

CHAPTER TEN	
The Rise of the Western World	127
CHAPTER ELEVEN	
The Rise and Fall of the Soviet Union	146
CHAPTER TWELVE	
Improving Economic Performance	155
CHAPTER THIRTEEN	
Where Are We Going?	166
<i>Bibliography</i>	171
<i>Index</i>	183

---

## Preface

UNDERSTANDING the process of economic change would enable us to account for the diverse performance of economies, past and present. We would be able to account for the long history of sustained growth of the United States and western Europe, the spectacular rise and demise of the Soviet Union, for the contrasting performances of the rapid economic growth of Taiwan and South Korea and the dismal record of sub-Saharan Africa economies, and the contrasting evolution of Latin America and of North America. And beyond understanding the past, such knowledge is the key to improving the performance of economies in the present and future. A real understanding of how economies grow unlocks the door to greater human well-being and to a reduction in misery and abject poverty.

The economic paradigm—neo-classical theory—was not created to explain the process of economic change. We live in an uncertain and ever changing world that is continually evolving in new and novel ways. Standard theories are of little help in this context. Attempting to understand economic, political, and social change (and one cannot grasp change in only one without the others) requires a fundamental recasting of the way we think. Can we develop a dynamic theory of change comparable in elegance to general equilibrium theory? The answer is probably not. But if we can achieve an understanding of the underlying process of change then we can develop somewhat more limited hypotheses about change that can enormously improve the usefulness of social science theory in confronting human problems.

This study is an extension—a very substantial extension—of the new institutional economics. A brief review of my earlier work on institutional change will provide the proper setting for that extension. From my initial studies with Lance Davis (Davis and North, 1971) and Robert Thomas (North and Thomas, 1973), I have placed institutions at the center of understanding economies because they are the incentive structure of economies. I also have focused on how economies that were composed of institutions that provided incentives for stagnation

and decline could persist. The underlying source of this persistence had to be features of the human environment and of the ways humans interpreted that environment. What I did not consider in earlier studies was the character of societal change and the way humans understand and act upon that understanding of societal change.

Economic change is a process, and in this book I shall describe the nature of that process. In contrast to Darwinian evolutionary theory, the key to human evolutionary change is the intentionality of the players. The selection mechanisms in Darwinian evolutionary theory are not informed by beliefs about the eventual consequences. In contrast, human evolution is guided by the perceptions of the players; choices—decisions—are made in the light of those perceptions with the intent of producing outcomes downstream that will reduce uncertainty of the organizations—political, economic, and social—in pursuit of their goals. Economic change, therefore, is for the most part a deliberate process shaped by the perceptions of the actors about the consequences of their actions. The perceptions come from the beliefs of the players—the theories they have about the consequences of their actions—beliefs that are typically blended with their preferences.

But just how do humans come to understand their environment? The explanations that they develop are mental constructs derived from experiences, contemporary and historical. Human learning is more than the accumulation of the experiences of an individual over a lifetime. It is also the cumulative experiences of past generations. The cumulative learning of a society embodied in language, human memory, and symbol storage systems includes beliefs, myths, ways of doing things that make up the culture of a society. Culture not only determines societal performance at a moment of time but, through the way in which its scaffolding constrains the players, contributes to the process of change through time. The focus of our attention, therefore, must be on human learning—on what is learned and how it is shared among the members of a society and on the incremental process by which the beliefs and preferences change, and on the way in which they shape the performance of economies through time.

Part of the scaffolding humans erect is an evolutionary consequence of successful mutations and is therefore a part of the genetic architecture of humans, such as innate cooperation within small interacting

groups; part is a consequence of cultural evolution such as the development of institutions to favor larger group cooperation. Just what is the mix between the genetic architecture and the cultural heritage is in dispute. Evolutionary psychologists have stressed the genetic component in the scaffolding process at the expense of the role of the cultural heritage. Certain universals in human mental constructs such as supernatural explanations—religions broadly construed—suggest that these are congenial to the underlying inference structure of all humans. Equally, the immense variation in the performance characteristics of societies makes clear that the cultural component of the scaffolding that humans erect is also central to the performance of economies and polities over time.

The wide gap throughout history between intentions and outcomes reflects the persistent tension between the scaffolds that humans erect to understand the human landscape and the ever changing “reality” of that landscape. That tension and its implications for the human condition both past and present, and indeed future, is the subject of this book. Part I explores the dimensions of the challenge involved in acquiring an in-depth study of the process of economic change. Part II takes us some distance along the trail toward a deeper understanding.

We cannot usefully model economic change until we understand the process. A good model entails a prior comprehension of the complex factors making up that process and then a deliberate simplifying to the crucial elements. Understanding is a necessary prerequisite missing in the economist’s rush to model economic growth and change. We are a long way from completely understanding the process. Until we do, we will have very little success in deliberately improving economic performance. What follows is an attempt to improve our understanding.

This study has been a long time in process—more than ten years—and could only have developed with the generous help of many organizations and individuals.

Both Washington University, my principal location, and the Hoover Institution at Stanford, my winter home, have provided hospitable settings for research. The Mercatus Center at George Mason University and the Stanford Institute for International Studies have hosted conferences focused on issues of this book, and I am deeply indebted to Paul

Edwards and Brian Hooks of the former organization, and to Syed Shariq who played a major role in organizing the Stanford conferences.

My colleagues at Washington University have patiently put up with my endless queries and arguments. I owe particular debts to Lee and Alexandra Benham, Pascal Boyer, Randall Calvert, John Drobak, Sukoo Kim, Jack Knight, Gary Miller, John Nye, Norman Schofield, and Itai Sened.

At Stanford Paul David, Steve Haber, Avner Greif, Walter Powell, Nate Rosenberg, and Barry Weingast have been particularly helpful in furthering my education.

Participants at the conferences (in addition to those listed above) focused on issues of the book, among them Lee Alston, Robert Cooter, Leda Cosmides, Thrainn Eggertsson, Jean Ensminger, Gregory Grossman, Philip Hoffman, Timur Kuram, Chris Mantzavinos, Joel Mokyr, and Vernon Smith, were valuable to me.

I am grateful to Kevin McCabe, who in collaboration with his colleagues in the experimental laboratory at George Mason University constructed experiments to test a number of the propositions central to this study. Lengthy discussions with Andy Clark and Merlin Donald improved my understanding of many crucial issues in cognitive science.

Joel Mokyr and John Wallis read the entire manuscript and provided detailed comments; Philip Keefer did the same while working in Nepal. Peter Dougherty of the Princeton University Press also provided detailed comments on the entire manuscript. Their comments substantially improved the final draft.

My incompetence in using a computer was more than compensated for by able experts who repeatedly had to set me right—Bob Parks and Florin Petrescu in St. Louis and Dan Wilhelm at Hoover. I am indebted to two valuable research assistants, Art Carden and Uri Sukhodolsky, and to my able secretary, Fannie Batt.

My greatest debt is to Elisabeth Case, my wife, who not only edited the entire manuscript but also bore the brunt of the lengthy and sometimes traumatic gestation period of this book.

I wish to acknowledge permission to make use of the following:

By Stanford University Press, Douglass C. North, "The Paradox of the West," from R. W. Davis, ed., *Origins of Modern Freedom in the*

*West*, copyright 1995 by the Board of Trustees of the Leland Stanford Jr. University.

By Yale University Press, Douglass C. North, William Summerhill, and Barry Weingast, "Order, Disorder, and Economic Change," from B. Bueno de Mesquita and H. Root, eds., *Governing for Prosperity*, copyright 2000 by Yale University.