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DOUGLASS C. NORTH AND NON-MARXIST INSTITUTIONAL DETERMINISM

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Men imprison themselves within structures of their own
creation because they are *self-mystified*.
— Edward Palmer Thompson[1]

Douglass North has written many essays and books over forty or more years in which he has sought to reintegrate economic theory and economic history. His project became more and more ambitious over time, producing interesting insights, questions, and narratives. His early interests and work centered on the economics of location, transportation costs, and interregional economic relations in American history. In mid-career, he seized on transaction costs—modified from time to time by other "variables"—as the main motor of history, economic history, and institutional development.

It was North's approach to combining history and theory that helped him bring into being the New Economic History and, later, what North and his school call the New Institutional History. For his efforts, North shared the 1993 Nobel Prize in Economics with Robert W. Fogel, a University of Chicago economist who is a major practitioner of Cliometrics, or quantitative economic history. The Nobel Committee cited North and Fogel "for having renewed research in economic history by applying economic theory and quantitative methods in order to explain economic and institutional change."[2]

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[1]E.P. Thompson, *The Poverty of Theory and Other Essays* (London: Merlin Press, 1978), p. 165.

[2]"Press Release," The Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel, *www.nobel.se/economics/laureates/1993/press.html.*

According to one of North's former graduate students,

> North has attempted to explain the historical transformation of property rights, legal systems, and other institutional arrangements by devising an explicit economic model of institutional change.[3]

In all of his work, North has sought to bring theory into economic history as an explanatory tool. There is, thus, a noteworthy resemblance to Marxism.[4] As with Marxism, practitioners of North's system run the risk of positing universal, directional laws of history.

In the end, though, North's work runs aground because of its reliance on unrealistic models derived from positivist premises and a failure to understand the proper relationship between theory and history.

THE OLD AND THE NEW ECONOMIC HISTORY

Before North and his New Economic History, much of the existing economic history was some variant of historicism. Economic historians offered partial or situational explanations of historical events, sometimes by gathering price series data, but they generally did so in the absence of economic theory (except, perhaps, for some very basic price theory). Such historical analysis was primarily, or even exclusively, empirical. William N. Parker, one the first of the New Economic Historians, describes the older economic history thus:

> The German economic historians who were interested in stages or the English who were interested, like Unwin and Ashley, in pre-capitalist forms were not really concerned with explaining growth. They were concerned with a stage or an historical period as a self-contained mechanism producing a certain class structure, a certain distribution of income and a certain standard of economic welfare and economic power. . . . Economic history was conceived

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[3]Richard Sutch, "Douglass North and the New Economic History," in *Explorations in the New Economic History: Essays in Honor of Douglass C. North*, ed. Roger L. Ransom, Richard Sutch, and Gary M. Walton (New York: Academic Press, 1982), p. 15.

[4]At the University of Washington in the early 1950s, North called himself a Marxist. See *www.nobel.se/economics/laureates/1993/north-autobio.html* for North's autobiographical comments on the subject. See also Jonathan R.T. Hughes, "Douglass North as a Teacher," in *Explorations in the New Economic History,* pp. 4–5 and 9.

> partly as a means of producing a repertoire of forms of economic organization, primitive, ancient, medieval, early modern, which could be drawn upon by anti-capitalist reformers to ameliorate and counteract the individualistic and exploitative aspects of nineteenth-century capitalism.[5]

In the United States, the older economic historians studied regions, particular industries, labor relations, slavery, or specific problems like the role of salt in the Confederacy, but all without the intrusion of much theory. From the standpoint of the New Economic Historians, this was the great failing of the older ones. The younger scholars also wished to displace competitors such as W.W. Rostow, whose Cold War Liberal presentation of economic history as a theory of *stages* of growth seemed insufficiently theoretical.[6]

Against this background, North and his school emerged. Rather than seeing economic history as something separate from economics, they viewed it as an application, and attempted to analyze history using neoclassical economic theory as a foundation. Neoclassical economics might be defined as "the research program that is founded upon individual rationality with fixed tastes."[7] As one commentator suggested:

> In its purest form, neoclassical economics deals with the allocation of resources under the conditions of perfect information and no transactions costs. Changes are brought on by changes in relative prices; such constraints as tastes, technology, population, and property rights are held constant.[8]

The new economic historians, then, tried to bring neoclassical order into what they viewed as the existing chaos of economic history. They wanted to build models from which testable hypotheses could be drawn.

Rational, maximizing, essentially identical individuals with fixed tastes competing in markets without information costs or transaction

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[5] William N. Parker, "From Old to New to Old in Economic History," *Journal of Economic History* 31, no. 1 (March 1971), pp. 11–12.

[6] W.W. Rostow, *The Stages of Economic Growth: An Anti-Communist Manifesto* (Cambridge: Cambridge University Press, 1960).

[7] Ben J. Heijdra, Anton D. Lowenberg, and Robert J. Mallick, "Marxism, Methodological Individualism, and the New Institutional Economics," *Journal of Institutional and Theoretical Economics* 144 (1988), p. 296.

[8] Andrew Rutten, "But It Will Never Be Science, Either," *Journal of Economic History* 40, no. 1 (March 1980), p. 140.

costs—the latter being the "economic counterpart of friction"[9]—are the rather unlikely and uninteresting human subjects of neoclassical theory. This circumstance flows from the neoclassical economist's ambition to emulate the proper "scientific" methods of physics.[10] This desire is much in the line of Leon Walras, who stated that "the pure theory of economics . . . resembles the physico-mathematical sciences in every respect." Samuel Bowles and Herbert Gintis observe that, on this ground, "interactions among economic agents might be represented *as if* they were relationships among inputs and outputs."[11]

However, there is "a wide range of problems for which" these neoclassical assumptions are "unworkable, since change in the parameters is the target for explanation."[12] Thus, the question quickly arises whether one can do *history*—even *economic* history—on such a basis? Surveying the early efforts to do so, a veteran of the older economic history, Fritz Redlich, wrote in 1965, that the "new approaches to economic history are definitely positivistic, in that for positivism nothing matters unless it can be counted, measured, or weighed."

However, Redlich argues that the new lines of attack, while "positivistic at their roots, are antiempiricistic through their reliance on economic theory."[13] This circumstance reflects a fundamental problem built into the reigning empiricist and positivist epistemologies which often leads to a discipline split between the advocates of Grand Theory and those of Abstracted Empiricism.[14]

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[9]Oliver E. Williamson, "The Economics of Organization: The Transaction Cost Approach," *American Journal of Sociology* 87, no. 3 (November 1981), p. 552.

[10]John C. Moorehouse, "The Mechanistic Foundations of Economic Analysis," *Reason Papers* 4 (Winter 1978), pp. 49–67.

[11]Samuel Bowles and Herbert Gintis, "The Revenge of Homo Economicus: Contested Exchange and the Revival of Political Economy," *Journal of Economic Perspectives* 7, no. 1 (Winter 1993), p. 84, emphasis in original. Walras is quoted on the same page.

[12] Rutten, "But It Will Never Be Science, Either," p. 140.

[13]Fritz Redlich, "'New' and Traditional Approaches to Economic History and Their Interdependence," *Journal of Economic History* 25, no. 4 (December 1965), p. 481.

[14]C. Wright Mills made a similar observation about the division between sociologists in *The Sociological Imagination* (New York: Oxford University Press, 1970), chaps. 2 and 3.

Thus, while the addition of economic theory to the study of history was long overdue, it is not at all clear that North's efforts were the correct way to incorporate it. Indeed, the New Economic History may create as many problems as it solves.

THE EVOLUTION OF NORTH'S THINKING

In his successive attempts to infuse theoretical rigor into economic history, Douglass North shifted his interest and focus from topic to topic. Like frontier historian Walter Prescott Webb, who started with the Texas Rangers, moved on to the Great Plains, and finished with the global Great Frontier, North, too, has broadened the scope of his work over time. At each stage, his attempt to reach for greater historical realism has conflicted with the grossly unrealistic assumptions of neoclassical economics, and quite reasonably, therefore, at each stage he has shed or loosened some of those assumptions.

North's Early Work

North's early work was in American economic history, centering on the economics of location and the costs of transportation. He stressed the "export-led" character of American economic development at the local level. Later, North presented a tri-regional model of nineteenth-century American economic development. [15]

North also focused on the use of government by economic interests seeking to channel trade in their direction or to lower artificially their existing transportation costs. His implicit Middle Way political philosophy left a fairly large and legitimate role for government.

Importantly, his arguments suggested that James Madison's political economy, as sketched out in *Federalist* No. 10, was doomed from the outset. Madison famously argued that widening the scope of the union would dilute "factions" (organized economic interests), thereby reducing their influence on public policy. As North's work suggested, a

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[15]Claudia Goldin, "Cliometrics and the Nobel," *Journal of Economic Perspectives* 9, no. 2 (Spring 1995), pp. 195–98. For a sample of North's early work, see Douglass C. North, "Location Theory and Regional Economic Growth," *Journal of Political Economy* 63, no. 3 (June 1955), pp. 243–58; Douglass C. North, "Ocean Freight Rates and Economic Development, 1750–1913," *Journal of Economic History* 18, no. 4 (December 1958), pp. 537–55; and Douglass C. North, *The Economic Growth of the United States, 1790–1860* (New York: W.W. Norton, 1966).

larger union simply set up a scene in which bigger interest groups could compete for control of the *central* government, and in the process wield various broad-constructionist arguments in favor of legislation they wanted.

North and the Cliometricians

Cliometrics, the quantitative study of economic history, was part and parcel of the New Economic History. It came into being, in part, through conferences held at Purdue University in the 1960s.[16] The increased availability of statistical material and price series data helped move it along, as well as the fact that the neoclassical method required numbers with which to work. Advances in computer technology also played a particularly important role. As Thomas Cochran wrote in 1969:

> Greater completeness in mathematical models has been enormously aided by the rapid spread in the use of the computer in the United States. Now the only limit to the number of operative variables is the ingenuity of the scholar in relating them to each other.[17]

For 10 or 15 years, the cliometricians—the statistical wing of the New Economic History—had a brilliant run, seemingly revolutionizing economic history, at least, until satiation or methodological disillusion set in. The most famous product of the school was probably Robert W. Fogel and Stanley L. Engerman's *Time On the Cross*,[18] which revised historical understandings of slavery and the Old South on the basis of statistical models helped along by conjectures, leaps of theoretical faith, and occasional common sense.

However, not everyone found convincing the notion that real historical insight could be gained by running statistical data through hypotheses based on wildly unrealistic assumptions. Fritz Redlich's assessment, already mentioned, was very critical. He distinguished between hypotheses "based on assumptions which are held to have a counterpart in reality" and "figments . . . assumptions having no such counterparts or at least known to be irrealistic." The latter were "mere

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[16]For perhaps the first important salvo from the Cliometricians, see Alfred H. Conrad and John R. Meyer, "The Economics of Slavery in the Ante Bellum South," *Journal of Political Economy* 66, no. 2 (April 1958), pp. 95–130.

[17]Thomas C. Cochran, "Economic History, Old and New," *American Historical Review* 74, no. 5 (June 1969), p. 1568.

[18]Robert W. Fogel and Stanley L. Engerman, *Time On the Cross: The Economics of American Negro Slavery* (Boston: Little, Brown, 1974).

'as if ' constructs . . . neither verifiable nor falsifiable."[19] He was very critical of the cliometricians as users of figments.

In its earliest phases, North supported Cliometrics, but he became increasingly critical. By the 1970s, a clear separation between North's vision and that of the cliometricians had come into view. Because of this separation, Redlich partly exonerated North from his strictures on Fogel and some others. North's argument in his *Economic Growth of the United States* was "clearly hypothetical as opposed to fictitious," and, thus, fell within the legitimate and necessary methods of the historian. Even so, Redlich went on:

> there is a fictitious element implied in his work, as in that of all scholars who identify economic development with some set of figures, whatever their character. . . . [North's] integrated discussion . . . was made possible by his bringing every phenomenon on a quantitative level . . . [but] figures are not identical with any process whatsoever . . . [since they] stand for something, in this case the *result* of a process.[20]

Douglass North worked in the New Economic History roughly from the late 1950s through the 1960s. He served as co-editor of the *Journal of Economic History* with William Parker from 1960 to 1966. By early 1970s, North was growing restless at the theoretical limitations imposed by neoclassical economic theory. He broke with the statistically-oriented cliometricians and set out on a new path: the New Institutional History, sometimes also called the New Institutional Economics.

To understand North's next evolution, it is necessary to take a momentary digression into the work of Ron Coase.

Ron Coase and the Role of Transaction Costs

Within neoclassical economics, a number of schools now exist,[21] sharing theoretical fundamentals but disagreeing on how best to apply

[19]Redlich, "'New' and Traditional Approaches," p. 484.

[20]Redlich, "'New' and Traditional Approaches," pp. 485–86, emphasis in the original.

[21]These schools and their key thinkers include Nobel laureate Milton Friedman and Monetarism, Nobel laureate Ron Coase and Law and Economics, Nobel laureate James Buchanan and Public Choice, Nobel laureate Douglass North and the New Economic / New Institutional History, and Nobel laureate Robert Lucas and the Rational Expectations / New Classical school.

those principles. When North and his colleagues began propagating their new economic history, they did so within the specific neoclassical tendencies that arose around the work of English economist Ronald H. Coase.

In his classic 1937 paper "The Nature of the Firm," Coase put forth the idea that transaction costs are the key to firms, and that firms are created because their transaction costs are lower than are the costs of using the price mechanism for allocating resources.[22] (However, according to Oliver E. Williamson, a proponent of explanations via transaction costs, it was "John R. Commons in 1934" who first maintained "that the transaction is the basic unit of economic analysis."[23])

Analysis centering on transaction costs was taken into the emerging Chicago School tool kit resulting in the rise of the Law and Economics field with its own *Journal of Law and Economics*, founded in 1958. In 1960, Coase added the very influential paper "The Problem of Social Costs," in which he extended his analysis of transaction costs and legal issues.[24] In 1964, Coase migrated to the University of Chicago, where he spent the rest of his academic career.

Although many commentators write as though Law and Economics has involved a raid by economists into the fields of the legal theorists, it was, in fact, the role of Coase and his successors to bring ideas of questionable value to economics from the law, where they already abounded.[25] As we have seen, Commons anticipated Coase's "turn" by a few years, when he observed that:

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[22]Ronald H. Coase, "The Nature of the Firm," *Economica* 4 (November 1937), pp. 386–405.

[23]Williamson, "Economics of Organization," p. 550.

[24]Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (October 1960), pp. 1–44.

[25]Judges were never shy about reallocating property titles between parties or even to the state itself in the name of the people. For an array of proto-Coasean decisions and polices, see Morton Horwitz, *The Transformation of American Law, 1780–1860* (Cambridge, Mass.: Harvard University Press, 1977); Harry N. Scheiber, "Property Law, Expropriation, and Resource Allocation by Government: the United States, 1789–1910," *Journal of Economic History* 33, no. 1 (March 1973), pp. 232–51; and Harry N. Scheiber, "Regulation, Property Rights, and Definition of 'The Market': Law and the American Economy," *Journal of Economic History* 41, no. 1 (March 1981), pp. 103–9.

> the court starts with a transaction. . . . The transaction is two or more wills giving, taking, persuading, coercing, defrauding, commanding, obeying, competing, governing, in a world of scarcity, mechanism and rules of conduct.[26]

But what comes into court is a dispute *about* a transaction. It hardly follows that transactions must therefore become the central theoretical unit of focus for economic theory. As for transaction costs themselves, we may provisionally define them as costs involved in the negotiation and enforcement of contracts.

Richard a Posner, a Coasean and a federal judge, summarizes the Coase Theorem thusly:

> If transaction costs are zero, the initial *assignment* of a property right—for example, whether to the polluter or to the victim of pollution—will not affect the *efficiency* with which resources are allocated.[27]

R.C.O. Matthews adds:

> Coase argued that any system of property rights is capable of leading to Pareto-efficiency provided it is a complete system, a complete system meaning one where all rights to all the benefits from all scarce resources are imputed to someone and are tradeable; but that a complete system is never possible, because of transaction costs; and that some incomplete systems, i.e. some institutions, are more conducive to a Pareto-efficiency than others.[28]

As such, Coaseans dislike "public intervention in markets beyond what is defensible in strict wealth-maximization terms." But the law should intervene when transaction costs are "incorrigibly prohibitive, to bring about the allocation of resources that would exist if they were zero."[29]

Here we are at the intersection of a whole set of issues, or maybe different aspects of the same problem. Coaseans claim that they can intelligently discuss efficiency at the level of whole economies mechanistically modeled on physics. From this, they can draw conclusions

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[26]Quoted in Richard Swedberg, "Major Traditions of Economic Sociology," *Annual Review of Sociology* 17 (1991), p. 256.

[27]Richard A. Posner, "Nobel Laureate: Ronald Coase and Methodology," *Journal of Economic Perspectives* 7, no. 4 (Fall 1993), p. 195, emphasis added.

[28]R.C.O. Matthews, "The Economics of Institutions and the Sources of Growth," *Economic Journal* 96 (December 1986), p. 904.

[29]Posner, "Nobel Laureate," pp. 201 and 203.

about transaction costs—what they are and who should pay them—in the name of overall "social efficiency." These problems, in turn, are bound up with such matters as "public goods," free-rider problems, and the ideal role (if any) of the state in economic life, as well as with "externalities," that is, "bads" such as pollution or trespasses.[30]

However, the term "trespass" necessarily assumes boundaries grounded on pre-existing property rights, boundaries which these writers wish to hold in suspense while they work out the larger social gains or losses. Thus, the Coaseans are making an elaborate end-run around the generally admitted (and then dismissed) problem of interpersonal comparisons of utility.[31] They stay within their utilitarian, positivist, and empiricist framework, and yet make statements about desirable public (state) policy.

Eirik G. Furubotn and Svetozar Pejovich catch the spirit of the movement when, discussing property rights, they write:

> If the prevailing structure is to be modified by social action designed to reduce or eliminate the effects of an externality, taxes must be imposed on those who will gain from the proposed legal change, and compensation paid to those who will suffer capital loss or loss of satisfaction [!] as a result of the new law.[32]

Thus, in the name of maximum economic growth, economic output, and social welfare, Coaseans call for elimination of "too high" transaction costs by some authority—the state, experts, judges—via reallocation of property "rights" to those who can absorb the shifted costs more cheaply.

Out of this theoretical orientation arose the very influential Law and Economics research program and a whole intellectual movement working within so-called "property rights economics." Yet, as Gary

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[30]The size of enterprises, the choice between enlarging a firm or using external markets, socialist calculation, and anti-trust issues are also implicated in these discussions.

[31]On the problems of interpersonal utility comparison, see Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," chap. 10 in *Money, Method, and the Austrian School*, vol. 1 of *The Logic of Action* (Cheltenham, U.K.: Edward Elgar, 1997), pp. 211–54.

[32]Eirik G. Furubotn and Svetozar Pejovich, "Property Rights and Economic Theory: A Survey of Recent Literature," *Journal of Economic History* 10, no. 4 (December 1972), p. 1142. Their survey, pp. 1137–62, stands as a good review of the so-called "property rights economics" literature up to 1972.

North has written, the whole undertaking was grounded on "R.H. Coase's theorem . . . one of the most subtle yet profound attacks ever written on the concept of private property rights."[33] In short, it could be argued that this "property rights" movement was "about" property rights, or "interested" in them, but not necessarily in favor of them.

North's Institutional Turn

In his next phase, Douglass North began incorporating Coase's ideas on transaction costs. North tried "to explain the historical transformation of property rights, legal systems, and other institutional arrangements by devising an explicit economic model of institutional change."[34] In 1970, North and Lance Davis sought to build a "model" which would predict economic-historical changes, given a set of institutions ("environment"), an institutional "arrangement between economic units," and disequilibrating forces. The explanation hinged on "an action group" which would seek institutional reforms if the members "recognized some potential income that *they* could receive if only they could alter the institutional structure." "Secondary action groups" spearhead such campaigns to capture extra income via one or another "institutional instrument."[35]

Next, total social income, externalities, "market failures," and other matters are canvassed, though we seem no wiser, in the end, than a traditional historian using his accustomed methods. Indeed, we may be less wise. For example, North and Davis write that the land values accruing to western farmers living near land bought up by a railroad typically rose dramatically, but the railroad could not somehow *charge* the farmers money for this unbidden positive externality. This is taken to be a terrible systemic "problem" that discourages the railroad from building, and thereby reduces the total social productivity and income. Given high information costs, North and Davis argue, risk and uncertainty may be so daunting that "markets [will] not operate at all."[36]

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[33]Gary North, *The Coase Theorem* (Tyler, Tex.: Institute for Christian Economics, 1992), p. xv.

[34]Sutch, "Douglass North and the New Economic History," pp. 14–15.

[35]Douglass C. North and Lance Davis, "Institutional Change and American Economic Growth: A First Step Toward a Theory of Institutional Innovation," *Journal of Economic History* 30, no.1 (March 1970), pp. 131–34.

[36]North and Lance, "Institutional Change and American Economic Growth," pp. 135, 137.

This, apparently, is a case of market failure, but in practice it just tells us that certain people did not trade with one another and so that there was no "market" which could fail. We begin to see here an ominous reification of the market which has little to do with economics or history. For Davis and North, the crux of the matter seems to be the following:

> Although the profit does not come from an increase in total income, there are profits inherent in any arrangemental innovation that leads to a redistribution of income. Since successful capture means a loss to someone, the probabilities that such capture can be effected without reliance on some governmental coercive power are very small. In these cases, it is very likely that the gains can be captured only by the innovation of an arrangement that puts coercive power in the hands of a governmental secondary action group or that effects "enabling" legislation which permits some voluntary or quasi-voluntary group to artificially alter the supply of inputs or output of a good or service.[37]

Here the New Economic History begins more and more to resemble an elaborate "social-scientific" rationalization of the actual interest-group liberalism or corporatism of mid-twentieth-century America. We are not long held in suspense over this. We are told that "[t]he decision to let government underwrite canal investment during the 1830s was, given the primitive state of the American capital market, a rational one." Further, say Davis and North, as the American market grew in the nineteenth century, "it created potential profits for those who would innovate institutional arrangements to reduce transaction costs."[38]

The political method of "perfecting markets" and reducing various kinds of costs alleged to have been "too high" has, over the past three centuries, brought into being a number of political movements—Jeffersonian, Jacksonian, etc.—whose members knew they were paying for someone else's improved position, and accordingly rejected the innovations. Their grievances do not matter to the Coaseans and Northians, who hold that property rights are not absolutes, and the losers can't complain provided they are "compensated" by taxes levied on the winners.

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[37]North and Lance, "Institutional Change and American Economic Growth," pp. 137–38.

[38]North and Lance, "Institutional Change and American Economic Growth," pp. 146–47.

Part of North's reworked system in his "middle period" of the New Economic History involved increased use of the Coasean theme of transaction costs. Over time, this supplanted or subsumed his older stress on location and transportation costs. In North's later work, indeed, attempts at reducing transaction costs became the key to political struggle as well as being the motor of western history.

Another important influence on North's new line of analysis was a paper written by Frederic C. Lane in 1958. In it, Lane discussed states as producers of a service: "protection." As specialists in violence, states were "natural monopolies" whose activities were a mixture of necessary policing and racketeering. Encumbered with the usual neoclassical assumptions and political biases, Lane saw no point in distinguishing payment for this service from plunder; a separation was not possible. As such, it would be useful to think of states as neoclassical *firms*.[39]

North soon mated these ideas with the Coasean focus on transaction costs, concluding that part of the "protection" provided by states was precisely the specification and allocation of property rights as such. When hypotheses are formed, given a set of mechanistic, neoclassical assumptions in which certain variables are functions of others, there tends to arise a search for the One Great Causal Key. Douglass North believed he found it in transaction costs. The outcome was the New Institutional History.[40]

The New Institutional History

In 1971, North expressed his desire to loosen his neoclassical bonds. Existing theory had "two major shortcomings. . . . It was not designed to explain long-run economic change" and, by assuming zero transaction costs, it could provide only "limited answers" to historical questions. What was needed was a theory that accounted for changes in the system of property underlying the whole economy. North believed transaction costs to be "the link between neo-classical theory and a broader study of property rights."[41]

In this newer body of work, we see North's discontent with standard theory driving him in the direction of the older institutionalism,

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[39]Frederic C. Lane, "Economic Consequences of Organized Violence," *Journal of Economic History* 18, no. 4 (December 1958), pp. 401–17.

[40]Swedberg, "Major Traditions of Economic Sociology," pp. 256–57.

[41]Douglass C. North, "Beyond the New Economic History," *Journal of Economic History* 34, no. 1 (March 1974), pp. 2, 4.

and even toward a near-Marxist attempt to explain the logic of social-institutional change. In North's new system, a struggle to reduce transaction costs stood in for the Marxist class struggle as the driving force of western history and the explanation of western economic development, as against stagnation elsewhere.[42]

North and co-author Robert Paul Thomas presented the gist of this new interpretation of history in a 1971 article, and repeated it in their 1973 book, *The Rise of the Western World*.[43] This argument, centered on the transition from feudalism to capitalism, touched off much debate and formed the basis of North's later work. At issue was nothing less than a complete reorientation of western history.

For North and Thomas, late medieval "serfdom in Western Europe was essentially not an exploitative arrangement where lords 'owned' labor."[44] Instead, lords provided the "public good" of protection services in exchange for revenue. In the absence of developed markets, bargaining between lords and peasants was over goods in kind, leading to a choice between fixed wages, fixed rents, or forms of shared input. In this view, the costs of making such contracts and enforcing them determined the outcome, which was some form of shared production inputs.

Rising population led to a "frontier movement" into previously unused or sub-marginal land. This, in turn, stimulated the growth of wider markets. Thereafter, a dramatically lowered population—the result of the recurring plagues of the fourteenth century—strengthened the bargaining position of peasants, especially as lords came under inflationary pressures. Arrangements involving shared inputs gave way to "fixed money payment—the value to the tenant of the public goods he received" from the lord.[45] Finally, competition between lords for relatively scarce labor led to long-term leases approaching private property for the peasants.

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[42]In fact, some of North's adherents have made precisely this comparison with Marxism. See Heijdra, et al., "Marxism, Methodological Individualism, and the New Institutional Economics," pp. 296–317.

[43]Douglass C. North and Robert Paul Thomas, "The Rise and Fall of the Manorial System: A Theoretical Model," *Journal of Economic History* 31, no. 4 (December 1971), pp. 777–803; and Douglass C. North and Robert Paul Thomas, *The Rise of the Western World* (Cambridge: Cambridge University Press, 1973).

[44]North and Thomas, "The Rise and Fall of the Manorial System," p. 778.

[45]North and Thomas, "The Rise and Fall of the Manorial System," p. 794.

Hereafter, North's work focused on the interaction between population, technology, and institutions specifying property rights, all referring back, in the end, to solving problems of transaction costs. The latter became the key variable in western history and the potential "explanation" of political outcomes, country by country, either of sustained economic growth, or of failure to achieve sustained growth, when the institutional structure was not modified so as to resolve transaction cost problems. Needless to say, whatever North's intentions at the start of his project, a kind of transaction-cost determinism soon characterized his work.

By 1979, North was calling for a more explicit "model" of the state as the next stage in understanding institutional development.[46] In his 1981 book, *Structure and Change in Economic History,* North undertook to answer those who had questioned his discussion of the transition from feudalism.[47] In 1988, developing Simon Kuznet's notion that defense expenditures were an "intermediate" product and not an "end product," North and John Joseph Wallis asked if transaction costs should "be subtracted" from figures for GNP.[48] They claimed that transaction costs accounted for some 30% of the U.S. economy, a proportion which has only grown in North's later work.[49]

In a major article in 1989, North and Barry R. Weingast explained the politics of seventeenth-century England in terms of the struggle to specify and secure property rights, all in the shadow of transaction costs.[50] The authors do manage to show that the triumph of the Whigs secured *some* people's property rights. However, their claim that the

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[46]Douglass C. North, "A Framework for Analyzing the State in Economic History," *Explorations in Economic History* 16 (1979), pp. 249–59.

[47]Douglass C. North, *Structure and Change in Economic History* (New York: W.W. Norton, 1981).

[48]Douglass C. North and John Joseph Wallis, "Should Transaction Costs be Subtracted from Gross National Product?" *Journal of Economic History* 48, no. 3 (September 1988), pp. 651–54.

[49]See Douglass C. North's 1994 lecture, "Institutions, Organizations and Market Competition," *http://www.ie.boom.ru/Library/North4.html*. In this version, transaction costs considered as "social costs" have eaten half the economy and threaten us with the end of life as we know it.

[50]Douglass C. North and Barry R. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England," *Journal of Economic History* 49, no. 4 (December 1989), pp. 803–32.

Bank of England raised economic gains to otherwise impossible heights does not seem as conclusive as they believe it to be.

In further scholarly productions, North sought to tighten his theoretical model, or models, with better definitions of institutions.[51] In his further moves away from neoclassical assumptions, North has concluded that a major task of future economic-institutional history is to show how ideology is based on information costs.[52] After all, it would be wrong to leave ideology to mere historians.

By 1994, North was writing about the importance of a "theory of economic dynamics" for the study of economic development over time. He had shed or loosened more and more of the assumptions which had given "mathematical precision and elegance" to the "frictionless and static world" in the original neoclassical synthesis, retaining only "the fundamental assumption of scarcity and hence competition and the analytical tools of microeconomic theory." His new formulation, he wrote, "modifies the rationality assumption" and "adds the dimension of time."[53] This last turn is very interesting from an Austrian standpoint, but it seems to have come too late in the game to pull North's theoretical wagon out of the historical ditch.

Thus, over forty years, North continued to work out of a theoretical outlook in which economies somehow generate a lot of stuff. Economic competition and political strife spring up over the "capturing of gains from trade" or the sharing of potential "rents."

A Critique of the Fundamentals of the Northian Paradigm

North has advanced some bold theses and, in his favor, it must be said that he does not always write in the manner of those who see history as a huge reservoir of empirical data which exists mostly so that hypotheses may be tested, falsified, and then re-tested. He believes that we can learn from history, that economic history is interesting and

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[51] Cf. Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990); and Douglass C. North, "Institutions," *Journal of Economic Perspectives* 5, no. 1 (Winter 1991), pp. 97–112.

[52] Heijdra, et al., "Marxism, Methodological Individualism, and the New Institutional Economics," pp. 301–2.

[53] Douglass C. North, "Economic Performance Through Time," *American Economic Review* 84, no. 3 (June 1994), p. 359.

important in itself, that there are lessons for policy, and that our understanding is increased by the enterprise of history. His willingness to take theory into history and to rethink his position when it seems to be wrong is admirable. It is too bad, however, that the theory he took into his enterprise was badly flawed, and that he created his syntheses without perhaps correctly understanding the difference between history and theory.

One might well wish, along with North, for a theoretical explanation of historical change, especially one that was systematic and directional. This accounts for the appeal of a theory which grafts the acting, maximizing individual onto big trajectories of collective action and property-"rights" specification. Unhappily, the theory provided by North seems somewhat wanting. While there are many nods in the direction of recognizing incentives that exist for state rulers, in the end, the Northian paradigm seems less realistic on these matters than does Marxism itself. In fact, the work of North and his allies on early modern history looks like nothing so much as an attempted explanation, on the basis of neoclassical economics, of the old Marxist problem of *how the bourgeoisie seized the state*.

Standing outside those two problematics, it seems more worthwhile to ask if, when elements of the bourgeoisie allied themselves, somewhere, sometime, with kings and against local aristocrats: 1) they can be seen as having stood in for all the bourgeoisie; 2) they were knowingly trying to reduce transaction costs; 3) they made a big historical mistake by not seeing what they were getting into; and so on. Concrete analysis would reveal purposive individuals making up differing blocs with different interests, acting out of differing motives, including plunder-seeking, avoiding trouble, and ideological commitments.

The more we know about such things, the more ready we will be to address the much more interesting question of *how the state seized the bourgeoisie*. Of course, to ask such a question is already to see more day-to-day "autonomy" and self-interest in the state than is customary, even among such Chicago School heirs as the Northians and the public-choicers.[54]

North's reading of the rise of the West empties the whole seventeenth-century crisis of any real meaning. At the very least, the seventeenth century witnessed massive popular resistance to ever-higher levels of state predation, resistance which fielded new and old ideas about the

[54]Murray N. Rothbard, "Public Choice: A Misshapen Tool," *Liberty* 2, no. 5 (May 1989), pp. 20–21.

proper limits of government power, that is, liberalism and constitutionalism.[55] Casting this struggle as "bargaining" over transaction costs seems quite perverse.

Even worse, Lane's and North's neoclassical equation of states with "firms" is *a literal inversion of Gustave de Molinari's insights about markets for protection*.[56] The Belgian economist argued in 1849 that if, as economists believed, free competition led to the best possible results in all other markets, the same would be true in the field of protection or security. At the same time, monopolistic states had all the disadvantages of other monopolies. It followed that social progress required the supply of protection through voluntary agencies and the abolition of states. North's position is also a literal reversal of the early liberals' account of how freedom and security of property promoted prosperity.

North's lack of realism about states is staggering.[57] Ideas, even interests, are left somewhat in the historical ditch by this approach. In the end, "models" rule the Northian world, and purposive individuals vanish. If necessary, "ideology" will be introduced, but only as another "variable"; no believable, acting human beings need apply. Such an approach necessarily involves neglect or loss of real insights available to historians using what Ludwig von Mises called "thymology"—a sort of everyday social psychology[58]—alongside economic theory to achieve understanding (*Verstehen*) of the complex details and unique events of history. The historian must often discover the "events" themselves and

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[55]Niels Steensgaard, "The Seventeenth-Century Crisis," in *The General Crisis of the Seventeenth Century*, ed. Geoffrey Parker and Lesley M. Smith (London: Routledge and Kegan Paul, 1978), pp. 25–56.

[56]Gustave de Molinari, *The Production of Security* (New York: Center for Libertarian Studies, 1977). See also Hans-Hermann Hoppe, "The Private Production of Defense," *Essays in Political Economy Series* (Auburn, Ala.: Ludwig von Mises Institute, 1998). Lance Davis, in "It's a Long, Long Road to Tipperary, or Reflections on Organized Violence, Protection Rates, and Related Topics: The New Political History," *Journal of Economic History* 40, no. 1 (March 1980), p. 9, remarks, rather mildly: "Political markets tend not to work as freely as economic ones."

[57]For a realistic view, see Murray N. Rothbard, "Anatomy of the State," in *Egalitarianism As a Revolt Against Nature* (Auburn, Ala.: Ludwig von Mises Institute, 2000), pp. 55–88.

[58]See Ludwig von Mises, *Theory and History* (Auburn, Ala.: Ludwig von Mises Institute, 1985); and Joseph T. Salerno, "Introduction" to Murray N. Rothbard, *A History of Money and Banking in the United States* (Auburn, Ala.: Ludwig von Mises Institute, 2002), pp. 17–23.

define their boundaries[59] and weigh all manner of possible causal relations with the help of all relevant bodies of outside knowledge. Economic theory has here as much (or as little) role as do chemistry, ballistics, and physics. Historians do not, however, give up studying the past merely because history itself is not a natural science.

Specific Objections to North's Reconstruction of Western History

Historians following their customary methods have gotten somewhat different results than has North. Recent work on feudalism has so altered our perception of "feudal" society that the whole problem of the "transition" from feudalism to capitalism is receding to manageable proportions. The key seems to be the "divided sovereignties" that characterized European society.[60] While North might go part of the way with this notion, his reconstruction seems in some ways seriously to downplay the autonomy of the political.

If anything, it may be the case that two antagonistic tendencies were in conflict from the late Middle Ages onward. On the one hand, cities sprang up and economic activity increased (for whatever reason), while, on the other hand, Kings began building modern states which incorporated others' territories and fought wars with like entities for expansion and survival. The competition between these rising states put pressure on growing economies and extracted resources from them on an unprecedented scale.

These pressures from war-making centers of organized crime, so to speak, built some states and eliminated others.[61] It is hard to find much

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[59]Gordon Leff, *History and Social Theory* (Garden City, N.Y.: Anchor Books, 1971); and Peter Munz, *The Shapes of Time* (Middletown, Conn.: Wesleyan University Press, 1977).

[60]Ralph Raico, "Prolegomena To a History of Liberalism,"*Journal des Economistes et des Etudes Humaines* 3, nos. 2/3 (June-September 1992), pp. 259–72.

[61]See, for example, Charles Tilly, "War Making and State Making As Organized Crime," in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge: Cambridge University Press, 1985), pp. 169–91; Charles Tilly, "Futures of European States," *Social Research* 59, no. 4 (Winter 1992), pp. 705–17; Margaret Levi, "The Predatory Theory of Rule," *Politics and Society* 10, no. 4 (1981), pp. 431–65; and John A. Lynn, "How War Fed War: The Tax of Violence and Contributions during the *Grand Siècle*," *Journal of Modern History* 65 (June 1993), pp. 286–310.

economic rationality or conscious reduction of transaction costs in the process. Certainly, despite his calls for a "model" of the state, North rather underestimates the self-regarding motives and actions of rulers. The most he can show is that some rulers became smart enough to not provoke violent uprisings over taxes every week.

As for North and Thomas's account of the waning of the medieval manor, Stefano Fenoalta has written that their:

> view of feudalism as a strictly voluntaristic system whereby the peasants obtained a public good seems empirically untenable, given the nature of the services actually provided by the lord, and the narrowness of the alternatives among which the peasants could choose.[62]

Theda Skocpol, criticizing historian Barrington Moore, Jr.'s similar claim about services-exchanged-for-revenue, wrote that:

> any upper class quite *un*manipulatively creates through its own existence and activities many of the problems that it simultaneously overcomes in "service" to "the community." Thus, if feudal lords had not been so wont to fight among themselves, "their" peasants would not have needed the protection for which they supposedly "gave" their surpluses in "fair exchange"![63]

Skocpol's criticism of Moore's Marxist argument applies equally well to North's claim, and the point would seem to apply even more to territorial states, a problem which seems largely absent from North's scheme of things. Economic historian E.L. Jones wrote of North and Thomas's work that:

> Their system is a "baggy" one which assumes a new shape depending on where one picks it up. The very generality which is the strength of economic reasoning may become something of a liability when faced with the perplexity of history.[64]

[62]Stefano Fenoalta, "The Rise and Fall of a Theoretical Model," *Journal of Economic History* 35, no. 2 (June 1975), p. 408. North did change his argument to meet Fenoalta's criticisms; see North, *Structure and Change in Economic History*, pp. 129–31.

[63]Theda Skocpol, "A Critical Review of Barrington Moore's *Social Origins of Dictatorship and Democracy*," *Politics and Society* 4, no.1 (Fall 1973), p. 9, emphasis in the original.

[64]E.L. Jones, "Institutional Determinism and the Rise of the Western World," *Economic Inquiry* 12, no. 1 (March 1974), p. 121.

And John L. Campbell and Leon N. Lindberg note that the "capacity to establish property rights gives the state a generally unrecognized source of *strength* insofar as it enables state actors to alter the organization of the economy."[65] This points toward states with considerable anti-social autonomy, rather than toward some sort of more-or-less-benign bargaining process between states and interest groups or citizens, leading to reductions of transaction costs.

North and Weingast's portrait of the English Whig oligarchy as a set of cost-reducers and property-specifiers in the face of the predatory Stuart kings has also come under fire. According to Bruce G. Carruthers:

> It was [James II's] Catholicism more than his absolutism that turned his subjects against him. The wealth holders of England who engineered the Glorious Revolution were more concerned with popery than with property.[66]

But this is a minor problem compared with North and Weingast's assumption that the Bank of England and monetized public debt were necessary instruments of economic progress.[67]

On any sustained reading, the whole Northian program seems a huge after-the-fact rationalization for what *did* happen, with the result that it is about as "predictive" in this way as is Marxism; and why, after all, does a historian need to *predict* the past? The "variables" specified are said to have been the very ones at work, because they are the ones the *model* requires. Political theorist Hendrik Spruyt makes just this point about the New Institutional History (NIH), when he writes:

> The existence of the institution is imputed to derive from the functions it performs. NIH assumes a direct connection between the preferences for an institution that would perform certain functions and the actual existence of a given institution. Sometimes preferences are then deduced tautologically from the functions that the existing institution performs. Finally, transaction costs are often imputed post hoc,

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[65]John L. Campbell and Leon N. Lindberg, "Property Rights and the Organization of Economic Activity by the State," *American Sociological Review* 55, no. 5 (October 1990), p. 635, emphasis in the original.

[66]Bruce G. Carruthers, "Politics, Popery, and Property: A Comment on North and "Weingast," *Journal of Economic History* 50, no. 3 (September 1990), p. 697.

[67]For a more realistic account, see John Brewer, *The Sinews of Power: War, Money, and the English State, 1688–1783* (New York: Alfred A. Knopf, 1989); and for a critique, see Murray N. Rothbard, *Economic Thought Before Adam Smith*, vol. 1 of *An Austrian Perspective on the History of Economic Thought* (Cheltenham, U.K.: Edward Elgar, 1995), pp. 229–30.

> as well. Depending on whether a particular outcome occurred, transaction costs are suggested to have been high or low.[68]

Theory and History

There are other such points which might be mentioned here. But the whole Northian project is wildly counterintuitive, and one must ask again: Does it make any sense to "do" economic history in this fashion? Evidently it does not, especially as there are no "directional laws" of history.[69]

In contrast to the neoclassical would-be historians and their use of unreal concepts susceptible to mathematical expression and/or abstract modeling, actual historians *can* use economic theory, or the pure theory of human action underlying it, to aid their reconstruction of the past. They can do this without overlooking the difference between the unrepeatable data of history and the principles derived from theory. Specific insights about human action in general can be used to rule out causal explanations which, in principle, could not be true, to define limiting cases, and so on. Thus, for example, sound theory tells the historian that if a general economic depression occurred, he should look for a prior episode of monetary inflation; it does not tell him that every inflation will lead to a depression.

This is precisely how Murray Rothbard, as a historian, deployed theory in *A History of Money and Banking in the United States*. On a more general level, Hans Hoppe's use of theory as a guide in reconstructing history also stays within proper methodological boundaries of theory and history.[70] Joseph T. Salerno's introduction to Rothbard's *History of Money and Banking in the United States* ably expounds the Misesian-Rothbardian view of historical method within the Austrian tradition.

North's system, however, conflates unlike methodologies and two very different disciplines in a vain attempt to convert statics into dynamics by way of "evolutionary-institutional" explanations. One stumbles at the threshold. Richard R. Nelson, a scholar interested in developing an evolutionary-theoretical economics, observes that "while evolutionary

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[68]Hendrik Spruyt, "Institutional Selection in International Relations: State Anarchy as Order," *International Organization* 48, no. 4 (Autumn 1994), pp. 532–33.

[69]Mises, *Theory and History*, pp. 210–14.

[70]Hans-Hermann Hoppe, *Democracy—The God That Failed* (New Brunswick, N.J.: Transaction Publishers, 2001).

theory may provide a useful language for historical discussion, the theory has little predictive power, and its explanations are at least partially ad hoc."[71] Nelson notes North's long march through the theories, writing that North once upheld, but has retreated from, evolutionary language.

Joseph Salerno's comments on North are more biting:

> This endeavor of North and others to deliberately extend the positivist program to economic history immediately confronts two problems. First, as North emphasizes, this approach narrowly limits the kinds of questions that can be investigated. . . . Those issues which do not readily lend themselves to formulation in quantitative terms or for which statistical data are not available tend to be downplayed or neglected altogether. . . . [The positivist] method precludes them from . . . identifying the ex ante purposes as well as ideas about the most efficacious means of accomplishing these purposes that motivated the specific individuals who lobbied for or initiated the change that effected a new income distribution.[72]

The second problem in North's approach is the relationship it posits between theory and history. Salerno recommends the program discussed by Mises and implemented by Rothbard which unites the pure logic of action (praxeology) with the method of understanding actors' motives by means of generalizations from social experience (thymology). A unique contribution by Rothbard was his insight that historical actors' often try to shift others' income to themselves by political means, and that they need, therefore, to spin justifying ideologies to obscure what is actually at stake.[73]

North, by contrast, often criticizes governments for having gotten in the way of economic growth historically, but despite his "modeling" of the state, has fewer useful things to say about rulers and their incentives than do Austrians or Marxists.

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[71] Richard R. Nelson, "Recent Evolutionary Theorizing About Economic Change," *Journal of Economic Literature* 33, no. 1 (March 1995), p. 67.

[72] Salerno, "Introduction," p. 9.

[73] The notion of the "political means to wealth" runs through all of Rothbard's work on economic history, mercantilism, and politics. See, e.g., Murray N. Rothbard, "Anatomy of the State," in *Egalitarianism As a Revolt Against Nature* (Auburn, Ala.: Ludwig von Mises Institute, 2000). A good summary of Rothbard's position is found in Salerno, "Introduction," esp. pp. 10–37. Mises developed his notion of "thymology" partly in reaction to Max Weber's discussions of the use of "ideal types" in history and sociology.

The View From the Top: Social Costs and System Adjustment

It will be useful now to look into some of the assumptions on which the NIH and related schools rest. At bottom, the infelicities of the Northian world outlook stem from the inversion (already noted) of early liberalism's insights into European development in relation to freedom and secure property rights. There is with such thinkers as Lane and North a full-blown mishandling of the relationship between carts and horses.

Rather than consider that "problems" of cost—transaction, information, whatever—arise on the basis of any human action whatsoever and, therefore, to that extent *presuppose* some sort of property and the possibility of exchange, the New Economic / New Institutional Historians make compulsory third-party enforcement of contracts and rules a precondition of economic action. As with Marxism, property and purposeful action become *effects* of an institutional arrangement. Putting himself in the imagined place of a central planner, the neoclassical-economist-turned-historical-Grand-Theorist claims to sift and arrange an unwieldy ensemble of economic-historical data and to factor in all manner of unknowable and unmeasurable subjective past costs in order to yield "testable and falsifiable theories" about how institutions emerged or failed to do so, and how economies either grew or did not grow. This falls only slightly short of an attempt to solve the socialist calculation problem in reverse.[74]

From the standpoint of the abstracted economic system as a whole, when supposed "divergences" between individual and "social" costs arise, they must be addressed at the level of the whole and, therefore, by the states in the form of rational bureaucracy, legislature, or Coasean judge. When, in their wisdom, these authorities reassign property "rights," the losers must be "compensated" by a tax on the winners. This follows from the counterintuitive Coasean claim that both sides in a dispute over "externalities" are right, while at the same time, both are wrong. Judge Posner must do the math, and, Presto! we are blessed with the no-fault, "free-market" socialism of endlessly adjustable property "rights" at the level of the social whole.

A central imperative of the Chicago tradition in the widest sense appears to be an impatient growthmanship, demanding maximization

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[74]It is interesting in this connection that the social calculation debate of the 1920s and 30s was carried on, by the socialists, largely in the language of neoclassical theory. See Oskar Lange and Fred M. Taylor, *On the Economic Theory of Socialism*, ed. Benjamin E. Lippincott (New York: McGraw Hill, 1964).

of *social* productivity by way of a sustained crusade to reduce "transaction costs." Growth is thereby enthroned as an unexplained, free-standing normative goal. One is reminded of Benny Hill's joke about the neutron bomb which kills the people, but leaves the real estate intact. "We have that already in England," he quipped, "it's called the mortgage." In a similar way, the Chicagoites allegedly preserve the people while destroying the property rights which support them. Imaginary models give rise to reified "markets" that become more real than are acting humans in actual markets.[75]

As wielded by North and his allies, the transaction cost concept has been "stretched to the breaking point," as economic historian Robert Higgs commented.[76] As Murray Rothbard said of the views of Ronald Coase and Harold Demsetz, "It is simply assumed without adequate support, for example, that external economies *should* be internalized. But why? What is the ethical groundwork for this position?"[77]

Further, the whole notion of "social" costs is per se questionable, without even trying to reconstruct them for the past. Rothbard writes:

> Professor Demsetz goes on to advocate an allocation of property rights in accordance with whichever allocation involves lower total social transaction costs, such as costs of enforcing the given property right. But once again, there are two grave flaws in this position. One, since social costs embody psychic costs or disutilities for each individual, it is impossible to measure and hence to add them up interpersonally. But apart from this, such a gauge for the allocation of property rights brusquely sets aside any consideration of the justice of property titles.[78]

In any case, the claim that "social costs *should* be minimized, or that external costs *should* be internalized, is not a technical or a value-free position." Elsewhere, Rothbard writes:

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[75]The neoclassical drive to fetishize imaginary prices in abstract markets affects socialists as well. Thus, West German feminists demanded some years ago that the state pay women "wages" for housework *as if* there existed a market which could generate prices for such work. Paleo-Marxist André Gorz made short work of this argument in *Farewell to the Working Class* (Boston: South End, 1982), pp. 82–85.

[76]Robert Higgs, "Eighteen Problematical Propositions in the Analysis of the Growth of Government," *Review of Austrian Economics* 9, no. 1 (1991), p. 29.

[77]Murray N. Rothbard, "Value Implications of Economic Theory," chap. 11 in *Money, Method, and the Austrian School*, p. 261, emphasis in original.

[78]Rothbard, "Value Implications," p. 262.

> There is the grave fallacy in the very concept of "social cost," or of cost as applied to more than one person. For one thing, if ends clash, and one man's product is another man's detriment, costs cannot be added up across these individuals. But second, and more deeply, costs, as Austrians have pointed out for a century, are subjective to the individual, and therefore can neither be measured quantitatively nor, *a fortiori*, can they be added or compared among individuals.

It follows that "of course any concept of social costs, including transaction costs, becomes meaningless." Finally, costs are ephemeral, existing only ex ante. Having acted, a particular "cost disappears" and "becomes a historical cost, forever bygone," and not subject to reconstruction by a later observer.[79]

The whole transaction cost conundrum which North puts at the center of history reveals an interesting kinship with the neoclassical construction of "monopoly" and, thus, with the socialist calculation problem, or even the "feudal calculation problem" as presented by North (albeit from the wrong end of the telescope). Gerald P. O'Driscoll, Jr. and Mario J. Rizzo noticed this when they wrote that:

> Coase's approach to the existence of firms [is] congenial [to an Austrian analysis and] incorporates the essential conclusion of the economic calculation debate. That is, calculation of profits and losses is impossible without competitive markets for inputs. Gains from hierarchical organizations can be captured only so long as they do not completely eliminate factor markets. Coase's approach is an excellent *static* conceptualization of the problem.[80]

On Reducing the Costs Arising from Fretting about Transaction Costs

It seems highly unlikely that history has been a struggle over transactions costs. R.C.O. Matthews comments that, for the most part:

> Transaction costs are costs of relations between people and people. . . . The objective of the economic agent is not to

[79]Murray N. Rothbard, "The Myth of Efficiency," chap. 12 in *Money, Method, and the Austrian School*, pp. 269–70.

[80]Gerald P. O'Driscoll, Jr., and Mario J. Rizzo, *The Economics of Time and Ignorance* (Oxford: Basil Blackwell, 1985), pp. 123–24, emphasis added. Also see Murray N. Rothbard, *Man, Economy, and State* (Auburn, Ala.: Ludwig von Mises Institute, 1993), pp. 560–660.

> minimise transaction costs as such, but to minimise the sum of transaction costs and production costs. There may be tradeoffs between the two.[81]

If we referred to these things as "costs of doing business," they would likely sink to their proper level of importance in the scheme of things. Costs are costs, as Rothbard's discussion suggests,[82] and transaction costs have no special characteristics all their own. All actions involve costs; to do one thing is to forgo doing some real alternative. Prefixing "trans-" to "action" does not and cannot create a special kind of cost with exceptional properties.[83]

Rothbard points out that governments are not "costless" agencies able magically to reduce everyone's transaction costs as needed. For example, it costs the state something to track down "free riders" (those amoral souls who fail to pay their "fair share" toward some public good). Such "cheating" follows logically from the model of "maximizing rational individual," but in real life, people behave better than in models, otherwise civilization itself would not exist.[84] Of course, it does not follow that the state should be providing this public good in the first place, nor that the so-called free rider would want the good if its purchase were left to his voluntary action.

This whole set of related problems results from attempts to justify the activity of states, or to account for certain results of that activity. In the perspective typically adopted, planners are seen as capable of making Benthamite interpersonal comparisons of utility and social utility, or, failing that, to discover and adjust social costs. But societies and markets, that is, people, are constantly overcoming and lowering costs of all kinds. The "invention" of money and, before that, the "invention" of language, if we may call it that, must have lowered costs tremendously, and with no state on hand to shove things along. If reduction of costs were a proper role of the state—and, indeed, something states could do or would wish to do—then by the same logic that demands state imposition of

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[81]Matthews, "Economics of Institutions and the Sources of Growth," p. 906.

[82]Murray N. Rothbard, "The Myth of Neutral Taxation," in *Applications and Criticisms from the Austrian School*, vol. 2 of *The Logic of Action* (Cheltenham, U.K.: Edward Elgar,1997), pp. 87–88.

[83]The Roman Law typically divided its subject matter into persons, things, and actions.

[84]Jeffrey Rogers Hummel, "National Goods Versus Public Goods: Defense, Disarmament, and Free Riders," *Review of Austrian Economics* 4 (1990), pp. 110–11.

weights and measures, states would be justified in making everyone learn English.

Just looking at it, it seems passing strange that if states are hard at work ridding us of transaction costs, North should spot a threatening increase in such costs, an increase which exactly parallels the expansion of governmental activity. One suspects a scam, on par with government efforts to combat inflation. As Robert Higgs puts it:

> Modern governments—the American and just about all the others—hugely *increase* the costs of transacting mutually beneficial exchanges in comparison with what those costs would be in a minimal or night-watchman state.[85]

Considering all the money paid so that lawyers may resolve transaction cost problems—having first created those problems in their capacity as legislators, bureaucrats, and advisors to states—one sees how the growth of arbitrary "laws"and state colonization of the life-world (to use a Habermasian expression) has unflinchingly *increased* such costs. One can also see why Coasean theses would appeal to lawyers. Self-interested maximization? You bet. Caused by the inherent logic of property and markets? Probably not.

States might, however, sometimes wish to reduce their *own* administrative costs. This explains state imposition of standard weights and measures, metrication, stable surnames, and so on. And states often prefer and promote large firms because having to deal with fewer independent entities reduces the costs of tax collection, regulation, and so forth.[86] Altruistic adjustment of "social costs" has probably not driven many state actions in history. State action is far better studied in terms of strategic command posts over society, ideological mystification, and the kinds of incentives present to those who get their income by compulsion.[87]

Douglass North and the Close of His System

In the end, the differences between an Austrian "free-market" view of policy and history, and that of the broader Chicago School, including the Northians, arise from irreconcilable differences in ethics and

[85]Higgs, "Eighteen Problematical Propositions," p. 30.

[86]See Jim Scott, "Socialism and Small Property—Or—Two Cheers for the Petty Bourgeoisie," *Peasant Studies* 12, no. 3 (Spring 1985), pp. 191–95.

[87]See Rothbard, *Man, Economy, and State*, chap. 12, pp. 765—890; and Hoppe, *Democracy, passim*.

epistemology. Hans Hoppe observes, in his introduction to Murray N. Rothbard's *Ethics of Liberty,* that when "Ronald Coase, Harold Demsetz, and Armen Alchian . . . began to redirect professional attention to the subject of property and property rights," the path they took was "categorically different" from that of Rothbard. As members of the Chicago School, these men:

> unswervingly accepted the reigning positivistic dogma that no such thing as rational ethics is possible. . . . [Hence,] the term property had to be stripped of all normative connotations attached to it in everyday "non-scientific" discourse.[88]

Rothbard noted that because some system of property rights is necessary in any society to lessen potential conflicts, the Chicago School's solution is to have assignments of property rights "made by government judges—based on utilitarian considerations and calculations."[89] In the Rothbardian-Hoppean view, private property is and *should be* the starting point of the analysis. And recall that Gary North regards the Coase Theorem as one of the most dangerous attacks ever made on private property.

This is rather striking in view of the tendency of left liberals and socialists to see the Chicago School and its heirs and assigns as "right-wing" and "reactionary" defenders of property and capitalism. This may be true, but only if an *ad hoc*, pragmatic defense of the state-ridden status quo is taken as a near-substitute for a principled defense of private property. In truth, Chicago School economics in its various manifestations functioned as the right-wing of Cold War liberalism.

As Laurence H. Tribe points out, the "systematic development" of the bureaucratic "policy sciences" began with "British and American responses to the onset of World War II."[90] When war liberalism became Cold War liberalism, the social engineers were ready to serve under the same epistemology and with the same methods. One example of semi-official anti-Soviet scholarship was W.W. Rostow's growth-and-takeoff model, with which the cliometricians and New Economic Historians were at first in competition.[91]

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[88]Hans-Hermann Hoppe, "Introduction" to Murray N. Rothbard, *The Ethics of Liberty* (New York: New York University, 2002), pp. xii–xiii.

[89]Hoppe, "Introduction," p. xiii.

[90]Laurence H. Tribe, "Policy Science: Analysis or Ideology?" *Philosophy and Public Affairs* 2, no. 1 (Autumn 1972), p. 67.

[91]Rostow, *The Stages of Economic Growth*.

North has strived to trace the beginnings of economic growth, but in a way that calls to mind the Marxists' quest for "primitive accumulation of capital." It is not enough for people to produce and exchange. Someone or something—the state, the "institutional mixture," whatever—must kick-start the motor of economic progress, showing, if nothing else, the sort of bind into which one can get by taking mechanical metaphors too literally. Mechanism and its corresponding political orientation are rooted in the Anglo-American, anti-realist, nominalist tradition of Bacon, Hobbes, and Bentham. As radical historian R. Jeffrey Lustig writes:

> Hobbes's nominalism has been frequently discussed, as has his authoritarian social theory. But the organic connection between the two has usually been ignored. If, however, as Hobbes said, there is "nothing absolutely so, nor any common rule to be taken from the nature of the objects," then any common rule that exists must be imposed *upon* those objects. The political implications follow straightforwardly. Where social order is not conceived as a product of participation or shared intentionality, external rules must emerge as the only source of social cohesion. Once the mind of the individual has been ignored for operational manipulation and force, as the result of managing objects externally, rather than of dealing with subjects rationally. The question of rights becomes irrelevant from such a perspective because nominalist particulars lack any deep structure of legitimacy. Paradoxically, the philosophic nominalism which at first appears to mandate great respect for particulars comes out, with regard to politics, supporting a doctrine that easily denies the integrity of those particulars.[92]

Northianism recapitulates the unedifying flirtations between history, on the one side, and Grand Theory and Abstracted Empiricism (the natural progeny of positivism and Anglo-American empiricism), on the other, which have flared up, from time to time, from the 1960s (and earlier) down to the present.[93] In the sixties, the paladins of Abstracted

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[92]R. Jeffrey Lustig, *Corporate Liberalism: The Origins of Modern American Political Theory, 1890–1920* (Berkeley, Calif.: University of California Press, 1982), p. 181; cf. Hans-Hermann Hoppe, "The Socialism of Social Engineering and the Foundations of Economic Analysis," in *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (Boston: Kluwer, 1989), pp. 95–125.

[93]See Mills, *Sociological Imagination*, chaps. 2 and 3; and cf. Rothbard's strictures on social-scientific talk about "mathematical functions" in *Man, Economy, and State*, pp. 277–79. On sociology as a methodology posing as a discipline, see Stephen Turner, "The Origins of 'Mainstream Sociology' and

Empiricism in economic history were the Cliometricians, while North chose the path of Grand Theory. The outcome was the abortive cramming of historical material into unrealistic *a priori* trajectories of development.

Perhaps Fritz Redlich was premature in exempting Douglass North from the full force of his (Redlich's) critique of the use of figments in economic history. North's brilliant efforts in support of what seems a fundamentally flawed system call to mind what Joseph Schumpeter said of the Austro-Marxist Otto Bauer's analysis of ethnic conflict in the Austro-Hungarian Empire: "the skill of the analyst only serves to show up the inadequacy of the tool."[94]

In a real sense, both North's "middle way" corporatism and the socialism of the Marxists amount to an attempt to solve minor, trivial, and manageable "free rider" and transaction cost problems by creating, in their place, immense and insoluble problems. This means, in effect, that the whole "free rider" dilemma, like the whole discussion of "distribution,"[95] is an effect of the existence of states and not something built into the nature of things such that states can take it in hand and "solve" it. All states can do is make it worse.

It is interesting that North has turned at last to the problem of ideology. His own system has taken on the character of an ideology suited to the present situation of the western welfare-warfare states. It is the sort of thing around which a Republican administration in the United States or a Social Democratic government in Germany could unite in everlasting Vital Center tandem. This is unfortunate because North is a very productive and often insightful scholar undone, one might say, by his commitments to assumptions overdue for interment.

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[94]Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper Torchbooks, 1962), p. 15.

[95]See Rothbard, *Man, Economy, and State*, pp. 554–56, on this fallacy.

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