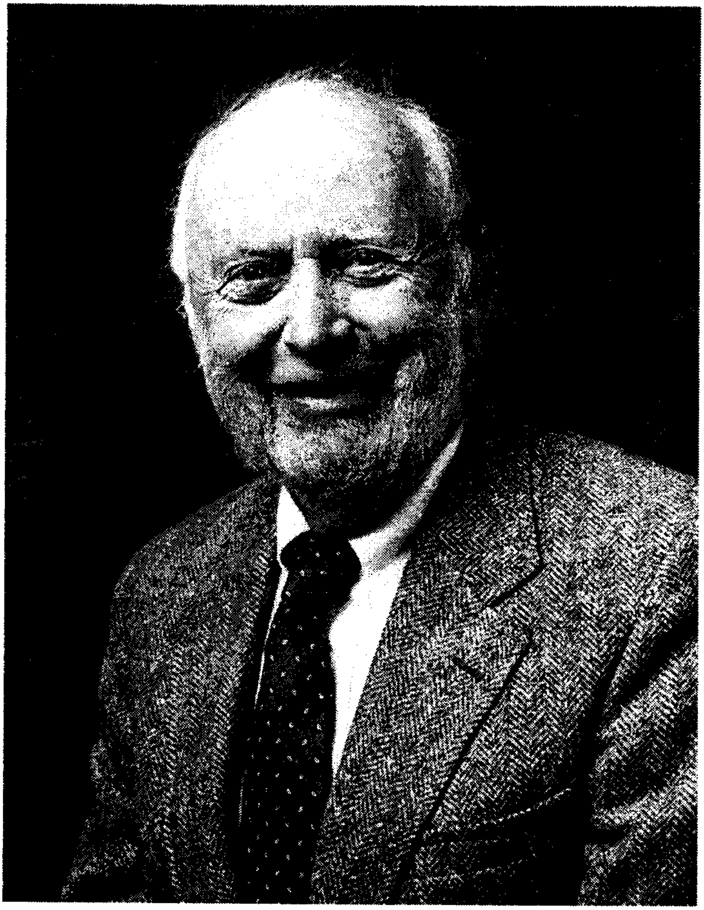

Douglass C. North

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PROFILE

Professor Douglass C. North

Douglass C. North, an American economist who jointly (with R. W. Fogel) won the 1993 Nobel Prize in Economics, was born in Cambridge, Mass., in 1920. He obtained his BA and Ph. D. at UC Berkeley where he started teaching. Before joining the George Washington University at St. Louis, where he teaches economics now he served at Rice and Cambridge universities.

North is a champion of institutional economics and is well known for his explanatory model of American economic growth before 1860s. He casts doubts on many traditional explanations of economic growth arguing that factors such as technical change and innovations are less important than previously claimed by main-stream economists. He puts more emphasis on legal and social institutions such as property rights, patent laws, legal obligations, which provides to the people right and proper inducements to undertake any economic activity (similar as does Ronald H. Coase). He strongly contends that 'one cannot leave development only to markets'. He has been trying to push boundaries of economics by getting economists to focus on institutions as well as exchange and allocation.

North wrote his doctoral dissertation on the history of life insurance in the US. His early work and publications centred around expanding on the analysis of life insurance in his dissertation and its relationship to investment banking.

He next turned to developing an analytical framework to look at regional economic growth and this led to his first article, *Location Theory and Regional Economic Growth*, which eventually led North to develop a staple theory of economic growth.

In 1956-57, he was at the NBER where he did the empirical work that led to his early quantitative study of the balance of payments of the US from 1790 to 1860. His first book, *The Economic Growth of the United States from 1790 to 1860* appeared in 1961. It was an analysis of how markets work in context of an export staple model of growth.

During 1966-1967, while in Geneva, North got interested in European economic history. He became convinced that since the neoclassical theory is static, and its tools not up to the task of explaining the kind of fundamental societal change that had characterised Europe from medieval times onwards, a new dynamic theory which providing new tools of economic analysis is needed. This is how he got interested in the new institutional economics.

In a world of uncertainty mankind has relied on institutions in an attempt to structure human interaction i.e. the rules of the society that provide the framework of incentives that shape economic, political, and social organisation.

Douglass North tried to incorporate institutions into historical economic analysis that resulted in his two co-authored books, *Institutional Change and American Economic Growth* (1971), and *The Rise of the Western World: A New Economic History* (1973), both published by the Cambridge University Press. Both were his early attempts to develop some tools of institutional analysis applied to economic history. Both studies were still predicated on the assumption of neoclassical theory. His self-critical examination of the neoclassical rationality postulate led him to evolve the new analytical framework, i.e. why institutions produce results that in the long run did not manage to produce economic growth, as well as developing a model of political economy in order to be able to explain the underlying source of institution. It was Nobel laureate Ronald Coase who provided the missing critical link which began to structure the evolving framework. Coase stressed that when transactions costs are positive, institution do matter and shape the resultant market structure. In his *Structure and Change in Economic History* (New York: Norton, 1981) Douglass North abandoned the notion that institutions were efficient and attempted to explain why inefficient rules would tend to exist and be perpetuated. In this work he explores the transaction costs underlying different forms of economic organisation in history and the way ideologies altered free-riding to influence political and economic decision-making. In *Structure and Change,* North developed a neoclassical model of the state which confronted the issue why a ruler would ever produce inefficient property rights when efficient rights would increase aggregate income and hence the revenue of the ruler. He concluded that in effect a competitive constraint and a transaction cost constraint were the source of inefficient rules.

The Economics of Public Issues, (co-author with Roger LeRoy Miller, New York: Harper & Row, 1987), is for an introductory economics course but it also deals with such new issues as: 55 mile speed limit on roads, high social costs of alcohol, cut-throat pricing, women and divorce, more taxes and less work, housing prices, and economic growth.

In 1990 North published *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990). In that study he attempted to evolve a theory of institutional change. First he separated institutions (rules) from organisations (actors). He contended that organisations and their entrepreneurs in pursuit of their objectives are the agents of change and that they have come into existence because of the opportunities resulting from the incentives of the institutional framework. In the world of scarcity and competition they compete to survive. That competition leads them to try to modify the institutional framework to enhance their position. Further, in this book he seriously questioned the rationality postulate. Nobel laureate Herbert Simon was the pioneer in examining the actor's subjective perception of real world. Simon maintained that if both the knowledge and computational power of the decision-makers are severely limited then, in order to understand the choices they make, we must distinguish the real world from their perception. However, while Simon's emphasis was on bounded rationality, North's concern is on the information available to the actor, and thereby the imperfect feedback resulting from his choices. North emphasised that one can not understand the ideologies without digging deep into cognitive science. He provides a theoretical foundation for the study of institutions and institutional change and for explanation of the problem of human cooperation.

In his *Transaction Cost Theory of Politics* (1991), North developed a more general model of why political markets are inherently less efficient than the economic markets. He tried to prove that in political markets the promises are exchanged for votes and there is no comparable enforcement mechanism, competition is imperfect, and issues are complicated the incentives for efficiency are thus diluted by the its structure and complexity of issues*.

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Zagreb, 15 October, 1999 Soumitra Sharma

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*Composed from the Swedish Academy citation and press releases on the eve of Nobel Award.