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The institutional approach to economic history: Connecting the two strands

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ABSTRACT

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This essay examines the historiography of two episodes in history—the scattering of plots in the open fields in the Middle Ages and the transition to the factory system in the Industrial Revolution—to shed light on the uses of institutional economics in economic history. In both of these episodes, economic "just-so" stories advanced our understanding of history. What animated intellectual innovation in both cases was a bold conjecture about the *raison d'être* of a puzzling institutional structure. But what ultimately enriched our understanding was the process of conjecture and revision those conjectures set off. In both episodes, the revised conjectures that best withstood criticism and revision were those that saw the phenomena not as static snapshots of economic agents confronting an economic problem but rather those that embedded the phenomena within a larger economic problem and within a process of economic change. In the end it is an account of institutional change—what I call the good old New Institutional Economics—that connects the use of institutional economics to explain puzzling historical phenomenon with the role of institutional economics in addressing the big questions of economic growth. *Journal of Comparative Economics* **45** (2017) 201–212. The University of Connecticut, Storrs, CT 06269-1063, USA.
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In recent years the economics of institutions has arguably taken center stage in economic history.[1] What has been less well noted, however, is that economic historians have tended to practice their institutional economics in two seemingly quite different ways. One could even say that these are two different varieties, or even two different strands, of institutional economics.

The boldest and most prominent strand in the institutionalist tapestry is that woven by the grand thinkers. Beginning at least with Nobel Laureate Douglas North (1981, 1990) and represented more recently by Daron Acemoglu and James Robinson (2012), these thinkers want to demonstrate the crucial role of institutions as central causative elements in economic growth.[2] The astounding rise in incomes per capita in the Western world in the modern period—and the Great Divergence of those Western per capita incomes from incomes in the rest of the world—is quite possibly the most significant historical phenomenon that social science must confront (McCloskey 2010). Here institutional explanations—focusing mainly on

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[1] As well as in its intellectual cousin, development economics. Once upon a time, the Third World was the whole world.

[2] Geoffrey Hodgson (2006, p. 2) defines institutions as "systems of established and prevalent social rules that structure social interactions."

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legal systems and structures of property rights—grapple and intertwine with explanations giving greater prominence to factors like geography, climate, resource endowments, culture, or ideas (Allen 2009; Diamond 1997; Jones 2003; Landes 1998; McCloskey 2010; Mokyr 2002; Pomeranz 2001).

At the same time, however, there is a quite different strand, or skein of strands, of institutional economics that wind their way in softer colors through economic history. In this version of the economics of institutions, which I will want to associate with the so-called New Institutional Economics (NIE) in its narrowest sense, one observes a (perhaps puzzling) matrix of institutions in history and asks: *what problem were these institutions solving*? Rather than labeling puzzling behaviors as ignorant and inefficient (as historians once tended to do) or exclusively as mechanisms for oppressing the lower classes (as many still tend to do), the NIE attempts to explain such puzzles as responses to the costs, constraints, and scarcities the economic actors faced. This is the method of comparative-institutional analysis, inspired by Coase (1937, 1960), pioneered by Demsetz (1969), and championed by Williamson (1991). Rather than comparing actual (maybe puzzling) behavior against some imaginary frictionless standard, the NIE insists on comparing plausible institutional systems in real-world contexts rich in transaction (and other) costs. Explanation here consists in arguing that, and in detailing precisely how, the institutional system we observe is actually confronting some specified economic problem better than alternative candidates would have done. The hard part—the creative part—lies in discovering or imagining the right economic problem. What economic problem were they solving?

Notice that this a rather different, and seemingly more modest, insertion of the economics of institutions into the debates of economic history. Of course, there is a trivial sense in which the enterprise of people like Acemoglu and Robinson is about "puzzle solving" as well. They see institutions as the solution to the biggest puzzle of all: what leads to sustained intensive economic growth. At this level, of course, all of science, social or otherwise, is about solving puzzles. My point is that one strand of the economics of institutions applied to economic history is about *micro-puzzles*, of the sorts I will discuss in more detail below.

I want to draw attention to two related issues. First, does this "puzzle solving" approach to economic history stand up to close scrutiny? And, second, even if it does, how do we get from the solution of micro-puzzles to tackling the big puzzle of economic growth? How do we connect the two strands? My argument will be that resolving the first issue resolves the second. By examining the historiography of two major puzzles in European economic history, I will argue that the methodological approach of the NIE in practice necessarily confronts the issue of institutional change. More than that, it casts institutional change in terms of the stuff of economic growth: productive rent-seeking behavior.

Notice that I said "in practice." Taken at an abstract level, the practice of supplying alternative economic problems that observed institutions might be solving sounds like the vice of functionalism. One would be creating a set of "just-so" stories: accounts that are sufficient but not necessary, that fit the facts but may not be the best, let alone the only, plausible story. But this would not take into account the larger process of appraisal and revision to which economic historians subject these "just so" accounts. One of the lessons of the philosophy of science, it seems to me, is that it is ultimately impossible to rule out theories—or solutions to historical puzzles—on abstract methodological grounds. What defeats a weak theory in the end is another, stronger theory. Comparative-institutional analysis thus depends and thrives on criticism and revision. Without criticism and revision, the "which problem?" approach would indeed be a slightly less fanciful version of Kipling. But *with* criticism and revision, including criticism from empirical evidence of various kinds, the "which problem?" approach is essentially what evolutionary biologists do.[3] I recount below a couple of cases in which, I believe, the process of criticism and revision has refined, modified, and enriched institutional explanations that began (among economists) with a conjectured just-so story.

I have long argued that it is important to place any just-so story in its proper temporal or historical context: to pay attention to how institutions change, not just to how they solve a static snapshot of an allocation problem (Langlois 1986). From a methodological point of view, one wants to engage institutional change because change helps focus us on the nature of the selection problem that inevitably sits behind every institutional problem. In asking the "which problem?" question, we really also need to ask: "why did this institutional solution come to be and why does it persist?" At the broadest level, of course, the answer to the existence and persistence question is ultimately some kind of mechanism of variation, selection, and retention (Hodgson and Knudsen 2010), even though conscious intention and design play a role in economic life that they do not have in Darwinian biology. At a finer level of detail, however, any explanation of specific institutional changes must take off from the initial conditions of some appropriate static "which problem?" conjecture. Institutional change in specific historical settings is about economic agents adapting to exogenous and endogenous changes in the economic problem they are confronting. Applying concepts like efficiency and optimality is no more appropriate here than it would be in assessing the "function" or adaptive properties of a relatively stable or static institutional system. But that does n't mean that basic economic concepts like relative scarcities are n't essential to explaining the why and how of specific institutional changes. One goal of this paper is to argue in favor of one approach to bringing economic principles to bear on the phenomenon of institutional change—an approach I will call the good-old New Institutional Economics.

Notice again how an account of institutional change connects the two strands of institutionalism. By identifying how the economic problems themselves change, we have some hope of talking about how resources might—sometimes—be

[3] Just one example: Ruxton (2002) surveys the various conjectures about, and evidence for, the benefits to zebras of having stripes. This is not an account of how the zebra *got* its stripes. As in the economics of institutions, the answer to the "how" question is evolution. But conjectures about the possible adaptive functions of stripes are an essential part of a specific account of the zebra.

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