivity-enhancing activities, paving the way to commercial and industrial revolutions. In other places (notably Spain and to some extent France), both rulers and organizations faced incentives for engaging in rent-seeking activities and patrimonial politics, facilitating the evolution of productivity-unfriendly policies and institutions.

In *Structure and Change in Economic History*, published in 1981, North articulated a new way of thinking about economic and political development. By explicitly rejecting some of the neo-classical assumptions underpinning the study of economic history, he contended that economic performance through time is largely explained by variations in society's 'institutional frameworks'. Economics is a theory of choice; yet, people's choice sets are constrained by the framework of political and economic institutions. In particular, the structure of property rights, together with the set of constitutional rules enforcing such structure,

"Spell out the system of incentives and disincentives that guide and shape economic activity...and they also determine the underlying distribution of wealth and income of a society" (North, 1981: 17).

In *Structure and Change*, North was particularly concerned about the logic of institutional change and the persistence of 'inefficient institutions'. The sources of institutional change, North contended, were economic as well as political. In principle, changes in relative prices should induce institutional change at the margin as societies innovate to reduce transaction costs in human interaction. But this does not occur automatically and instantaneously. Institutional change is an intensely political process. For one thing, some elites (notably rulers) play a key role in the game of institutional selection, as they enjoy a comparative advantage in overcoming collective-action problems.

[4] Previously, North had focused on American economic history. These early works included *The Economic Growth of the United States 1790-1860* (North, 1961), *Growth and Welfare in the American Past. A New Economic History* (North, 1966), and *Institutional Change and American Economic Growth* (Davis and North, 1971). His early writings also included a number of groundbreaking essays on institutions and economic history (North, 1965, 1971). For excellent reviews of these early writings, see Menard and Shirley (2010) and Wallis (2010).

For another, institutions create vested interests, which then prevent prospective changes in the status quo. In addition, the legitimacy of alternative institutional structures is also a function of the prevailing ideologies, understood as the competing rationalizations of the world around us.

In 1990, North published *Institutions, Institutional Change and Economic Performance*, clearly his most influential book. Like in *Structure and Change*, North continued arguing that institutions fundamentally affect economic performance by structuring incentives. Yet this work offered a more thorough analysis of (1) the concept of institutions, (2) the channels through which institutions shape outcomes, and (3) the way institutions themselves change over time as a response to alterations in the political economy environment. North (1990: 3) famously defined institutions as ‘the rules of the game, or more formally the humanly devised constraints that shape human interaction’. But he also stressed that the real incentive structure of a society is made up of ‘formal institutions’ (constitutions, property rights), ‘informal constraints’ (social norms and conventions, codes of conduct) and ‘enforcement characteristics’. In addition, he crucially contended that people make choices on the basis of ‘subjective mental models’ that do not tend to converge over time.

In this book, North was also interested in accounting for ‘the survival of economies with persistently poor performance over long periods of time’ (North, 1990: 92). His story revolved around *path dependency*. In the context of increasing returns and high transaction costs, institutional pathways are self-reinforcing. Inefficient institutions create organizations and interest groups with a stake in the existing (inefficient) constraints. In addition, ‘the subjective mental constructs of the players will evolve an ideology that not only rationalizes the society’s structure but accounts for its poor performance’ (North, 1990: 99). Path dependency explains why similar changes in relative prices may lead to dissimilar outcomes in different societies. It also explains why it is so difficult to change institutions. Yet the notion of path dependence is often misused and abused. This concept should not be understood in a ‘deterministic’ way (North, 2005). Societies can break, and indeed have broken, with path dependency. However, history suggests that, once countries are in a given track, institutional structures are resilient and development paths very difficult to reverse.

Understanding the Process of Economic Change, published in 2005, was an extension, a ‘very substantial extension’ in North’s own words, of new institutional economics. In this book, North continued to be concerned about the way institutions shape economic performance by structuring incentives. However, the central aim of *Understanding the Process* was to explain how different societies arrive at the institutional infrastructure that then greatly determines their economic trajectories. North’s new analysis of how institutions evolve and how economies change through time was strongly cognitive. According to North (2005: 5):

“Beliefs and the way they evolve are at the heart of the theoretical issues of this book...Economic change is for the most part a deliberate process shaped by the perceptions of the actors about the consequences of their actions.”

It is worth underlining that in *Understanding the Process* ‘shared beliefs’ (or mental models according to North’s earlier formulation) attained causal significance. Drawing lessons from anthropology and cognitive science, North (2005) highlighted that the institutional

structure reflects the accumulated beliefs of the society over time.⁵ Economic development involves people making ‘intentional’ choices in the context of institutional incentives. Yet the issue is that ‘we choose among alternatives that are themselves a construction of the human mind...individuals from different backgrounds will interpret the same evidence differently and in consequence make different choices’ (North, 2005: 11-62). This cognitive mechanism plays a crucial role in the context of the pervasive uncertainty that dominates social interaction. In particular, causal beliefs regarding how the economic system works and how it should work affect both economic performance and institutional development. According to North (2005), beliefs are also a key source of path dependence; they constrain the choice set of the actors by defining the range of perceived legitimate change.

The publication of *Violence and Social Orders* in 2009 marked a new milestone in Douglass North’s already impressive scholarship. This thought-provoking book, by North and his colleagues John Wallis and Barry Weingast, has opened an ambitious agenda aimed at integrating the systematic study of violence into the political economy of development. As a starting point, these scholars challenged the Weberian assumption that the state has a monopoly in the legitimate use of violence. If anything, all societies have to deal with either violence or the threat of it. Moreover, violence should be politically contained and managed. This stresses the importance of studying the institutions that emerge to control violence and its implications for economic and political development. In essence, *Violence and Social Orders* articulated the underlying logic of two alternative patterns of social organization and explained how societies make the transition from one social order to the other.

The alternative models of social organization are natural (or limited access) states, on the one hand, and open access societies, on the other. Natural states reduce the problem of endemic violence by granting special privileges (rents) to certain elites, but at the cost of penalizing political and economic development. In open access societies, violence is controlled through the state in the context of an institutional framework that favors credible commitments towards limiting the use of violence and maintaining open political and economic markets. An open access society is the key condition for both economic and political development. Unfortunately, the features of open access societies have been the exception rather than the norm.⁶ From the point of view of development, “the big question is how natural states make the transition to open access societies” (North et al., 2009: 25). *Violence and Social Orders* made some ground in specifying the conditions under which elites transform their personal privileges into impersonal rights. The so-called ‘doorstep conditions’ of economic development include: (1) rule of law for elites, (2) perpetually lived forms of public and private elite organizations, including the state itself, and (3) consolidated political control of the military.

There has been a great deal of continuity in North’s writings. This scholar has developed a conceptual framework for understanding economic change over time. North has consistently claimed that institutions (property rights and contract enforcement) affect economic performance by setting incentives. He has also argued that ‘credible commitment’ is

[5] On the fundamental role of beliefs, see also Denzau and North (1994), Knight and North (1997), and North (1999).

[6] North et al (2009) shows that the default social outcome is the natural state; around 175 countries and up to 85% of the world’s population still live in limited access orders.

the fundamental problem of developing societies (North, 1993). Institutions emerge to reduce uncertainty and transactions costs in the transition from personal to impersonal exchange. The key analytical conundrum North confronted was that of integrating an analysis of institutional roles with a theory of institutional change. In an early essay, he claimed that economics should integrate an explanation of the formation, mutation and development of institutional arrangements (North, 1971). Forty years later, we face the very same challenge. The attempt to marry theories of institutional effects and institutional evolution is both the strength and Achilles' heel of the Northean approach to development.

However, there has been also a significant evolution in North's ideas. This learning has been shaped by conscious rethinking based on the observation of reality, including the evident and uncomfortable policy gaps of the institutions for development agenda. Despite theoretical advances in institutional theory, the reality of developing countries shows that underdevelopment paths are highly resilient and institutional fixes undermined by unintended consequences. In this context, the evolution of North's writings reflects an increasing concern with the cognitive and political sources of imperfect institutions. Achieving economic development is not only about setting the right prices by transplanting best-practices economic institutions. It is fundamentally about the political and social orders supporting effective economic governance. North has also moved beyond property rights, emphasizing that a range of formal and informal institutional arrangements should emerge to support credible commitments and growth.

All in all, North's intellectual journey, observed in the richness and complexity of his scholarship, has been a tour de force. He initially made a contribution to economic history by stressing the role of transaction costs, property rights and institutions. But over time his institutional approach became more political and, significantly, more cognitive. Institutional change is intensely political because powerful elites have high stakes in the survival of the status quo. Culturally embedded beliefs are also fundamental determinants of both economic and institutional change, explaining the persistence of highly divergent development paths. In his latest works, North's approach came full circle, as he sought to integrate growth, governance and conflict into a comprehensive political economy of development. Promoting development is not only about creating the conditions for economic growth; it is also about providing the sources of political stability and social control. In other words, it is about articulating the politics of accumulation and redistribution.

North has been always eager to ask novel questions, contest established assumptions, propose new frames of thinking, and explore uncharted territories. As a true master, he has been also prepared to reconsider his own ideas along the way. As one review put it:

"It is a remarkable fact that Douglass North is never satisfied with his previous work, however important it may have been. He always pushes forward for new insights" (Myhrman and Weingast, 1994: 192).

3. ANALYTICAL GAPS OF THE INSTITUTIONAL APPROACH

'Understanding is a necessary prerequisite missing in the economist's rush to model economic growth and change' (North, 2005: ix)

The theoretical implications of North's approach to development are less obvious and more complex than commonly assumed. The main thesis of new institutional economics is that institutions shape economic performance by structuring incentives. However, the way institutions and its likely effects are conceptualized in North's writings remains contested. In addition, North emphasizes that imperfect enforcement and subjective mental models mediate the relationship between institutional incentives and outcomes. Finally, and perhaps more importantly, the very institutions that are meant to constrain behavior are human choices themselves, raising questions of causality and endogeneity. This section spells out the remaining analytical gaps of the institutional approach to development.⁷

3.1 The Fundamental Problem of Development: Credible Commitment

To begin with, it is worth stressing what economic development is about from a Northean perspective. Like most development economists, North is concerned with how societies increase productivity and realize gains from trade. But he contends that what's missing from development economics is an understanding of the nature of human cooperation required to sustain impersonal exchange. A developed politico-economic system assumes a complex web of impersonal contracts across both space and time. The problem is that the existence of uncertainty and transaction costs undermines specialization and division of labor. If contracts are constantly violated, economic agents will neither realize gains from trade nor engage in wealth-maximizing activities. In this context, North (1990: 12) writes that 'institutions matter precisely when transaction is costly'. Institutions emerge to reduce the ubiquitous uncertainty of human interaction. Governments' inability to create and sustain credible commitments is the most fundamental binding constraint on economic and political development (North, 1993).⁸

3.2. The Elastic Meaning of Institutions

Concept formation is one of the crucial challenges of new institutionalism. Although it is widely accepted that institutions matter because they place constraints on actors' behavior, different neo-institutional schools still disagree on (1) the very definition of institutions, (2) the way institutions affect outcomes, and (3) how institutions emerge and evolve over time.⁹ Some of these uncertainties are reflected in North's works. The conceptualization of institutions is a case in point. Unlike many political scientists, North does not merely focus on the formal rules of political economy games. He claims instead that the real 'institutional matrix' of a society is composed of formal institutions, informal constraints, and enforcement characteristics (North, 1990). Moreover, he claims that elusive concepts such as dogmas, myths and prejudices might play institutional roles in different contexts.

In the extreme, every patterned form of social interaction can become an institution (Calvert,

[7] These issues are discussed in more detail in Dellepiane-Avellaneda (2010).

[8] The importance of credible commitment is also analyzed in North and Weingast's (1989) classic work on England's Glorious Revolution. North (1997) discusses the contributions of new institutional economics to the study of third world development.

[9] See, among others, Crawford and Ostrom (1995), Hall and Taylor (1996), Peters (1999), Thelen (1999), Matzavinos (2001), and Weingast (2002).

1995). This conceptual ambiguity is the source of conceptual stretching and leads to serious problems regarding the choice of research and measurement strategies.

3-3. Too Much Institutionalism, Too Little Politics

Problems of concept formation induce analytical stretching, a common problem in the new political economy of growth. Scholars seeking to study the institutional foundations of economic growth typically focus on mechanisms such as political stability, bureaucratic efficiency, corruption, expropriation risks, policy certainty, social polarization, and ethnic conflict (e.g. Mauro, 1995; Knack and Keefer, 1995; Alesina, 1998; Acemoglu et al. 2001). The issue is that these mechanisms do not refer to the rules of the game per se, but to the way the game is played in different societies. Indeed, as one critic put it, some scholars ‘tend to see institutions everywhere’ (Sangpman, 2007). If institutions simply become a proxy for ‘politics and society’, the concept loses its analytical value. Thus, we should distinguish between the institutional and the political embedded in the concept of governance. In a public conference, North acknowledged that institutions should refer to the rules of the game and governance to the way the game is played given those institutions (North, 2008). This critical distinction is largely overlooked in the good governance agenda.

3-4. Beliefs, The Great Omission of Political Economy

It should be remarked that North’s analytical framework is not only about institutions; it is about institutions and beliefs. In his Nobel lecture, North highlighted that an ‘institutional/cognitive approach’ should be used to make sense of the economic past and present (North, 1994).¹⁰ This scholar deeply believes that conflicting beliefs are the source of most of the problems we confront, including poverty and violence (North, 2008). Yet he also believes that a proper understanding of the way beliefs and institutions interact is the biggest omission in political economy (North, 2006). A proper assessment of the role of beliefs and learning is also missing from the international development agenda. It seems that development experts are shying away from this task in order to evade the sensitive issue of cultural determinism. But this is not a case of cultural determinism. It is a case of how mental models constrain actors’ choices by affecting the range of acceptable actions. In other words, it is about comprehending the cultural and ideological roots of path dependence.

3-5. Sources of Cooperation: Beyond Property Rights

Property rights and contract enforcement are undoubtedly important for economic development. Yet North’s lessons are more general. Institutions are basically solutions to problems of cooperation. And the transition from underdevelopment (personal exchange) to development (impersonal exchange) entails the solution of multiple cooperation and credible-commitment problems, both in relation to accumulation and redistribution. A narrow focus on property rights has led scholars to underestimate the breadth of institutional arrangements needed to support the transition towards development, including the role of the state in

[10] Indeed, his sensitiveness to cognitive issues looms large. In his 1971 article, North argued that ‘people frequently act in terms of general ideological positions’ (North, 1971: 122). Let’s also remember that his 1981 book put emphasis on the ideological underpinnings of inefficient institutions.

facilitating public-private cooperation at early stages of industrialization (Bardhan, 2005; Lange and Rueschemeyer, 2005; Leftwich, 2008).¹¹ Drawing lessons from China, North once stressed that there are different ways of setting up the right incentives. In his own words:

“China is intriguing because it does not appear directly to do any of the right things...There are lots of different ways to achieve wealth. There are lots of different ways to structure the game, to provide the correct incentives (that is what institutions are, incentives structures) to do the right thing” (North, 1999: 23; see also North, 2005).

3-6. Endogenous and Distributive Institutions

At the analytical level, the most pressing challenge of new institutionalism is reconciling the institutions-do-matter and the institutions-are-endogenous claims. If institutions are endogenously determined, they can hardly be the primary cause of economic development (Przeworski, 2004). This is not merely an issue of reversed causality: only rich countries can afford good institutions. The real issue is that the very institutions that constrain behavior are human choices themselves. North is fully aware of this. Moreover, he has consistently argued that institutions are not only endogenous, but also distributive. Institutions are not created to be socially efficient; they are chosen to ‘serve the interests of those with the bargaining power to create new rules’ (North, 1994). So far the literature has largely paid attention to the effects of institutions, however conceptualized and measured, on economic performance. Much less effort has been dedicated to understanding the nuances of institutional origins and the dynamics of self-enforcing institutions (but see Greif, 2007). Despite evident advances in evolutionary economics (Aoki, 2010), we still need to develop better theories of institutional change (Eggertsson, 2005; Menard and Shirley, 2010).

[11] The fascinating literature on the management of shared natural resources shows the diversity of institutional solutions to cooperation problems and hence the limits of narrow (private) property rights perspective. See, e.g. Poteete et al. (2010).

4. EMPIRICAL AND METHODOLOGICAL ISSUES

The neo-institutional revolution in the social sciences has led to the proliferation of studies seeking to document the empirical effects, and more recently, the determinants of institutions. Some progress has been clearly made. However, the methodological foundations of many of these empirical studies can be disputed. This section points out some methodological issues surrounding the empirical literature on institutions and development.

4.1 Concept Formation and Measurement of Institutions

As Giovanni Sartori (1970) argued, concept formation should be the first step towards measurement. This wise lesson is often ignored in comparative institutional analysis. Although scholars typically start their studies by citing North's famous definition of institutions, they then choose empirical strategies that are inconsistent with the Northean approach. Indeed, measurement is one of the most outstanding methodological gaps of the literature on institutions and development. On the one hand, we have experienced a revolution in the measurement of institutions (Knack, 2003). On the other hand, the indicators commonly used to substantiate the claim that institutions cause growth might be unsuitable for that purpose (Glaeser et al., 2004). Specifically, the standard practice of measuring institutions through outcome-variables is highly problematic. Perceived ratings of expropriation risk, bureaucratic efficiency, and corruption are not meant to capture institutions-as-constraints; they capture the way the game is played in different countries. Consequently, the observed association between rules and outcomes is often induced by the choice of flawed measurement strategies. This serious issue has not been properly addressed yet.¹²

Conceptual ambiguity also haunts the good governance agenda of development (Weiss, 2000). The conventional wisdom is that governance, broadly defined as the institutions and traditions that determine how authority is exercised in a country, matters to economic development (Kaufmann et al., 2000). The trouble is that governance and eventually good governance are commonly used as catch-all buzzwords that include almost everything, from the rule of law to bureaucratic efficiency, from corruption to expropriation risks, from property rights to political stability. This conceptual vagueness raises questions regarding the analytical and empirical merits of the governance agenda.

Another issue is that North attributes importance to formal institutions, but also to informal constraints and enforcement characteristics. He suggests moreover that the pervasiveness of informal rules and imperfect enforcement play a central role in developing countries. The good governance discourse seeks to accommodate this concern by loosely referring to countries' 'traditions'. This crucial point deserves a deeper and more rigorous discussion, both in relation to conceptualization and measurement. We also need more systematic research on the sources and effects of informal rules and enforcement mechanisms. As North et al. (2009: 271) point out:

[12] Even committed institutionalists have been denouncing this practice. See, e.g., Menard and Shirley (2010) and Wallis (2010). On the uses and abuses of governance indicators, see the comprehensive analysis of Arndt and Oman (2006) and the rich exchange between Kurtz and Schrank (2007) and Kaufmann et al. (2007).

"We still are some distance from a deeper comprehension of the interaction of formal rules, informal norms and enforcement characteristics that together determine the performance of the overall institutional framework".

4.2 Analytical Stretching

Conceptual and measurement flaws question the value of comparative research on institutions. Consider an important work on the political economy of development: Feng's (2003) *Democracy, Governance and Economic Performance*. Building explicitly on North's analytical framework, Feng finds that 'political institutions' do affect economic growth by affecting individuals' decisions in the marketplace. At first glance, these findings have a strong institutionalist flavor, suggesting that institutions cause development. Yet the real picture is more nuanced. Political institutions are operationalized in terms of political repression, political instability and policy uncertainty. Moreover, policy certainty, the main mechanism explaining the contrasting performances of East Asia and Latin America, is measured with inequality indicators. Feng's broad concept of institutions is simply capturing the political environment of growth rather than pointing out to country's specific institutional features. From a research design perspective, we face the problem of 'same data, different conclusions' (Przeworski, 2004). Is inequality or institutional decay the underlying factor explaining the divergent development paths of East Asia and Latin America?

The following example may also illustrate the problem of conceptual stretching. In *Democracy, Governance & Growth*, Knack (2003) provided a list of countries showing negative growth of relative per capita income in the period 1960-1998. The list of 'fall-back' countries includes Argentina, Venezuela, South Africa, Bolivia, Nicaragua, Peru, Venezuela, Equatorial Guinea, Angola, and Zambia. It is evident that 'bad governance' was a major factor hindering economic performance in those countries. However, to claim that poor institutional quality, reflected in bureaucratic inefficiency, corruption and insecure property rights, was the primary factor explaining those growth collapses stretches the analytical reach of new institutionalism. Most of the above-mentioned countries were facing deeply rooted political struggles, if not a state of latent civil war. As Easterly and Levine (1997) showed, ethnic conflict has been behind Africa's governance and growth tragedies. In this context, there is a case for putting institutions in their place and taking distributional struggles more seriously. North's recent scholarship on political order and violence is pointing in this direction.

4.3 Towards an Empirical Agenda on the Sources and Role of Beliefs

Beliefs and human learning are a core component of the Northean institutional/cognitive approach. Moreover, beliefs have acquired causal preeminence in North's most recent writings, as he claimed: 'where do the rules, informal norms, and for that matter the effectiveness of the enforcement, come from? They are derived from the beliefs human have' (North, 2005: 48). This means that making sense of beliefs, how they change over time, and their relationship with institutions is crucial for understanding development. However, despite some commendable but isolated efforts (notably Inglehart's World Values Survey research program), the empirical analysis of culture is not a priority in the good governance discourse.¹³

[13] Fortunately, some scholars are moving away from conventional practices. For example, in an original paper Licht et al. (2007) examine the cultural foundations of different aspects of governance, including the rule of law, corruption, and democratic accountability. See also Tabellini's (2010) study on the cultural roots of governance across European regions and Becker et al.'s (2011) work on the cultural legacy of the Habsburg Empire.

The development community is understandably cautious about stressing the cultural and ideological determinants of economic and political development. Yet the cognitive dimension of development needs to be taken out from the black box.

Building on Putman's (1993) influential work on Italy, scholars have tried to fill this gap by looking at the role of 'social capital' (Lyon, 2000; Knack and Keefer, 2003). But the social capital for development agenda should be the starting point of a wider research effort. For example, in an original work, Reis and Moore (2005) assessed the patterns and implications of elite perceptions of poverty and inequality in places such as Brazil and Indonesia. This is the way forward: the influence of ideas on economic development should be systematically and thoroughly investigated. What's missing, though, is an ambitious research program examining how prevailing beliefs constrain policy choices and institutional reform in different contexts. Research should also focus on how shared beliefs evolve as a response to new information and changes in the politico-economic environment. By emphasizing the role of conflicting 'causal beliefs' (i.e. mental mappings between actions, events and outcomes), North (2005) spells out the scope of this challenging but much-needed agenda.¹⁴

4.4 The Politics of Property Rights and Institutional Pathways

Empirical studies on the institutional conditions of development should expand beyond property rights, looking at the range of institutional arrangements that are required to sustain political order and self-enforcing growth at early stages of development (Bardhan, 2005). Campos and Root's (1996) brilliant analysis of credible commitment in East Asia illustrates this point. This work documented the multiple institutional arrangements, both in relation to accumulation and redistribution, which emerged in some East Asian countries to secure the cooperation of elites and non-elites. Campos and Root's groundbreaking work underlined the importance of examining the set of economic and political bargains supporting the credibility of institutional arrangements. The field is relatively short of empirical studies systematically analyzing how the state interacts with powerful interest groups. Sen and Te Velde (2009) pioneering research on state-business relationships in sub-Saharan Africa demonstrates the added value of exploring this uncharted territory.¹⁵

Moving beyond property rights assumes the existence of alternative institutional paths to success. As a result, cross-national studies on governance and development should be complemented with comparative case studies exploring intensively how local conditions, institutional development, and economic performance interact in different societies (Rodrik, 2003). Scholars should also pay more attention to the unpleasant trade-offs associated with the idea of expanding and protecting private property rights. An established literature shows that economic freedom and secure property rights create incentives for capital accumulation and growth (Gwartney et al., 1999; Wu and Davis, 1999). Yet another line of research shows that inequality and social polarization hinder both good governance and growth (Keefer and Knack, 2002). These two important areas of inquiry need to be integrated.

[14] Cognitive issues also shape donors' behavior. For example, Gibson et al's (2005) *Samaritan's Dilemma* put the emphasis on incentives, but also on underlying cultural and learning processes.

[15] This research program is inspired by Robert Wade's (1990) and Peter Evans's (1995) classic works on East Asian developmental states.

4.5 Studying Self-Enforcing Institutions

An empirical agenda on the institutional foundations of development should bridge accounts of institutional effects and endogenous institutions. Research on the potential benefits of certain institutions must include an analysis of the conditions under which those institutions are likely to emerge and be sustained in equilibrium. Evaluating the economic impact of institutions requires 'examining them in the broader context of the factors influencing the extent to which the political system is self-enforcing' (Greif, 1998: 60). This assumes a profound understanding of the political conditions underpinning credible commitment and self-enforcing growth. This should involve the study of both domestic and international conditions. A scholarly literature in comparative politics and international relations suggests that international factors facilitate sustained growth, democratic governance and conflict resolution (Boix, 2002; Stubbs, 2005). Knack's (2003) list of 'fall-back' and 'catch-up' countries also points to the relevance of geopolitics. It is suggestive that all of the twenty-one countries with negative or slow growth are from Africa and Latin America. On the other hand, all the countries with strong growth, with the exception of Botswana, are from East Asia and the EU periphery.

5. POLICY IMPLICATIONS

'The new institutional economics has made good progress in analyzing the role of institutions in shaping economic outcomes, but the field has made less headway formulating clear principles of institutional policy in many crucial areas (Eggertsson, 2005: 191)

'We know a lot about politics but not how to fix them' (North, 2005: 67)

Does the Northean perspective offer any lessons for development policy? Understanding the past, North argues, is 'the key to improving the performance of economies in the present and future...a real understanding of how economies grow unlocks the door to greater human well-being and to a reduction in misery and abject poverty' (North, 2005: vii). However, North has been always concerned about our limited ability to improve the performance of developing countries by design (North, 2005: 67). It is worth noting that, despite the consolidation of the good governance rhetoric in international development, the policy implications of North's ideas are far from obvious. It is striking, for example, that while international financial institutions have been increasingly accepting the importance of institutional issues, critiques of development assistance have been also strongly influenced by North (Menard and Shirley, 2010: 18-19). This section sheds some light on this crucial issue.

5.1 The Policy Gap of the Good Governance Approach

Plenty of intellectual, financial and political resources have been allocated in the last decades to improve the economies and politics of developing countries. Despite these efforts, the outcomes have not been always satisfactory (Easterly, 2002). Up to 85% of the world population is still living outside open access societies characterized by modern forms of economic and political organization (North et al., 2009). In many areas, the gap between development thinking and development practice remains hugely disappointing. We have made important inroads in understanding the economic and institutional foundations of development. We are also increasingly aware of the political and social conditions underpinning wealth-enhancing policies. Yet the problem is that 'we do not know yet how to get there' (North, 2008).

Both academic and policy research have highlighted that institutions play a major role in economic development. Yet the unpleasant reality is that we still live in a world of 'imperfect institutions' (Eggertsson, 2005). Moreover, the sources of imperfect institutions are still elusive. Take the policy gap of the good governance agenda. Since the mid-1990s, global financial institutions (e.g. IMF, World Bank), governments' development agencies (e.g. USAID, DFID) and international NGOs (e.g. Transparency International) have strongly advocated the good governance paradigm (Weiss, 2000).¹⁶ The principle of institutional conditionality has been also applied to improve the effectiveness of foreign aid in various regions, notably Africa. Some of the results have been dismal, though. North et al. (2009) documents that the so-called third-wave of democratization relented in the last ten years.

More tellingly, the intellectual fathers of World Bank's Governance Indicators have suggested that the quality of governance in developing countries has not appeared to improve since the

[16] On the penetration of the Northean approach on the development agenda, see especially World Bank (2002) and International Monetary Fund (2003, 2005). The pivotal change in the development game took place in the late 1990s, when the international community began to claim that good government was not a luxury, but a vital condition for development (World Bank, 1996; IMF, 1997).

emergence of the 'governance matters' discourse. Specifically, they claim that:

"There is little evidence of significant (or quantitatively important) changes in world averages of governance over the past decade...this evidence highlights major governance challenges worldwide, where improvements in governance in some countries are largely offset by declines in others, with the result that world averages show little change" (Kaufmann et al., 2009a: 23-4).

This policy anomaly has led to efforts aimed at rethinking governance (Kaufmann, 2003; Grindle 2004). Some of these efforts are welcome: the recognition of the limits of a technocratic account of corruption, the rejection of a blanket approach to best practices, the increasing focus on context and local conditions, the rise of a more holistic and theory-based approach to development evaluation, and the growing awareness of politics. Yet this reassessment of governance should be strengthened further. A good starting point is to revisit the analytical and policy implications of the Northean approach. Can we really promote economic development, improve politics, and accommodate social conflict through institutional design? Can we really remove the binding constraints on development by working around countries' institutional frameworks? North has provided answers to these questions, but also warnings. Unfortunately, some of these warnings have been ignored.

5.2 The Quandary of Transplanting Institutions

Even though North has been always extremely cautious when it comes to deriving policy implications from his works, people continue to draw soft lessons from the institutions-do-matter proposition. Institutions do indeed matter; yet the relationship between institutions and outcomes is problematic. For one thing, the effects of changing the formal rules of the game are highly uncertain in the context of pervasive informal constraints and imperfect enforcement. For another, institutional incentives are filtered through culturally derived, and often conflicting, mental models. As a result, the adoption of the same formal rules by different societies may induce highly divergent outcomes. North illustrates this point by stressing that many Latin American countries sought to replicate the American constitutional model in the nineteenth century, with diverging and mostly disappointing results (North, 2005; North et al., 2000).¹⁷ In his 1990 book, he clearly explains what happens when a common set of rules is imposed on two different societies:

"Although the rules are the same, the enforcement mechanisms, the way enforcement occurs, the norms of behavior, the subjective mental models of the actors are not. Hence, both the real incentive structures and the perceived consequences of policies will differ as well. Thus, a common set of fundamental changes in relative prices or the common imposition of a set of rules will lead to widely divergent outcomes in societies with different institutional arrangements" (North, 1990: 101).¹⁸

Although the lesson is obvious, it is worth repeating it. Transplanting institutions is not always a good solution; it can even be a recipe for disaster in the context of pervasive unintended consequences. As North argued in the *Process of Economic Change*: 'the creation of a stable consensual polity takes time and simply putting in place the formal rules is a recipe for disappointment, not to say disaster' (North, 2005: 161). It should be emphasized that institutional engineering is even more taxing in light of North's most recent works. In *Violence and Social Orders*, North and his colleagues explained that: 'until societies are at least on the

[17] Putman's (1993) account of Italy's uneven democratic performance also illustrates the long-lasting influence of informal rules and cultural predispositions.

[18] Interestingly, in his 2005 book, North's explanation became more culturally grounded, remarking that the source of the contrasting institutional patterns of the U.S. and Latin America was 'the fundamental beliefs of the key players in each case' (North, 2005: 114).

doorstep of a transition to opening access, however, transplanting these institutions and policies cannot produce economic development in natural states...Worse, if these institutions undermine the political arrangements maintaining political stability, these new institutions may unleash disorder, making the society significantly worse' (North et al., 2009: 264-5).¹⁹

5-3 Articulating Accumulation and Redistribution

North's concerns about political stability touch another crucial issue: the articulation of accumulation and distribution.²⁰ Development strategists should take more seriously Karl Polanyi's great insight: markets are a powerful force of sociopolitical change, but they are also a potential source of political conflict as societies seek to protect themselves from market forces (Polanyi, 2001). Leaders in developed countries are fully conscious of this tension (hence, the massive nationalization of banks in the context of the recent global economic meltdown). However, this lesson is often ignored in the world of development assistance.²¹ The case of Bolivia, a country that made a swift transition from donor darling to basket case, vividly exemplifies this dilemma. In that country, an attempt to push market reforms beyond the limits of political feasibility led to a political backlash against the very property rights that the government wanted to enforce in the first place.²² It is intriguing that many studies documenting the importance of property rights, also stress the significance of political stability (e.g. Alesina, 1998). What is missing from those studies, though, is a rigorous assessment of the policy issues stemming from the competing aims of protecting property rights and securing political legitimacy and stability.

5-4 Alternative Institutional Paths to Success

North's writings underscore that the consolidation of institutions such as property rights, democratic accountability and independent judicial systems have created the conditions for economic growth in the Western world. However, North has also argued that there is no single institutional path to economic success. Reflecting upon the unique experience of China, whose development path has defied conventional prescriptions, he remarked that 'the key is the incentive structure that is created, not the slavish imitation of western institutions' (North, 2005: 159).²³ We should repeat that institutions are essentially solutions to cooperation dilemmas and that multiple institutional arrangements should emerge to support credible commitment in the transition to democracy and economic development. Interestingly, in the last years we have been witnessing a willingness to depart from orthodoxy, which suggests a break in development thinking (Rodrik, 2006). For example, building on the 2004 Barcelona Development Agenda and World Bank's (2005) *Economic Growth in the 1990s*, the 2010 *Human Development Report* stressed the context-specificity of institutional reforms and the diversity of development pathways (UNDP, 2010).

Recognizing the possibility of alternative development pathways does not mean

[19] This point is quite similar to the one made by Paul Collier (2008) in his book *Wars, Guns & Votes*

[20] North's concern about political stability is not new. In 1990, he warned that 'when there is a radical change in the formal rules that makes them inconsistent with the existing informal constraints, there is an unresolved tension between them that will lead to long-run political instability' (North, 1990: 140).

[21] Remarkably, the 2010 Human Development Report draws some lessons from Polanyi. Yet Polanyi's insights should be incorporated more systematically into development thinking and practices.

[22] Other Latin American countries, including Ecuador, Nicaragua, Venezuela, and Argentina (which also evolved from IMF's poster child to basket case), have experienced relatively similar patterns.

[23] Quian (2003) and Rodrik (2010) provide good insights into China's singular development path.

we could not draw lessons from successful and unsuccessful experiences. It simply means those lessons should be extracted from carefully designed political economy analyses aimed at identifying the political, institutional and social constraints on development. The challenge is to strike the balance between a naïve one-size-fits-all approach and a helpless everything-depends-on-local-conditions one. In other words, we need to master the art of contingent generalizations. For example, Campos and Root's (1996) work on East Asia still offers lessons regarding the importance of reconciling the politics of accumulation and redistribution. Similarly, Rodrik's (2003) analytical narratives throw light on the interactions between governance, institutions and development. Some scholars have been even more ambitious. Bates et al. (2006) build on the experience of post-independence Latin America to inform Africa's contemporary quandaries; Ravallion (2008) draw lessons for Africa from China's successful poverty reduction strategy, even knowing the cases are hardly similar.²⁴

5-5 Beliefs and Institutional Design

Knack (2003) concludes that the making of development policy should be grounded in a thorough political economy analysis of the political, institutional and social bindings constraints on development. Following North, we can safely argue that, without an understanding of how conflicting beliefs limit the range of feasible options, this analysis is bound to fail. As Eggertsson (2005: 38-9) argues: 'when our knowledge of social mechanisms is scarce, policymaking can become a walk in the dark'. The issue is not 'wising-up' elites, a point usually attributed to the late Mancur Olson. The real issue is having a proper understanding of the margins at which a given institutional structure, and its multiple components, can be changed. It is also about comprehending the cognitive roots of social conflict, political disorder and economic backwardness. The latter is crucial for identifying policy windows and estimating degrees of freedom in institutional reform. Without a deep understanding of the cultural heritage of a society and the structure of beliefs underlying a given institutional structure, we can hardly have good insights into possible reform, including its implications for political and social order. In North's words:

'In order to improve the institutional structure we must first have a clear understanding of the sources of such institutional structure...We must have not only a clear understanding of the belief structure underlying the existing institutions but also margins at which the belief structure may be amenable to changes that will make possible the implementation of more productive institutions' (North, 2005: 163-4)

5-6 From Institutional Stability to Adaptive Efficiency

The dominant good governance discourse put the emphasis on the predictability and stability of the rules of the game. But the importance of adaptive efficiency and institutional adaptation is often unappreciated (Helpman, 2004). We should repeat that the key issue for developing countries is not lack of growth during good times, but the size of growth destruction during hard times. Poor countries stay poor because 'they experience more frequent episodes of shrinking income and more negative growth during the episodes' (North et al., 2009: 6). Stop-and-go growth has been for example the Achilles' heel of development in Latin America (North, 2005). Smart institution building is about striking a balance between commitment and flexibility. Institutions have to be strong enough to induce innovation, investment and wealth creation, but flexible enough to accommodate negative shocks and unexpected events. The principle of

[24] Rodrik (2010) proposes a different model. Specifically, he claims that development economists should be 'diagnosticians', trying to help policymakers choose the right remedy for their specific realities.

adaptive efficiency, ‘an ongoing condition in which the society continues to modify or create new institutions as problems evolve’ (North, 2005: 169), should inform development strategies. We should understand that institutional stability sometimes involves a dose of institutional adaptation (Thelen, 2003).

5-7 The Unsolved Dilemmas of Institutional Conditionality

One of the most contentious issues in development policy concerns the relationship between development assistance and institutional reform. Does the strategic manipulation of foreign aid foster or hinder the prospects of better governance in developing countries? Sorting out the so-called ‘aid-institutions paradox’ (Moss et al., 2006) lies beyond the scope of this paper. Yet some issues can be highlighted.

Seeking to improve societies through institution building is always challenging; it is even more challenging from a Northean perspective. In the short run, all we can do is to modify, and with limited degrees of freedom, the formal rules of the game. But this would hardly alter the real structure of incentives guiding choices, given the pervasiveness of informal constraints, enforcement mechanisms, and mental models. In this context, the idea of making the availability of foreign aid conditional on institutional performance, one of the main tenets of the good governance consensus, is highly problematic, if not controversial. In an influential paper, Alberto Alesina (1998: 217; emphasis added) made a bold case for ‘institutional conditionality’:

‘Given that foreign aid typically increases government consumption, the World Bank and other international organizations should consider withdrawing financial and technical assistance from countries that do not satisfy minimum standards of institutional quality. Cutting off assistance may increase growth and foster social development in the medium run by creating incentives for institutional development.’

Alesina’s argument raises a number of issues. It is evident that aid creates perverse incentives, for both donors and recipient countries (Gibson et al., 2005), eventually removing incentives for institutional reform. Yet it is naïve to believe we can create incentives for institutional development simply by pulling the plug or threatening to do it (or by not giving aid in the first place). Playing moral hazard games with real countries is full of unintended consequences, mainly if the sequence of moves undermines political stability.²⁵ But the most important issue, from a Northean perspective, is that we can hardly create incentives for institutional reform without having a thorough understanding of the interactions between the various components of countries’ institutional matrix. We also need to have a deep understanding of the possibilities and limits of institutional reform, including ways of overcoming ‘the determinacy paradox’ (Eggertsson, 2005). Without taking the politics of institutional change seriously, institutional conditionality is a gamble, occasionally a very expensive one. In the meantime, development policy attempts to square, not very successfully, the aspiration of using aid as an instrument for institution building and the idea of allocating aid conditional on institutional performance.

5.8 Natural States: A New Way of Thinking About Development?

The policy implications of Violence and Social Orders do not sit well with the good governance discourse. As Menard and Shirley (2010: 22) explained, ‘aid interventions that try to embed elections, entry into markets, property rights, or other aspects of open access orders

[25] This was the case in Argentina in December 2001, when the international community decided to remove support in the worst moment, triggering political instability, a development disaster and, crucially, a systematic process of governance regress.

and that try to eliminate rent seeking...can destabilize elite agreements and unleash violence and disorder’. North, Wallis and Weingast conclude, controversially, that the main insight of their work is that ‘natural states are not sick’: ‘natural states have their own logic; they are not dysfunctional’ (North et al., 2009: 269). They also denounce that most development advice attempts, with little effect, to induce a transition towards open access societies. This strategy embedded in the good governance framework can be self-defeating, mainly when it undermines the conditions supporting political and social order. These scholars suggest a new way of thinking about both economic and political development. Developing policy, they contend, should promote development within the logic of natural states (unless the country has already met the doorstep conditions), focusing on building state capacity, increasing impersonality, and controlling the dispersion and use of violence.²⁶

5.9 Rediscovering Institutional Policy

Institutional policy is the weakest link of new institutional economics (Eggertsson, 2005). It is the weakest link of the good governance approach as well. Paradoxically, a development agenda that emphasizes the causal role of institutions tends to overlook institutional reform. As Dani Kaufmann and his colleagues critically observed:

‘In spite of the growing consensus among policy analysts, civil society groups, aid donors and scholars, that good governance matters for sustained growth and development, implementing concerted efforts to improve governance and fight corruption often do not get priority in industrialized and emerging economies’ (Kaufmann et al., 2009b: 1, emphasis added).

Existing research showing that governance matters for development ‘does not often point the way towards specific reforms, because it is based largely on very broad and aggregated indicators of institutional performance’ (Knack, 2003: 294). In this context, drawing policy lessons from empirical studies on institutions is not always straightforward. For example, Feng (2003: 37) concludes that ‘a nation can achieve “economic miracles” by reducing political instability, building policy certainty, and increasing political freedom’. So what? The problem is that most empirical studies on the effects of institutions are too general (and sometimes too naïve) and therefore unable to provide lessons for institutional design.²⁷ As Rodrik (2003: 8) put it:

‘Once one moves beyond general statements that property rights are good for growth and corruption is bad, there is much that remains unclear. Which institutions demand priority? What are the specific institutional reforms that are required? Do these differ across countries according to the level of development, historical trajectory, and initial conditions?’

Let’s finish this section by stating clearly what an institutionalist approach to development policy should be about. There are two competing thesis regarding the influence of institutions on development. On the one hand, some scholars have an optimistic but naïve understanding of the role of institutions. We can improve societies by simply setting the right incentives through institutional reform. On the other hand, some scholars believe that there is no institutional fix to politics. Institutions are epiphenomenal and redundant; they simply reflect underlying political equilibria. In my opinion, these extreme positions are both wrong.

[26] Despite its inconvenient implications, these ideas are already attracting the attention of the development community. According to Menard and Shirley (2010: 23), the World Bank and some development agencies, including France’s Development Agency (Afd), have been commissioning case studies based on Violence and Social Orders’ analytical framework.

[27] Methodological issues, including the practice of measuring institutions through outcomes and the problem of same-data-different-conclusions, further complicate the interpretation of policy lessons.

Institutions do have a systematic effect on outcomes; yet, the relationship between institutions and outcomes is messy and full of unintended consequences. An institutionalist-minded reformer should show that a specific institutional innovation would improve outcomes *ceteris paribus*. Institutional change should induce a positive behavioral change given the prevailing structure of interests, informal constraints, and beliefs. This assumes a profound knowledge of the politics of institutional change, including the conditions under which institutions emerge and evolve in equilibrium. As Greif (2006) argued:

'Whether a society's institutions achieve socially good or bad outcomes, they cannot be studied independently from the broader society of which they are an integral part'

6. CONCLUSION: STILL A PROGRESSIVE RESEARCH PROGRAM?

'Doug's deepest contribution as an economist has been his powerful intuition about what questions we should be asking next' (Wallis, 2010: 3)

'A second curious feature is the apparently cyclical nature of the research in development. Each generation of work is a self-conscious reaction to past thinking, and is superseded in turn by a similar reaction to itself' (Rodrik, 2010: 34)

Douglass North is deservedly a towering figure in the social sciences. Among other contributions, he has played a leading role in the rise of new institutional economics and the renaissance of political economy. By asking timely and sometimes inconvenient questions about the institutional conditions of prosperity, he has also made a massive contribution to development studies. North's research program has been to a large extent successful. Building on his insights, we can now tell a better story about the sources and dynamics of economic and political development that we would do otherwise. However, despite its obvious merits, the institutional analysis of development still faces serious analytical and policy gaps. Moreover, both academic and policy studies on the institutional foundations of development are still overlooking, if not blatantly ignoring, some of North's main lessons. In this conclusion, I shall outline the key arguments of this article and reflect upon the future of the research program on institutions and development.

The central claim of this article is that the Northean approach is about institutions and property rights, but not only about institutions and property rights. Since his 1981 book, North has consistently underscored the cognitive and political underpinnings of both economic and institutional change. Without recognizing that the processes of economic and institutional development are intensely political,²⁸ it would be impossible to make progress in understanding how pervasive informal constraints and imperfect enforcement interact with formal institutions in defining society's incentive structure. Similarly, it would be impossible to make sense of the political and ideological patterns explaining the stickiness of inefficient institutions.²⁹ North has been also advocating a move beyond property rights, stressing the possibility of alternative institutional paths and emphasizing the issue of adaptive efficiency. Many of these issues cannot be easily accommodated within the prevailing governance-matters discourse. Instead of cherry picking, and eventually distorting his ideas, the development community should take more seriously the implications of North's writings, including his latest research on beliefs systems and social orders.

In order to remain a progressive research program, the 'institutions rule' paradigm should also address anomalies and respond to critiques. The conceptual and empirical issues raised by Glaeser et al. (2004), Przeworski (2004) and Sangpman (2007) are too serious to be ignored. Moreover, prominent neo-institutionalist scholars seem to share some of their concerns. Take one of the most contentious issues, the measurement of institutions. John Wallis, one of North's closest colleagues, has recently warned that 'what passes for institutions in much of the economics literature, however, are really outcomes, not institutions. Secure property rights, governments that make credible commitments, rule of law, impersonal exchange,

[28] North is not alone claiming that politics should be brought back into the study of development. See, e.g., Leftwich (2000), Bates (2001) and Bardhan (2005). Even Kaufmann (2003: 27), from the World Bank Institute, claimed that 'one of the most difficult issues in the field of governance is the imperfect understanding of how politics shapes governance and developmental outcomes'.

[29] Wallis (2010) provides an insightful discussion about the 'persistence' of inefficient institutions.

and trust are real phenomenon. However, they are the result of institutions, they are not themselves institutions' (Wallis, 2010: 14). Or take the primacy-of-institutions thesis. Wallis also recognizes that 'the dynamics of social interactions –political, economic, religious, military, and educational- determine which changes are rejected, which are sustained, and which changes persist to have a large impact' (Wallis, 2010: 20).³⁰ Wallis' comments are totally consistent with the main messages of this article: further research on institutions and development should address issues of concept formation and measurement, overcome conceptual stretching, and reconcile theories of institutional effects and endogenous institutions.

The literature should not only accommodate anomalies, but also pay attention to new issues. What questions should we be asking next? First, we should be asking original questions about beliefs. We cannot make sense of economic and institutional change without understanding how people in different societies interpret their environment and solve the problems they confront. Without understanding the implications of belief systems, institutional policy remains a walk in the dark. In this context, as North forcefully argued in *Understanding the Process of Economic Change*, we should systematically study the complex interaction between events, belief formation and institutions. This research should focus on assessing how beliefs constrain the choice set of the actors, defining the range of perceived legitimate change and the scope for institutional reform. This research effort should cut across the boundaries of economics, political science, sociology, anthropology, and cognitive science. Despite North's constant cries, this research program is still wanting.³¹

Second, if we trust North's intuition, we should also be asking bold questions about conflict. *Violence and Social Orders* is actually part of a new generation of research raising provoking questions about the linkages between political regimes, economic development and violence (Bates, 2008; Collier, 2009). Much of the most exciting political economy research in the last decade has been devoted to disentangling the sources and implications of conflict, including the interactions between ethnicity, natural resources, governance, and development.³² There is also a growing literature assessing the dynamics of governance and development in fragile states.³³ This research interest is based on the increasing awareness of the inadequacy of understanding the governance and development profiles of countries such as Congo, Zimbabwe, Ivory Coast, Haiti, Bolivia, Nicaragua, or Venezuela without reference to their deeply rooted political struggles. The 2011 World Development Report, which precisely focuses on conflict and development, epitomizes this important shift in development thinking (World Bank, 2011).

Third, there is also a renewed interest, in both academic and policy circles, in the political economy of redistribution (World Bank, 2006; Robinson, 2010). The recent focus on the economic and governance implications of inequality has been driven by empirical and academic developments. On the empirical side, the gap in well being between rich and poor countries is still obscenely high. In addition, despite improvements in some aspects of human development,

[30] Menard and Shirley (2010) also provide a powerful internal critique of the remaining challenges of the institutional analysis of development. Tellingly, these authors also point out systematic problems in the conceptualization and measurement of institutions and the modeling of institutional effects.

[31] For some useful insights into the interactions between beliefs and institutions, see Grief (2006).

[32] Research on these issues has literally exploded in the last decade. See, e.g., Fearon and Laitin (2003), Hoeffler and Collier (2004), Fearon (2005), Kalyvas (2006), and Besley and Kudamatsu (2007).

[33] See, e.g., Francois and Sud (2006) and Collier (2008).

including poverty reduction, education, and health, the extent of income inequality within countries remains a major concern.³⁴ On the academic side, scholars have been documenting the hindering effects of inequality on institutional and economic development (Chong and Kradstein, 2007) and stressing that pervasive distributive conflicts are behind the stickiness of inefficient institutions (Bardhan, 2005). In this context, the shift in emphasis from poverty reduction to equity, and from pro-poor growth to inclusive and shared growth, is not very surprising and certainly welcome.

Fourth, we should stimulate research about the international dimension of development. Global governance, domestic institutions and economic development are inevitably linked (Rodrik, 2008, 2011). Developing countries are embedded in a global system of power and economic relations, which shapes the contours of both economic and institutional change. Robert Bates (2008) showed that state failure and the breakdown of political violence in Africa have been rooted in self-defeating domestic policy choices and local elites' predatory behavior. But he also showed that changes in the international environment have crucially affected domestic elites' structure of incentives. Governments' capacity to accommodate negative external shocks in the context of latent social conflict is one of the key challenges of economic development (Rodrik, 1999). Governance issues should be studied in a global context. Corruption, for instance, is not exclusively a 'domestic' issue; corruption opportunities are also rooted in the working of the global economic system, including the behavior of transnational companies. Finally, a new body of research suggests that the marriage between democracy, economic growth and social progress would not be achieved in the absence of facilitating external conditions, or even intense international interventions (e.g. Collier, 2009). The development community should not neglect the challenging implications of this literature.

As Dani Rodrik recently highlighted, development thinking tends to exhibit a cyclical nature, as the profession seeks to learn from previous policy failures and accommodate emerging issues. It remains to be seen whether a new focus on beliefs, informal politics, distributive conflicts, endogenous institutions, and context can be successfully accommodated within the dominant governance paradigm, or whether this new research agenda would eventually lead to a post-institutionalist consensus. The content of the new agenda may suggest the latter, but one may expect, using one of North's favourite concepts, an element of path dependence, pointing to a new generation of governance discourse (an improved governance agenda). After all, the creation and circulation of ideas in development research is not always guided by evidence and findings; it is also shaped by vested interests, intellectual fads, ideological considerations, and geopolitical realignments.

[34] According to the 2010 *Human Development Report*, 'since the 1980s, income inequality has risen in many more countries than it has fallen' (UNDP, 2010).

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