

Beyond the market-institutions dichotomy: The institutionalism of Douglass C. North in response to Karl Polanyi's challenge

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Abstract

On the basis of the “challenge” North [1997 (1977)] identified in the works of Polanyi, we propose to outline the originality of North’s institutionalism, especially in comparison with “new institutionalism” in economics as well as in sociology. Far from endorsing the dichotomy between market and non market dimensions of economic activities at the basis of the analyses of Williamson and Granovetter, North’s definition of institutions as “rules of the game” allows him to conceive of institutions as the institutional foundations of the market and therefore as explanatory principles of historical dynamics.

Keywords: institutions, institutionalism.

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1. Introduction

The relationship between institutions and the market is one of the key objects of what is known today as “new institutionalism”¹, both in economics, with “new institutional economics” and in sociology, mainly with economic sociology². Those who embrace new institutionalism commonly observe that “institutions matter” as variables explaining economic performance. However, the market, seen as a self-regulated adjustment mechanism of supply and demand, remains the usual reference to conceive of economic activity. Institutions are then defined negatively in contrast to the market, as social regulations limiting economic agents' scope for action.

But isn't such a conception of institutions as constraints weighing on the market from the outside too simplistic? It seems to give credit to the existence of a market sphere taken as given, alongside the community or the hierarchical organization. By analyzing the “instituted process” leading to a market society, Polanyi brings to light the historicity of the economic categories of the market. Polanyi's “challenge” according to North (1977) requires reflecting on the very existence of a market sphere by studying the historical dynamics explaining its emergence. We aim to underline the relevance of North's answer to this challenge through his renewed conception of institutions in his pioneering thought in the early 1990s. It differs in particular from that of “new institutionalists” who posit dichotomously that institutions are a sphere external to the market, which naturalizes market mechanisms.

By conceiving of institutions as “the rules of the game”, providing a framework for economic activities, North's analysis implies taking into account the institutional foundations of the market. By avoiding both economic sociology's fascination with informal norms and networks, and the focus of organizational economics on contracts and organizational forms, this analysis calls into question the usual dichotomy between institutions and the market.

In order to show the originality of North's contribution and to understand how he has answered Polanyi's challenge, we shall first discuss Polanyi's analysis of the emergence of a market society. The challenge is to identify explanatory mechanisms leading from community societies to market societies. We shall then see how “new institutionalism” ignores this challenge by sticking to the coexistence of two spheres, market and non-market, in economic activities, the latter referring to “social structures” in which the economy is “embedded”. We shall finally discuss North's works to show how they lead to a refoundation of institutionalism

¹ Cf. for example the summary presented by Williamson (2000).

² Cf. Nee (2003) and his integration of economic sociology in the general approach he calls “new institutionalism”.

based on a conception of institutions as explanatory factors of historical dynamics by going beyond the opposition between market and non market dimensions of the economy.

1. The market as the outcome of a complex historical process

In *The Great Transformation*, Karl Polanyi sheds light on the 19th century genesis of an impossible “market society”, through a historical process initially supported by social and political institutions. Paradoxically, institutions organize the operation of the market conceived of as outside any political influence. Polanyi’s analyses are however limited by their difficulty to conceive of institutions, in market societies, other than as devices creating an artificial scarcity that pushes agents to seek monetary gain as the main motive of their activity.

The historical emergence of the market

One of Polanyi’s main objectives is to call into question the economists’ view that the existence of price-creating markets is natural. To do so, he first presents the main characteristics of traditional societies that preceded this situation of market hegemony. Traditional society was characterized by a strong communitarian dimension, as evidenced by the principles of reciprocity in gifts and redistribution of subsistence to the needy (Polanyi 1971 [1944], p.47 et seq.). Redistribution is undertaken on the basis of an initial centralization of resources carried out through “indirect” transactions which are radically different from market transactions. In this context, there were markets on the margins of social activity in the form of transactions on surpluses with other communities (ibid., p. 57 et s.).

According to Polanyi, the existence of societies dominated by the market is a historical phenomenon which requires conceiving of the categories of the market as historical products. North (1977) considers this to be one of the main contributions of Polanyi and to constitute a challenge for the “New economic history” – even if North is one of its founders – which tends to focus on multi-secular econometric regressions without pondering upon the significance of these categories for the actors at the different epochs studied³.

In *The Great Transformation*, Polanyi identifies three factors that explain the passage from traditional society to market society: the affirmation of the state, mechanization and the recognition of social mechanisms beyond the control of the state that reveal the existence of “civil society”.

The affirmation of the state allowed, through continental mercantilism, the extension of the scope of economic activities from the local to the national level. Paradoxically, this affirmation of the state involved considerable regulation of productive activities with regard to products as well as working conditions. Economic activity tended to take the form of “One Big Market” (p. 72), so that “internal trade in Western Europe was created by the intervention of the state” (p. 63).

In the transformations that came about, “the invention of elaborate and therefore specific machinery” (p. 74) gave rise to a new relation between the tradesman and production. In a way, investments forced producers to sell, putting tradesmen in a central position to ensure the sale of their products. Activity directed towards monetary gain predominated progressively.

Gradually, the extension of markets, relative to goods as well as to labor and means of subsistence, led to the experience of a “palpable interdependence” (Polanyi 2007) between the

³ This criticism of quantitativism in history finds an echo in the works of Robert Salais and Alain Desrosières on the historicity of statistical categories and in the debate following the publication of the book by Marchand and Thélot (1991).

prices formed on these markets. According to Polanyi, this was a “discovery – one of the most decisive emotional and intellectual experiences in the constitution of the modern world – which was for the physiocrats an illumination which transformed them into a philosophical sect”. The discovery of social dynamics in the form of the division of labor (Smith), or even “civil society” (Hegel), led to conceiving the reconciliation between personal interest and public interest outside of any state intervention. This heralded what Polanyi calls an “institutional pattern”⁴ within which “a self-regulated market demands nothing less than the institutional separation of society into an economic and political sphere” (p. 71).

The commodification of labor as the anchoring of the market in the concrete social world

The general dynamics of the “commodification of the world” (Sobel 2007) that Polanyi describes corresponds to a reversal of embeddedness: “instead of the economy being embedded in social relations, social relations are embedded in the economic system” (p. 57). At the macro-social level, this reversal of embeddedness gave rise to an “avalanche of social dislocation” (p. 40) and “the transformation implies a change in the motive of action on the part of the members of society: for the motive of subsistence that of gain must be substituted” (p. 41). This change occurred through the commodification of land, labor and money, described as “fictitious commodities”.

Polanyi analyses first the commodification of land. It took place in Great Britain through the enclosure movement, which plunged landless peasants into extreme poverty. In this process, Polanyi emphasizes the initiative of the Parliament in enforcing the enclosures and the Crown’s responses to limit the movement. He goes on to discuss the commodification of money through the institution of the gold standard and the doctrine of exchange rate stability. But he concentrates above all on the commodification of labor that drastically altered the existence of individuals. The essential point of his argument focuses on a specific intervention of the state: the creation, in 1795 by magistrates in Speenhamland, of a scale of wage supplements instituting a minimum income “assured to the poor *irrespective of their earnings*” (p. 78, italics in the original).

This income guarantee, which lasted from 1795 until the abolition of the scale in 1834, was an obstacle to the commodification of labor. This scale can thus be seen as a temporary suspension of the market mechanism. The role of the state was ambiguous: it introduced redistributive systems alleviating the effects of the market for it to be better accepted. Once the market principle was established, this type of regulation was overthrown and the action of the state was narrowed down to the “invisible” administration of the market through the law (property rights, contracts). Trade unionism and unemployment compensation can similarly be seen as specific measures compensating the commodification of labor to actually strengthen the “self-regulation” (p. 77) of the market.

Polanyi beyond Polanyi

Polanyi’s analyses underscore the social dislocations that accompanied the emergence of “market societies” based on the pioneering experience of Great Britain. In his conclusion however, Polanyi (1971) pushes his analysis further. He envisages dynamics of freedom that are not reduced to an “atomization”, but rather refers to “these high values inherited from the market economy” and “the most precious traditions of Renaissance and Reformation” (p. 255). What is at stake here is to go beyond the hegemony of the market, the “economic sophism” (Polanyi 2007), to rediscover the true scope of these values which, hidden by the market, were trampled by totalitarian regimes.

⁴ Compared with the “institutional pattern” of reciprocity in traditional society (p. 48).

One would probably have to be more “Polanyian” than Polanyi himself to reach beyond the rejection of instrumental rationality implied by his denunciation of the hegemony of the “market” and to assume that liberty is a core value of social activity (Postel and Sobel 2008). The conception of a democratic policy of liberty, which is only suggested in *The Great Transformation*, is to be found in the rest of his writings, elaborated in reference to the various historical contexts he lived in (Maucourant 2007). For example, his idea of a “functional democracy” (Polanyi 2008) seems inspired by the model of the Viennese municipality of the 1930s which sought to combine associative democracy and social learning (Mendell 2003). Polanyi’s thought therefore pleads for the recognition of the consequences of public action in economic activities so that liberty does not turn out to be a mechanism of social dislocation. But it is necessary to go beyond the liberal negation of the state and of institutions to conceive of their effective role in society and in the economy.

2. Organization and embeddedness: the two faces of the dichotomy between market and institutions

Polanyi’s analyses describe a process where the market is “disembedded” from society which leads to a major crisis and to the challenge to democracy that was fascism in the 1930s. According to the most astute commentators of “new institutionalism” (such as Nee (2005)), Polanyi’s political diagnosis is of secondary importance. The crisis he analyzes is only a sign of the limits of “disembeddedness” and a proof, *a contrario*, of the ongoing embeddedness of economic activities as investigated by economic sociology following Granovetter, or of the existence of “governance structures” alternative to the market in the perspective of Williamson. The institutional dimension in these studies seems to be the identification of a plurality of coordination “structures”, masked by neo-classical economics’ focus on the working of the market⁵. We shall first discuss transaction costs, the common starting point of these analyses which are not opposed to the neo-classical approach of the market and only suggest to enrich them. Then we shall evoke the plurality of “governance structures” presented by Williamson, and the dynamics of networks and of strong and weak ties analyzes by Granovetter.

Transaction costs as the building block of “new institutionalism”

To account for the diversity of economic situations, the notion of “transaction costs”⁶ makes it possible to bring the various phenomena of transactions back to a single scale. On this basis, it is possible to identify social gains in situations where a hierarchical model of organization is dominant as well as in those where interpersonal relationships are dominant. In both cases, conditions can be identified under which a governance structure different from the market is more efficient in terms of transaction costs (Nee 2005, p. 53).

Indeed, contrary to the common knowledge of orthodox theory, market transactions do not always lead to greater economic efficiency, because they are constantly threatened by the

⁵ The recurring concept of “structure” in new economic sociology, following the analysis of the market as a “social structure” by White (1981) and following the works of Williamson, raises the question whether “new institutionalism” is not in a large part a “new structuralism”. This “new structuralism” can be identified for example in the sociology of networks, networks being considered as “structures” constraining individual behavior (Lazéga, Mounier and Snijders (2008)).

⁶ As developed by R. Coase (1937). [Retrouver la citation en anglais.](#)

lack of loyalty of individuals who are tempted by an opportunistic behavior due to the form of rationality that is posited. According to Williamson (1975, 1985), the main sources of transaction costs are indeed uncertainty and asset specificity which give rise to temptations of “opportunism”, which is “self-interest seeking with guile” (Williamson 1985, p. 70). Opportunism gives rise to bilateral dependence (called “hold up” in the incomplete contract theory) and explains the need for organizations and therefore authority.

Orthodox theory is not invalidated but rather enriched by taking into account new assumptions on the cost and asymmetry of information, the cost of fulfilling commitments, etc. Williamson (1985, p. 20-21) distinguishes between *ex ante* and *ex post* transaction costs. *Ex ante* transactions costs are “the costs of drafting, negotiating, and safeguarding an agreement”. “*Ex post* costs of contracting take several forms. These include (1) the maladaptation costs incurred when transactions drift out of alignment [...], (2) the costs of haggling incurred if bilateral efforts are made to correct *ex post* misalignments, (3) the setup and running costs associated with the governance structures (often not the courts) to which disputes are referred, and (4) the bonding costs of effecting secure commitments”.

Transaction costs correspond to the fact that every exchange presupposes the existence of the necessary physical and institutional equipment, which inevitably leads to a gap between real prices and the equilibrium prices that would have resulted from the operation of a “pure” market.

Hierarchical organizations and market transactions

In the face of these sources of transaction costs, the choice of various governance structures⁷ alternative to the market, in particular the hierarchical organization, reduces the temptations to deceive thanks to the incentive structure they impose on agents and the contractual protections they confer upon them (particularly the threat of enforcement by the law, courts and the police). Williamson identifies a whole range of governance structures, from large integrated firms to market transactions with various hybrid forms in between. They bring graduated responses according to the frequency of the transactions and the degree of asset specificity.

Vertical integration is the most radical way of eliminating opportunism, in the presence of highly specific assets and very frequent transactions thanks to the replacement of coordination by prices by coordination by authority. Williamson is nevertheless aware of the costs of hierarchical organization linked to weakened incentives compared with market transactions and to the operating costs of a bureaucracy, costs which leave room for market transactions alongside large integrated firms.

According to Williamson, institutions are governance structures of transactions. The market is one of them but Williamson is more interested in organizations (vertical integration) as a hierarchical monarchy submitted to formal rules defined in opposition to the market sphere. This entails that organizations are assimilated to institutions distinct from the market, which leads to a naturalization of the market: it is the inevitable reference of economic efficiency and organizations are supposed to obtain the same results as a market that would not be plagued by opportunism.

Identifying a plurality of governance structures therefore does not aim to shed light on the dynamics of emergence of a market society that we observed in Polanyi’s works. Williamson’s approach is more akin to a perspective of trade-off between these governance

⁷ “By governance structure I have reference to the explicit or implicit contractual framework within which a transaction is located (markets, firms, and mixed modes – e.g. franchising – included)” (Williamson 1981, p. 1544).

structures to optimize economic performance at the micro-economic decision level. To the extent that transaction costs result mainly from agents' opportunism, interpersonal links are suspected of masking situations of conflicting interests.

The communitarian structuralism of Mark Granovetter

In the face of this initial wariness of new institutional economics towards personal ties, Granovetter (2005, p. 38) suggests that these ties may also have beneficial effects, thus making room for sociological investigation alongside economic theory:⁸ "To understand how deviations from competitive equilibrium price may occur requires analysis of both the economics and the sociology of the situation" (ibid.).

Granovetter's study of the sociological dimension of transaction costs refers to his perception of the sustained embeddedness of economic activities, a term that he uses in direct reference to the "disembeddedness" he perceived in Polanyi's analysis (1971 [1944]). Indeed, he argues that it is necessary to accept the permanent role of family, territorial and ethnic groups in economic activities. To identify this communitarian dimension, Granovetter relies on revealing the existence of "networks" that are frequently hidden by the agents. In his opinion, these networks constitute the fundamental communitarian structure, seen as a refutation of the existence of Marxist social classes:

"Karl Marx asserted [...] that family and friendship ties would be fully subordinated under modern capitalism to the "cash nexus". But despite intimate connections between social networks and the modern economy, the two have not merged or become identical. Indeed, norms often develop that limit the merger of sectors" (Granovetter 2005, p. 36).

This conception of embeddedness leads to naturalize the communitarian dimension of all social activities, in the same way that orthodox economic theory and common Marxism naturalize the market and the economy. It is fundamentally different from Polanyi's conception, where embeddedness is only considered at a global level and concerns the relationship between the economic and the social, without assimilating the social to the "communitarian"⁹. Thus, disembeddedness according to Polanyi does not refer to the loss of communitarian and social links which characterizes, for example, Castel's "desaffiliation" (1995); rather, it concerns a deep social mutation akin to the passage from mechanic solidarity to organic solidarity in *The social division of labor* of Durkheim, which leads to an embeddedness of the economic in individuals' motivations.

Entrepreneurs as heroic opportunists

According to Granovetter, the ongoing development of economic activities can be explained by the existence of "strong ties" resulting from communitarian links, but also by the

⁸ North (1977) already suggested the possible explanation of reciprocity in transactions mentioned by Polanyi in terms of reducing transaction costs, but it was in comparison with a system where jurisdictions enforce contracts. Reciprocity is seen as a general principle aiming to guarantee transactions in the absence of any court system to enforce contracts. Granovetter focuses only on social control in close-knit groups, ignoring the effects of general principles and institutions on transaction costs.

⁹ As suggested by Caillé (1995), the concept of embeddedness is torn between a "conception of order" to which Polanyi relates and a "conception of context" akin to Granovetter's approach.

existence of “weak ties” established by exceptional individuals, able to break free from the hold of the community and its norms (Granovetter 1973). Indeed, by considering embeddedness as the communitarian basis of economic activities, it is necessary to resort to the actions of exceptional individuals to explain their dynamics. Thus, while strong ties are economically advantageous, so too are weak ties. This is illustrated by the success of individuals who discover new opportunities that arise when relationships are established between initially unconnected resources and networks, which usually implies taking liberties with the norms and values of their group. According to Granovetter, such individuals can be described as “entrepreneurs” in the sense of Joseph Schumpeter or Fredrik Barth (ibid., p. 46). These “entrepreneurs”, through their ability to abstract from usual social norms and rules which is not dissimilar to following a purely instrumental rationality¹⁰ leaving aside ethical principles¹¹, thus have much in common with Williamson’s “opportunists”.

Weak ties thus refer to the ability of some exceptional individuals to cut loose from the “over-socialized” world of the strong ties of the community. But in this approach, the dynamics of economic activity are fundamentally indeterminated as they are explained sometimes by strong ties and sometimes by weak ties. Furthermore, this constant switch evokes the tension between economic analysis reduced to the study of the behavior of rational agents and sociological analysis reduced to the study of socially constrained behavior. Williamson (2000) thus goes so far as to consider new institutionalism as a superposition of levels. The analysis endogenizes a growing set of “institutional” variables: the level of the market as the fundamental level of allocation and employment of resources is supplemented by that of governance structures, then that of the institutional environment (formal rules) and finally the level of embeddedness, defined as informal institutions linked to networks and small groups. This results, as shown by Orléan (2007), in a sort of social division of labor between economics and sociology where standard economics defines the range of possible evolutions on the basis of the choices of rational agents, whereas sociology focuses on the analysis of the reproduction of communitarian structures.

3. Institutions, organizations and economic performance in history

In the approaches of Williamson and Granovetter, the debates are focused on the margins of the market and this prevents apprehending the institutional dimension of the contract and tends to naturalize the operation of the market. Moreover, by defining institutions as organizational forms and informal norms, the authors introduce considerable semantic confusion between “institutions” and “organizations” and leave aside an actor – the state – whose role is essential both in creating and enforcing institutions. By proposing a clear definition of institutions and considering them within complex historical dynamics, North aims to find a way out of this dichotomy between market and non-market dimensions to apprehend institutional dynamics explaining the emergence of the market.

Institutions

The definition of institutions in North’s works has evolved and we identify a decisive turning point in 1990-91. In 1984, he defines institutions as “a series of constraints on

¹⁰ They do this by eliminating from rationality all principles hindering their projects, which leads them astray from the “axiologic rationality” identified by Boudon (1999) as **the most common one among social actors**.

¹¹ This conception of the entrepreneur is radically different from that found in Weber’s *Protestant ethic* (1904-05).

behavior taking the form of principles and regulations” (North 1984 p. 8). Institutions are associated to individual behavior as constraints. This conception of institutions is close to the “deontic” conception according to which the rule of law is considered as a “rule of behavior” (Jeammaud 1990, p. 199).

In the definition North proposes in 1990, the constraint is not exercised on the same object. According to him, “institutions are “the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. In consequence, they structure incentives in human exchange, whether political, social or economic” (North 1990, p. 3). They no longer constrain individual behavior but their interaction¹². This wider definition of institutions leads the way out of a deontic conception to envisage the structures of the interactions, that is the framework of reference¹³ agents rely on to define, organize and evaluate their relations with each other. The contract can then be considered as an institution to the extent that it is defined in relation to contract law which is not itself contractual. As wrote Durkheim, “all is not contractual in the contract” (1930).

North’s analyses also depart from the conception of the law in the Law and economics approach as developed for example by judge Posner. As pointed out by Lazéga (2009), Posner’s initial analyses conferred a central role to the economic maximization of utility in the resolution of disputes submitted to the judge. Even if Posner later on also recognized the role of a “softer” pragmatism” (Lazéga 2009, p. 207), he still gives prime of place to a form of “charismatic” justice, based on the judge’s sense of equity, in contradiction with the institutional reality of the existence of the rule of law. Thus, institutions as references for actions tend to be subsumed, in Posner’s analyses, in the judge’s common sense. On the contrary, in North’s view, institutions are an essential basis in the ordering of social relationships and in the resolution of disputes that arise. They are conceived as a motive of action for individuals and organizations, whose effects cannot be understood outside the framework of their social actions. North’s conception of institutions is thus akin to the “empirical point of view on the law” as a motive of action of agents in weberian sociology (Didry 2006).

Organizations and institutional change

In North’s perspective, markets as “price-creating mechanisms” as considered by Polanyi can only be apprehended through the mobilization of institutions such as property rights, contracts and money, in the context of the rule of law which guarantees to contractants the possibility to appeal to common law jurisdictions in case of disputes. In contrast, Williamson equated institutions and governance structures, which implies opposing the market as a decentralized institution to the organization as a hierarchical institution.

North refuses to assimilate institutions and organizations and to oppose institutions and the market. Institutions are, according to him, the rules of the game, and organizations are the teams of players (North 1994, p. 361). The organization is a group of individuals sharing a collective goal which belongs to the set of opportunities defined by institutions. It is often related to an “entrepreneur”, in charge of representing its interests¹⁴. It exists in numerous

¹² This is in opposition to the structuralist scheme which highlights the constraining action of social structures on individuals.

¹³ Jeammaud (1990) suggests to call them “models” for action.

¹⁴ Here, the entrepreneur is not an amoral actor, he acts **as the responsible for** an organization.

spheres, including political, social, educational and economic organizations, which, for North, include not only firms but also trade unions, cooperatives, etc.

Having thus distinguished organizations from institutions, North conceives of an incremental process of institutional and economic change resulting from the interaction between organizations and institutions. Individuals and organizations are characterized by their learning ability¹⁵ that enables them to discover new opportunities for action in a given institutional environment, which they help to change through their actions. This learning process took on a collective dimension in the case of medieval Western economic organizations, with the involvement of merchants and market organizations in institutional dynamics.

The “institutional” learning process of organizations takes place within the set of possible interactions between organizations and institutions, what North calls “the institutional matrix”:

“The institutional matrix consists of an interdependent web of institutions and consequent political and economic organizations that are characterized by massive increasing returns. [...] Network externalities arise because of the initial setup costs (like the de novo creation of the U.S. Constitution in 1787), the learning effects described above, coordination effects via contracts with other organizations, and adaptive expectations arising from the prevalence of contracting based on the existing institutions.” (North 1991, p. 109).

Institutional change driven by organizational learning is constrained by the interdependencies in this matrix. This explains that the result may be partly unintentional, even if institutional change concerns a multitude of individuals and organizations pursuing intentional goals.

Institutional change is not reducible to a trade off between governance structures. It embodies specific historical dynamics which affect the entire set of economic activities and determines what North calls the “economic performance” of a society. The problem is no longer to seek economic efficiency while supposing the existence of a unique and identifiable model of development; it is to explain specific social trajectories defined by economic activities embedded in institutional matrixes themselves in evolution. Furthermore, institutions are not only external to organizations: as collective groups, organizations rely on interactions framed by institutions as in the case of the wage-earning worker whose condition is inseparable from the labor contract as defined by common law. North thus finds a way out of the dichotomy between the market and non-market dimensions of the economy as his analysis relies on other categories: institutions vs. organizations, formal vs. informal institutions, the hierarchy of formal rules between constitutions, laws and contracts (cf. North 1990 p. 47).

The active role of the state through the creation and enforcement of institutions

The institutional dynamics North identifies are based on an organization that is assigned a central position beyond its traditional allocative, redistributive and stabilization roles: the state. Indeed, the state plays an essential role in the creation and enforcement of institutions. This latter role is documented, in particular, for an institution that economists have naturalized in their analysis of the market: the contract. In the perspective of the German historical school, North (1990) underscores the relationship between the emergence of the state and the extension of trade, with the search for an institutional framework allowing to

¹⁵ This learning is relative to markets and institutions as well as to the productive processes and the scientific laws pertaining to them.

“depersonalize” trade. In this search, “more resources must be devoted to measurement and enforcement” (North 1991, p. 99).

In addition to the enforcement of institutions provided by the state because it has a monopoly on the legitimate use of physical force, its members contribute to producing institutions. North suggests to apprehend representative democracy as providing a framework for debates between groups of different natures, constituted on the basis of economic interests but also of “ideas” or “values” in the case of the abolition of slavery (North 1990, p. 85). These groups send representatives to the Congress, who have to compromise with the representatives of other interests which may be different or even contradictory, in order to arrive at a majority vote to pass a law. The role of organizations in legislative activities thus further enriches the analysis of the interactions between institutions and organizations within the institutional matrix. We can identify a process of action-retroaction with on the one hand the influence of organizations on the institutional framework and on the other hand the way organizations learn to adapt to this institutional framework¹⁶.

As the enforcer and the central producer of institutions, the state plays an essential role in the incremental historical processes identified by North. Thus, North proposes a study of the gradual institutionalisation of commercial exchange by the state in the Western world, adopting a point of view symmetrical to that of Polanyi on the role of the state. Indeed, the state instituted a monopoly on the legitimate use of physical force which ruled out violence in interactions and joined the efforts of merchants to protect their goods. For North as for Polanyi, the way the British Parliament gained supremacy over the Crown after The Glorious Revolution of 1688 illustrates a decisive mechanism in this process.

By emphasizing the institutional construction of the framework of commercial exchange, North’s analyses lead to a critical perspective on recent “liberal” reforms that aim to institutionalize the market only by calling existing regulations into question. The experience of the post-socialist transition in the 1990s is especially enlightening in this regard. The first recommendations addressed by the World Bank and the IMF to the governments of former socialist countries concerning how the transition should be conducted underscored especially the importance of a withdrawal of the state from the economy. The “Washington consensus”¹⁷ recommended liberalizing markets, deregulating the economy and privatizing assets to enable a free, and therefore necessarily efficient, market to emerge. This approach insisted far more on the destruction of the socialist institutional framework than on building a capitalist one, which was supposed to emerge by itself. The experience of the early transition years led, however, to the emergence of particularly inefficient institutional dynamics (Cf. World Bank 2002, and Koleva and Vincensini 2000 on the case of the Czech Republic), resulting in the former Soviet Union in powerful lobbies capturing both the market and the state (Frydman et al. 1998). It was not until the second half of the 1990s that international financial institutions became more sensitive to the need to build the institutional equipment of

¹⁶ On the learning of the scope of the institution of trade unions in France, as from the Act of 1884, leading to the elaboration of legislation on **collective conventions**, see Didry (2002).

¹⁷ This term designates the consensual position of the World Bank and the IMF located in Washington.

markets, referring explicitly to North (World Bank 2002)¹⁸. Their recommendations then shifted to regulating relationships between economic actors, re-institutionalizing the economy and especially rebuilding the state (Bruszt 2002), whose central role in creating and enforcing the institutional framework was finally recognized.

Three institutional worlds

Refusing to attribute the Western world's economic performance to a sort of cultural superiority, North (1990, 1994) identifies a variety of "institutional matrixes"¹⁹ for which we suggest to speak of "worlds" in the sense that they correspond to processes reinforced by the activity of individuals, according to specific path dependent trajectories²⁰.

The *Anglo-saxon world* (Great Britain, United States) is defined by the pre-eminence of the Parliament, the guarantee of property rights and the openness of institutions – particularly legal ones, i.e. laws and jurisdictions – to the influence of organizations. Within a lasting institutional matrix, representative democracy is linked here to political and economic organizations that draw capabilities for action from institutions and, in return, accumulate knowledge from their experience of these institutions that leads them to introduce legal and jurisprudential adjustments.

In this regard, North's analyses evoke the process of formal "rationalization" that Weber (1986) identified in the development of Western law (Coutu 1995). Organizations, particularly economic organizations, act within it like what Weber calls the "forces of the market" in an "interdependent network" of formal rules and a hierarchical system of jurisdictions.

The *world of the Souk*²¹ is defined by the talent of the merchants as well as their individual qualifications and their ability to monopolize information on products so as to raise the transaction costs of their co-contractants. The Souk escapes almost entirely from state control and disputes are settled internally by resorting to direct testimony on the actions of individuals within a framework evoking what Weber (1986) calls "Cadi justice". The Cadi "invents" his decision without referring to prior rules. In other words, "regulation of disputes involves testimony by reliable witnesses to factual matters, not the weighting of competing, juridical principles" (North 1991, p. 103). In this institutional world, learning remains individual and it is not communicated to institutions, which remain on the whole informal.

A third institutional model can be found in the history of Spain in the form of the *world of state majesty*. In this world, the state imposes a common religion and endows itself with a bureaucracy capable of overseeing in detail the functioning of the various spheres of activity. Individuals and organizations other than the sovereign are deprived of any institutional voice.

¹⁸ However, North (2005) criticizes the approach of the World Bank, which preserves an optimizing approach and claims to know the set of "good" institutions to implement, whereas North emphasizes how difficult it is to conceive of and create efficient institutions.

¹⁹ Baechler (2009) speaks of "cultural matrixes" to qualify the dynamic plurality of human societies.

²⁰ This is similar to the identification of a plurality of worlds of the law in Weber's sociology of law by Didry (2006).

²¹ Which North describes on the basis of the observations of Clifford Geertz.

The identification of these three worlds refers to consolidation processes that define specific “institutional trajectories” (Vincensini 2010). It raises the question of a possible convergence between different institutional configurations: to what extent are the other institutional worlds required and able to align themselves with the one identified as leading to the best economic performance? This alignment was sought frequently throughout history, such as in the case of South American countries aligning themselves with the model of the United States after their independence. But although it is possible to import formal institutions, it is almost impossible to deliberately transform existing informal institutions. Any institutional transfer will therefore be necessarily incomplete, insofar as it does not affect, at least in the beginning, informal institutions such as beliefs and cultural norms. It also remains threatened by the backlash of informal institutions. As a result, the transfer of more or less identical institutions to Central Europe and the countries of the former Soviet Union had divergent effects –more efficient in Central Europe than in the CIS – due to the difference between their underlying informal institutions (Chavance 2008). Similarly, specific national institutional trajectories persist in Central Europe, qualifying the scope of the thesis of a convergence with EU countries, particularly because institutional change is not prompted solely by the quest for efficiency but by a set of far more complex processes (cf. Vincensini 2010).

Towards a new research program in social sciences?

Based on a clear definition of institutions as rules of the game, North’s analyses provide an important contribution to the explanation of complex historical processes which comprise economic dynamics. Institutions are references for the actors and lead to institutional learning which allows to explore the scope of institutions and sometimes to suggest improvements.

In their juridical dimension, institutions also lead to reconsidering the role of the state in economic and social life. First, we can no longer oppose the market with its pure mechanisms and the intervention of the state which would disrupt them. The state, through the institutions of the market, is rather a continuous presence defining the categories of economic activity, among which principally references and guides for the actors. Second, the state also appears as the locus of the resolution of disputes to obtain the enforcement of commitments between agents, in the general framework of the available institutional framework. This view of institutions assumes the existence in the background of a judiciary system allowing individuals to seize a judge and allowing the proportionate use of public force. These elements sketch out the constitutive dimensions of the state which are present through institutions. The state represents force and military supremacy which North often evokes. It is also the judge and his ability to listen to requests addressed to him by individuals and organizations to reach a juridically acceptable decision. It refers finally to the essential mechanisms of production of institutions according to processes more or less transparent and reflecting more or less the interests of citizens.

Complex historical processes, which affect both the institutional matrix and economic performance, are thus at play in the most commonplace economic activities. Progressively, North elaborates a research program aiming to analyze the explanatory power of institutions on economic performance, by subtly transforming the notion of transaction costs, which he still uses, albeit in a slightly different sense than its original use. Initially coined in reference to a pure market, this notion was first used by authors developing an “efficiency explanation” according to which institutional change is only explained by the search by agents for optimal institutional frameworks, such as Demsetz (1967). It then becomes, in North’s perspective, a vector of historical comparatism. The scale of transaction costs is no longer evaluated in reference to a “pure” market but in reference to a given historical institutional configuration

which the researcher studied beforehand. This semantic transformation goes hand in hand with the emergence of the term “economic performance”, which according to us is best understood as a historical development forming part of the “tableau” of a given epoch, rather than just a competition between national systems.

By identifying the specific dynamics of the institutional matrix, North develops an analysis of “complex interactions between beliefs, institutions and other factors which influence change such as geography, military techniques and the evolution of competition”. He is thus led to consider a science of the “human environment” going beyond the philosophical and psychological temptation of economics’ individual utilitarianism. This endeavor is akin to Durkheim’s project of “explaining social facts” through the search for social causalities, which aims precisely to link individuals’ activities with a “social *milieu*” considered as the nexus of a complex causal interaction between social facts. This analysis leads to an illustration of the diversity of human societies, in time and in space, recalling Durkheim’s conclusions on history as the science of human diversity in *Pedagogical evolution in France*.

This approach is an invitation for both economics and sociology to go beyond methodologies assuming a given human nature²², whether in a utilitarian mode or in forms where some altruism is possible but where it is not possible to introduce human historicity. By turning to the study of “human historicity”, North intends to counter the influence of cognitive science on certain approaches of economic theory which seek the determinants of instrumental rationality in the physiological architecture of the brain, or even in the structure of human genes (genome).

North’s interest for the institutional matrix also implies going beyond an interactionist approach which limits relevant interactions to a small set of individuals. This type of approach, which exists in sociology with the works of Goffman and Becker as well as in economics with those of “*économie des conventions*”, offers a solution to the polarization of research objects at the macro and micro levels. But it nevertheless leaves aside the role of institutions as references for actors’ decisions. The notion of “convention” as developed by Lewis (1969) thus leads to an analysis of interindividual coordination on the basis of a common knowledge which emerges between interacting agents, but does not take into account the effects of conventions on the very course of individual interactions, in particular through the evaluations and juridical resources in disputes the agents find in them. As Robert Salais (2009) suggests, the conception of institutions is a challenge for the “*économie des conventions*” which can be explained by the difficulty to identify its effects in ordinary economic transactions: “In order to buy bread at the bakery, it is absolutely not necessary to draw upon the entire institutional arsenal. This does not diminish the crucial role of institutions but makes it necessary to define them in relation to their modes of *presence* in the interaction”.

Considering institutions as an evaluative framework and a procedure of appeal which may influence, or even call into question, the interaction process leads to taking into account that institutions offer agents possibilities to take their distance with the interaction and even possibilities to influence the interaction. Furthermore, this vision of institutions implies recognizing the importance of formal institutions alongside informal ones. The role of formal institutions as frameworks for social activity – their “effectivity” (Auvergnon 2008) reveals the possibility of intentional institutional change, as a change of the rules of the game in a universe dominated by organizations and habits (informal regulation). The intentional change of the rules of the game thus opens up a new page of history that actors (as “players”) have yet to write.

²² Citation Durkheim.

Conclusion

North gradually broadened his research outlook towards institutions, on the basis of an initial interest in orthodox economic history²³. This increasing openness goes back at least to the discovery of the works of Polanyi in the 1970s. The first stage of this broadening led him to question the universality of economic categories and to investigate their historicity. Polanyi's "challenge" underscores the observation of the diversity of forms of economic organization on the basis of the results of ethnology. But according to North, Polanyi's use of ethnology prevents him to conceive of historical dynamics to account for changes leading from a traditional society to a market society. "Polanyi provides us with an account of reciprocity and redistributive systems which is inherently changeless. There is nothing in his framework that explains changes in the mix of the system over time" (North 1977, p. 715).

North's (1977) initial answer to Polanyi, which assumed that traditional societies were optimal in terms of transaction costs at a given time, remains unsatisfactory. It drew on the works of Williamson on the plurality of governance structures, dominated by the opposition between market and non-market structures, without providing a clear explanation of the historical dynamics leading to the emergence of the market society. North reached a turning point in the early 1990s when he defined institutions as the framework of human interactions. This approach unveiled the ideological mistake of the conception of the market as a self-regulated mechanism, independently of any reference to institutions. At the heart of the market, market transactions indeed suppose the existence of contracts and civil jurisdictions which guarantee their execution.

North's contribution is thus not quite reducible to "new institutionalism". He finds a way out of the dichotomy between market and non-market implied by the plurality of governance structures according to Williamson as well as by the social embeddedness of economic activities according to Granovetter. North's institutionalism leads him to posit economic dynamics through the complex interactions between a plurality of social dynamics, among which that of the institutional matrix is the most fundamental. Thus economic history is intimately linked to a history made of political revolutions and democratic transformations in which institutions continue their existence in the most ordinary daily life activities through the uses the actors make of them.

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²³ On the evolution of North's ideas, see Milonakis and Fine (2005). These authors also underline the changing nature of the notion of "transaction costs" in the works of North, but they do not point out his rare ability to call himself into question and the gradual crystallization of his analysis around the concept of "institutions".

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