Debating the Role of Institutions in Political and Economic Development: Theory, History, and Findings

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Abstract
This essay examines the recent use of the concept of institutions in economics and political science, and the impact of institutions on economic growth and democracy. The discussion includes the definition of institutions, the question of endogenous and exogenous origins of institutions, the role of fixed and flexible institutions, and the relations among different types of institutions. Particular attention is given to recent books by Avner Greif and by Daron Acemoglu & James A. Robinson.
INTRODUCTION

In recent years, economists and political scientists have again become concerned with the study of the origins and impacts of institutions. This has led both to more complete explanations of long-standing questions and to a broadening of the types of issues examined. The most important reason for the resurgence of research on institutions has been the perceived failure of earlier explanations to provide satisfactory explanations of important economic and political phenomena, such as rates of economic growth, the distribution of income, and the changing political structures within society.

Within the study of economic growth, the belief developed that an exclusive reliance on so-called economic factors failed to explain why some countries had developed economically and others had remained poor, relatively and/or absolutely; why some nations that had developed early fell behind areas that developed later; and how gaps between nations have greatly widened over time, whatever magnitudes of differentials existed in earlier times. These intellectual failures meant, in regard to contemporary policy, a limited ability to determine what conditions need to be changed to spur growth. Thus, a broader range of determinants of economic change have come to be considered, and these broadened factors came to be applied to other economic issues, such as the nature of the firm and the operation of markets. In political science, the main questions involved formalization of the analysis of the rise, stability, and persistence of various political structures, such as dictatorship and democracy. The causes and consequences of democracy have been central issues in the study of the role of institutions within political science. Given the economists’ interest in examining the impact of democracy on economic growth, there is some overlap in the studies of the two disciplines. As Thelen (1999) points out, one strand of the political science literature on institutions relies on methodological individualism and rational choice, and this strand of research came to resemble that of economists. Another strand, that of historical institutionalism, is more concerned with the study of the historical emergence of institutions, and this fits in less well with the approach of economic theory. In this article, given our training as economists, we devote more attention to the economic aspects of institutions than to the particular questions of primary interest to political scientists.

OLD AND NEW INSTITUTIONALISM

The “old institutionalism” of the 1920s and 1930s—exemplified by the work of, among others, John R. Commons, Wesley Mitchell, Thorstein Veblen, and Richard Ely, and discussed by Dorfman (1949, 1959) and Samuels (1987)—was primarily concerned with describing the organization of the economy and the manner in which the structure of power influenced the control of the economic system. The basis of legal rights and constraints in the market sphere were critical issues in this early-twentieth-century institutionalism. In the nineteenth century, institutions had been examined by the historical schools in Germany and Great Britain. Much that traditional economic theory considered exogenous was argued to be endogenously determined within the society’s system of behavior and beliefs. Consumer tastes were not exogenous, the legal codes reflected primarily the society’s power structure, and market equilibria did not always have desirable social characteristics. The market itself was not regarded as an independent force but was merely

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1This has long been a source of debate, given the changes (in the very long run) in patterns of economic leadership by broad continental areas as well as among particular nations within these areas. Obviously, in broad perspective, being first has never been a guarantee of long-term domination. Given these differences across time and space, it is not clear that the same explanation for economic development will hold in all cases, and arguments valid for the contemporary era may not be applicable to earlier times.
another institution to be examined and whose existence was to be explained. These institutional studies also focused on the basis of the formation of the private and public organizations that influenced the economy. Institutionalism, at this time, presented a critique of standard economic theory, providing a substitute analytical method, not a supplement.

The “new institutionalism”—exemplified by the more recent pioneering works of Douglass North, Ronald Coase, Oliver Williamson, and others—reflects a similar concern with the role of nonmarket arrangements in influencing economic behavior. Several useful collections of essays deal with these arrangements, including Ménard & Shirley (2005), Ménard (2000), and Ménard (2004). The key institutions of influence on the economy reflect informal arrangements either among individuals or between governmental units (or rather the individuals who compose the ruling elite) and the individuals ruled by them. Greif (2006) and Acemoglu & Robinson (2006) discuss each of these variants. The questions studied—which include the determination of how economies are organized, and how the decisions that influence economic outcomes are made—resemble those of the old institutionalism, with their focus on the importance of nonmarket factors in market outcomes, the role of institutions in economic growth, and the factors that enable the existence of democracy and changes in government structure.

The main distinction between the old and new schools has been the use of formal economic and political science methods by the new institutionalists. Their analysis is based on the acceptance of economic theoretic models, particularly the formal methods of rational choice theory and game theory, to examine the nature of the impact of institutions on the political system and the manner by which individuals derive formal and informal rules to regulate behavior. The old institutionalists had regarded economic theory as an inappropriate way to understand the economy. The new institutionalism thus fits much better into mainstream economics than did the old, and there is now much more overlap in interest and approach between traditional economists and political scientists regarding institutions than before.

EXPLANATIONS FOR ECONOMIC GROWTH

In recent years, economists have become concerned with explaining the past in order to be of use in designing policy for future economic growth. There has been a shift in the key variables of interest. In regard to the study of modern economic growth, a transition has occurred over the past few decades from a concentration on the role of narrowly defined economic factors to a focus on the significance of various social structures and culture in providing the conditions conducive to economic development. Arguments based on conditions such as favorable natural resources, high rates of capital formation, extensive markets and other circumstances that encourage a faster pace of technological change, and other economic forces that have long been central to our understanding of why some economies enjoy better performance than others have recently been supplemented (or supplanted) by arguments concerned with the sources of differences across societies in political and cultural institutions, and how these influenced growth.

Although we cannot conceive of any process of economic growth or political change that does not involve institutions and institutional change, we here outline various reasons why we should be cautious about resting a theory of growth narrowly on specific institutions, or at least on institutions exogenously determined. Below, we discuss important caveats to indicate the range of concerns that must be considered.

Economic and Noneconomic Factors

Institutional structures that appear very different have often been found to be
reasonable substitutes for each other. In the antebellum United States, for example, the North and South both grew relatively rapidly with their sharply contrasting institutions of labor. The historical record, therefore, does not seem to support the notion that any one particular institution, narrowly defined, is indispensable for growth.² Institutions matter, but they are influenced by the political and economic environment. If any aspect of institutions is crucial for growth, it may be that institutions must change as circumstances change to permit growth to be maintained.

It has become fashionable to distinguish between economic and noneconomic factors. Discussions of noneconomic factors (encompassing the cultural, political, and institutional) in accounting for differences across societies in economic development can be traced back many centuries. Several of the classic theories for the rise of European capitalism and the onset of modern economic growth are based on conditions that clearly fall outside of the conventional definitions of economic forces. One such condition is the spread of particular religious beliefs, such as Protestantism (see Weber 1992 [1904–1905], pp. 40–45), Judaism (Sombart 1969 [1913]), and changes in the orientation of Islam (Rodinson 1974).³ Others include the advance of scientific and rational thought, the impact of changing tastes for consumer goods, and the effects of choices between work and leisure on the supply and intensity of labor during early industrialization (see, e.g., Mokyr 2002 and de Vries 1994). The willingness of a society to exercise force, internally and externally, will have a significant impact on its economic development, as conflict frequently helps cause or retard economic change. Changes in legal systems, in degrees of trust and the extent of social capital, and in the nature of political organization and the extent of democracy have been advocated as critical factors explaining differentials or shifts in economic performance. Although changes in these kinds of circumstances are generally treated as exogenous to the economy, the interaction between “economic” and “noneconomic” factors can be complex; indeed, the distinction is somewhat artificial, as the nature and impact of cultural forces cannot be determined independently of economic forces (and, of course, vice versa).

Recent work attempting to explain why Britain industrialized first, and to understand differences in economic performance more generally, often gives more attention to institutions than to culture per se. In emphasizing property rights and other aspects of the British legal framework, this view breaks from the previous stream of work on institutions by economists who emphasized culture in treating the evolution of economies. Instead, current analysis of the causes and consequences of institutions and institutional change is grounded on economic and political theory, following North’s approach (North & Thomas 1973, North & Weingast 1989, North 1990; for an interesting discussion regarding the choice of institutions in the United States, see Davis & North 1971). This perspective defines institutions, although the concept is difficult to define with precision, as encompassing the specific organizations or rules that constrain and influence human behavior. A key aspect of these humanly devised rules is that they structure human actions by providing incentives that shape economic and political behavior. Formal rules, plus the informal constraints that
develop, influence the costs of production and of transactions within society. Among the institutions that are most important for economic performance are those that define and enforce property rights, both between the government and private parties and among the individuals within a society.

The key connection between appropriate institutions and economic growth is that institutions reduce the costs of production and distribution, allowing private agents more scope to benefit from specialization, investment, and trade. Institutions, as human-imposed constraints, are not the only constraints that societies and private sectors confront. Others are imposed by the state of technological knowledge, demographic forces, nature (including climate and topography), and other features of the environment that have implications for the patterns of economic activity. Institutions influence the beliefs and behaviors of individuals and groups, and thus the preferences and priorities expressed through both private and public decisions. Another important role of institutions is providing for efficient property rights, trust, and effective incentives, thus facilitating the organization and conduct of appropriate and constructive transactions and interactions among individuals and firms. Indeed it is argued, by North and others, that it was the sound property rights and incentive schemes made possible by Britain’s distinctive institutions that enabled it to industrialize first (North & Weingast 1989).

The specification of formal rights is only one part of society’s problem, however. The nature of the enforcement of institutional provisions is critical to the success of whatever institutions exist. Enforcement must be effective and accepted as legitimate. Similarly, the nature of legislative decisions and judicial rulings will also influence outcomes. Enforcement is sometimes bilateral, between individuals, with no government role to ensure compliance, but in other cases enforcement requires government action.

Although those who stress the institutional framework have somewhat different concerns than those who highlight culture, both perspectives emphasize that “noneconomic” variables evolve somewhat independently, either as cause or as consequence, of the processes of economic forces. Proponents of both views describe the usefulness of this pattern as an intellectual advance over the economic-development literature of the 1950s–1970s. This earlier work had focused primarily or exclusively on economic variables, such as natural resources, physical capital, human capital (mainly education), exchange rates, and technological change. That generation of economists certainly had to accept the importance of institutions, culture, and political stability, but presumed either that the appropriate institutions and beliefs existed already, or that they would evolve in desired directions once the economic factors that could generate economic growth were in place.

### Institutional and Noninstitutional Explanations

It is often hard to distinguish between, or gauge the relative power of, the institutional and noninstitutional explanations of economic differences. It is doubtful that anyone would claim there is a general answer covering all cases, and indeed most, if not all, individual cases seem to allow some role for each type of explanation. There are numerous possible causes of changes in institutions. Among the many factors that have been suggested as influencing the development of institutions are (a) externally generated changes in mentalité, via change in religious belief or secular attitudes; (b) the outcome of a military conflict, via either externally generated changes in the power structure or internal revolutionary action that alters the balance of political power; (c) the nonmilitary introduction of new foreign influence and contacts, reflecting, in part, improvements in transportation and communication; and, as discussed below, (d) the settling of new areas by people from a distant metropolis. We do
not consider endogenous institutional explanations to imply an absence of institutions (since that is, by definition, not possible); rather, the presence of institutions is regarded as endogenous to the socioeconomic process. This would be the case even when the circumstances giving rise to the endogenous institutions can themselves be regarded as exogenous to the economy (e.g., climate and natural resources).

EXOGENOUS OR ENDOGENOUS INSTITUTIONS

There has been considerable recent interest in trying to make the empirical work relating institutions and economic growth more tractable. We ask, elsewhere, what are the major elements in determining whether the key institutions are exogenous or endogenous? This has long been debated by US colonial historians, who argue whether settlers' attitudes were based on their British background or on the conditions they faced after arrival in America (Engerman & Sokoloff 1997, 2002). This distinction has been with us a long time, as have the debates over the superiority of British institutions, but has more recently figured prominently in the study of how the various economies established as colonies by Europeans (and others) developed over time (see Engerman & Sokoloff 1997, 2002; Acemoglu et al. 2002, 2003). Even without a substantial indigenous population in the area of settlement, the presence of one group of settlers in the colony, arriving from the metropolis, while another, larger component remained in the metropolis, means that different circumstances influenced institutional development in the two areas. In principle, therefore, a researcher could evaluate just how strong an impact the different circumstances had on the ways the institutions evolved. That many of the European countries established multiple colonies in very different environments further enhances the quality of the information arising from this “natural experiment.”

In evaluating whether institutions are endogenous, there are several approaches that could be taken. One concerns the impact of resources and natural and human endowments on institutions. A number of scholars, including us, have recently argued that systematic patterns in the types of institutions evolved as settlers in European colonies adjusted to conditions that differed from those of the metropolis in terms of crop potentials, disease environments, and economic opportunities. Subjecting this notion to empirical testing is complicated by the enormous range of institutions that could be tested, some of which reflect metropolitan carryovers, others of which developed very differently in the colonies than they did in the metropolis. Metropolitan institutions did not necessarily disappear in the process of settlement, but many were modified over time, and differences in economic performance across economies could be attributed to adaptations to the new environment by endogenously determined institutions. Because institutions are human-designed structures that presumably reflect the efforts of populations trying to make the best of the opportunities and problems they face, many observers would expect them to be at least partially endogenous. Indeed, the institutions that emerged across the colonies established by Europeans do seem to have varied systematically with aspects of the environment, such as climate, land types, and natural resources. Some would go even further and suggest that the direction of institutional change is often endogenous to the nature of the growth process. Changes in technology and incomes lead to changes in tastes, with consequent differences in the means of organizing production and transactions, and changes in patterns of behavior more generally.4 The classic case here is the British

government’s commitment to repay its debt and not impose losses on private bondholders (see North & Weingast 1989).

To argue that there is some endogeneity to the development of institutions does not imply that institutions are unimportant or that they have only a limited impact on economic performance. Endogenous institutions, once in place, can prove as crucial as if they were exogenous, and they might persist as long as or even longer than those exogenously determined. Those who contend that institutions are exogenous and those who maintain they are endogenous do not necessarily disagree about the impact and influence of institutions, but, rather, about where the institutions come from and the extent to which they are, or might be expected to be, revised over time.

**FIXED OR FLEXIBLE INSTITUTIONS**

It is generally argued that it is often useful to society to have institutions fixed and unchanged over time. Credible commitment to acknowledge private property rights, whether in the interests of the elite or the majority of the population, is the classic example of the value of certainty about policy action. More generally, however, allowing some flexibility in institutions, such that they can be altered to allow private or public agents to take fuller advantage of new opportunities that arise as technology or the environment changes, would be expected to foster improved economic performance and more rapid growth. Determining the optimal degree of flexibility in institutions, and designing mechanisms suited to respond constructively to ever-changing circumstances, are complex issues. Although some see a constitution as a means for ensuring stability in the decision-making process, most constitutions include provisions for amendment, and allow some degree of legislative and governmental flexibility in setting the legal structure. Allowance for modifications to existing laws need not harm the potential for growth, nor even lead to instability, particularly given that the voting and other costs of implementing changes are typically high. Indeed, there are possibly more cases where nations and economies suffered from inflexible institutions than from excessive flexibility, although this could vary with the rapidity of change (see Olson 1982 on the causes and impacts of institutional rigidity).

The argument for the necessity of fixed and determinable institutions is that they may promote higher income growth, either directly or (via greater social stability) indirectly. Certainty of behavior and a fixed set of rules should reduce risk and thus lead to more favorable outcomes. A frequent expectation is that a more stable and (presumably) more democratic set of institutions will provide “all good things,” including higher growth and more equity, but this need not always be the case.

**Institutions and British Growth**

The role of specific, and unchanging, institutions in influencing growth may often be problematic in imposing rigidity within a world of change. Not only must the specific institution have favorable effects, but whether it contributes (and how much) to the social good will also depend on the overall set of institutions. For example, Weber argues that the Protestant ethic leads to capitalism and growth, but only in societies in which conditions permitting growth already exist.  

It may be that one bad institution could prevent similar argument, as do the descriptions of evolving institutions by cultural anthropologists (see Hoselitz et al. 1960, Herskovits 1948).
growth and that one good institution is insufficient to have the expected positive effects. Even if a particular institution is consistent with economic growth, it may not be the optimal institution for growth, since its presence along with different institutions might have facilitated higher economic growth. Unchanging institutions may dictate a fixed set of actions for long periods, beyond the time when any positive payoff is obtained.6

Belief in defined commitments did not characterize all aspects of early modern British society. Thus, in the debate in the 1790s about ending the British slave trade, Burke argued that the government could always change policy, and this could be done without any new votes, since change was always understood to be a governmental prerogative. At about the same time, Pitt argued that the government could always change policy without paying compensation to those hurt by the changes, since otherwise no government would be able to accomplish any changes. At this time, however, the British government did introduce legislation not only to end the slave trade (and a quarter century later, slavery), but also to limit hours of work for women and children in certain industries, to levy an income tax, and to expand the franchise (see Porter 1970, pp. 41–49; Cobbett 1806–1820, 28:96–97, 29:1145–46).7 In addition, the Peterloo Massacre led to the death of several protestors, and

6It is argued (e.g., North & Weingast 1989) that early nineteenth-century British economic growth was spurred by a certain set of institutions, but presumably when these did not change in the second half of the nineteenth century, they were instrumental in the relative British decline. See Elbaum & Lazonick (1986), particularly the editors’ introduction, and Clarke & Trebilcock (1997), particularly the essay by Supple.7

7On labor standards, see Engerman (2003). On changes in the franchise, see Hanham (1968), Acemoglu & Robinson (2000, 2006), Alemoglu et al. (2005), and Lizzetti & Persico (2004). Also important were frequent changes in tariff rates and variations in tax rates and government expenditure policy (see Daunton 2002). For descriptions of the debates at this time on economic policy changes advocated by politicians and economists, see Checkland (1983), Gordon (1979), and Fetter (1980).8

8This argument is familiar from Toynbee’s (1946, pp. 60–145) challenge-and-response thesis. It has attracted most attention among US economic historians. The Habakkuk
Another issue that is central to understanding how institutions influence growth concerns the likelihood that no one specific institution is required. As mentioned above, various institutional forms or structures are reasonable substitutes for each other and may lead to similar economic performance. The differential between the benefits of the “best” and the “second best” institutional arrangements may be quite small. Those who hold the view that nonoptimal institutions may still be consistent with high rates of economic growth, though perhaps not the highest rate that was considered possible, often point to the stark contrasts across industrialized countries in (a) the importance of banks relative to securities markets in financial intermediation, (b) the reliance on common versus civil law, (c) how bankruptcy laws balance the rights of creditors and debtors, (d) systems and levels of taxation, and (e) the division of power between the executive, the legislature, and political party structures. (On various aspects of law and financial institutions, see Goldsmith 1969, Glaeser & Shleifer 2002, Beck et al. 2001, and Lamoreaux & Rosenthal 2005.) The role of institutions is considered analogous to the role of technology, in that the contributions to change can be important but no single method of accomplishing a goal seems indispensable (see Fogel 1964 for the classic statement of this point).

Perhaps a more serious political issue is that among the feasible set of institutional solutions to a general problem, different approaches may have different implications for different segments of the population. **The Evolution of the Franchise**

As we have discussed, the evolution of institutions across New World societies reflected adjustments to different circumstances. An important example is provided by the history of how the franchise was extended over time and what fractions of populations actually voted (Engerman & Sokoloff 2005a). The ability to impose franchise restrictions represents a major source of power within society. To limit voting to the powerful elite should reduce the benefits presently going to the lower classes, as well as reduce their future prospects.

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9. Property rights without opportunities for social mobility can limit growth, if that is in the interests of the elite. For much of Europe, the first decades of the twentieth century saw broadened suffrage and also an increase in the share of government expenditures in the national budget (see Musgrave 1969, Flora et al. 1983, Tanzi & Schuknacht 2000, Aitd et al. 2006).
The power to influence elections and governmental policy has obvious effects on economic life.

Because most societies in the Americas had achieved independence from their colonial masters, and were at least nominal democracies, by the middle of the nineteenth century, suffrage institutions had a direct bearing on the extent to which elites (defined largely by wealth, human capital, and gender) held disproportionate power to shape government policies in their respective countries. The ability and inclination of the elites to maintain disproportionate political influence through the formal rules associated with the electoral process varied with a number of circumstances. Among these were the extent of inequality in wealth, human capital, and political influence that existed at the time of independence, when conventions were generally held to draw up constitutions for the new nations. Presumably, the disparity in resources was much less in the United States and Canada than in South America and the Caribbean. This led to a much higher rate of enfranchisement in North America than elsewhere. Thus, as late as 1900, few of the countries in Latin America had the secret ballot, and in most, the share of even the adult male population casting votes was quite small. Most European nations, as well as the United States and Canada, achieved secrecy in balloting and universal adult male suffrage long before Latin American countries, and the proportions of the populations voting in the former were always higher, often four to five times higher, than those in the latter. Although many factors may have contributed to the low levels of political participation in South America and the Caribbean, wealth and literacy requirements, responding to the nature of factor endowments, presented binding constraints.

One obvious explanation for this pattern of diffusion of universal male suffrage is that differences in the degrees of inequality in wealth, human capital, and political influence were related to the likelihood of compelling such an institutional arrangement. The histories indicate that universal male suffrage and the secret ballot were often products of a long series of hard-fought political battles. Another important factor, however, was the desire to attract immigrants. It is striking that pioneers in extending suffrage, such as the new states (those after the original 13) in the United States and also Argentina and Uruguay, expanded suffrage during periods in which they hoped to attract immigrants. When elites, such as large holders of land or other assets, desired laborers to locate in the polity, they often chose to extend access to privileges and opportunities, even without the threat of civil unrest. (On US land policy, see Hibbard 1924, Wellington 1914, Robbins 1942, Gates 1968, and Engerman et al., unpublished manuscript.)

**TWO NEW BOOKS**

Two particularly important books on institutions were published in 2006. Although they deal with quite different aspects of institutions, both Greif (2006) and Acemoglu & Robinson (2006) greatly advance the discussion. Both studies draw heavily on theory and historical examples, and both should prove to be influential for a long time. Both of these clearly argued works have opened up broader debates, although Acemoglu & Robinson will have a broader appeal to political scientists.

The main novelty of Greif’s discussion of institutions is its primary concern with the endogenous generation of institutions, particularly the informal arrangements among individuals. The historical study deals with a
small geographic area for a limited time period, but Greif wishes to generalize the analysis rather broadly. He deals little with the nature of the state, political rules, and legal institutions, which are the concern of Acemoglu & Robinson; indeed, a central contention of Greif relates to the generation of agreed-on institutions in the absence of a central authority. According to Greif (2006, p. 33), the key characteristics of institutions are those that are exogenous to each individual and “reflect intentional or unintentional human actions.” Institutions are nonphysical and rationally motivated, reflect shared cultural and religious beliefs, and are based on the interactions of individuals or coalitions of individuals (Greif 2006, pp. 21, 30, 33).

To Greif, the key sets of rules studied are those dealing with individual transactions. They might be written or unwritten, formally spelled out or informally known, but, in any case, they come to be accepted by the relevant members of society. Governments can provide the enforcement that increases the certainty of the rules being adhered to, but the government need not be a party to transactions. Greif (2006, ch. 3 and 4 and pp. 441–43) describes in detail various means of enforcement. An important point is that even without a direct governmental role, individuals will be able to form trading coalitions to enforce behavior. A major issue for Greif is whether the importance of recurring transactions among individuals or groups would lead to a different set of institutions than would infrequent transactions with few repeat contacts among trading units.11 The influence of repeat dealings leads to a need for informal agreements to enforce the outcome of future negotiations.

Even without government and formal laws, the behavior of rational people, motivated by observing the consequences of their actions, will be consistent with some form of codified rules governing transactions. The importance of trust, or at least imposed behavior to create the equivalence of trust, in permitting agreements without government imposition is reflected in the many private commercial dealings between individuals within nations and across international borders.

For Acemoglu & Robinson, the major concern is not bilateral individual agreements but the role of government and its impositions on private individuals. They provide an analytical framework with which to examine a rather broad question—the terms of establishing a democratic government and understanding how it changes with demographic and other factors. The preferred political system for most citizens is democracy, although in many cases constraints (via legislative rules and the court system) inhibit the effect of democratic outcomes. The government sets voting requirements and participation. A major concern to Acemoglu & Robinson is how or why democracy exists and what causes the transitions in political power. Several different scenarios for changes are presented, including various degrees of repression the currently empowered regime might be willing to implement. The trade-off between coercion and more peaceful forms of transition remains an option, for those ruling society and the terms of the trade-off may be expected to vary over time, with military technology and social ideology (Acemoglu & Robinson 2006, p. 29).12 Primary causes of transitions, within the Acemoglu & Robinson framework, are (a) revolution or the threat of revolution, (b) a shift in norms or ideology to a more egalitarian set of beliefs, (c) new ethical and moral codes about the role of individuals in

11See Greif’s (2006, pp. 418–20) discussion of repeated games. The behavior of individuals is expected to vary with the number of transactions anticipated in the future. If none are anticipated, then opportunism should be expected. Fraudulent behavior might be expected to be relatively more likely the day before an individual leaves the country.

12See Drazen et al. (2007) for a description of the advances made by the authors, and some pitfalls in their application. This set of reviews highlights the significance of the authors’ contributions to economics and political science.
society, (d) a split within the elite leading to some willingness to dilute their power in the interest of achieving specific goals, and (e) a bargain to obtain particular goals that can be accomplished with a changing franchise. They contend that “coups are more likely in societies when there is greater inequality between the elites and the citizens” (Acemoglu & Robinson 2006, p. 222; see also pp. 67–75). 13

The nature of the power relations that determine the introduction, implementation, and enforcement of democratic institutions themselves may vary over time. The useful simplification of analyzing a system with only two groups, elites and citizens, leaves some complications unexplained. For some models they introduce a third group, the middle class, but this raises problems of its own (Acemoglu & Robinson 2006, pp. 38–40, 273–78). Another important problem is to determine how the initial set of rules came about and what power relations influenced them, as the authors give only limited attention to Hobbes and Locke (Acemoglu & Robinson 2006, pp. 21, 120). The types of political organizations and their characteristics could include dictatorship of a powerful ruler or rulers; or democracy of varying forms with, at times, constraints set by a constitution or with an implicit weighting system to allow privileges for an elite. There can also be continuous bargaining and negotiations among equal or unequal groups regarding voting and expenditures. And even with democracy, institutional rules are not always followed by members of society or enforced, providing a form of individual veto to those who wish to disregard the rules, although possibly at some risk or cost to the violator.

Acemoglu & Robinson examine a type of government that provides laws and public goods, influences the efficiency of the society’s output, and affects the distribution of resources among members of society. The governments they consider vary from dictatorship to democracy. There may be restrictions on voting that limit the extent of democratic legal provisions, with the ruling elite influencing the political and economic terms. Restrictions on state confiscation of the resources of individuals are of critical importance, defining the key relations between government and individuals.

Although provisions of government goods tend to reflect the existing nature of power, there are circumstances under which provisions may occur for groups with little or no political power, whether as a one-shot experience or as something more permanent. To provide voting power might mean a long-term granting of an ability to influence resource distribution, whereas a system of temporary provision at the will of the elite, without a change in voting arrangements, may achieve some desired results at lower long-term costs. Elites may provide goods and services to nonelites (a) because of the perceived effects on the health and productivity of the nonelite population, (b) because of a desire to limit emigration or to encourage immigration of nonelites, (c) as a response to the threat of revolution, or (d) as a bribe to attract votes or to get support for extended military activity or other government actions. An alternative to the provision of goods and services (in cash or kind) is the granting of some franchise rights, although presumably the nonelite would have opinions as to which alternative they prefer. Acemoglu & Robinson (2006, pp. 133–36) argue that the granting of franchise rights helps to resolve the commitment problem because it is presumably less reversible than expenditure decisions.

**DEmocracy AND economic growth**

An important, if debatable, argument made for democracy is that it can generate rapid economic growth due to the links between
the political and the economic spheres (see Persson & Tabellini 1994, 2005, 2007; Aron 2000; Przeworski et al. 2000; Boix 2003; Acemoglu & Robinson 2006, pp. 48–64; Easterly 2007). One standard definition of democracy is that there are contested elections between two or more parties, some alternation of office, and relatively stable transitions from one officeholder to the next (Przeworski et al. 2000, pp. 20–30; also Acemoglu & Robinson 2006, pp. 15–30). In the economic sphere, this leads to individuals being able to capture much of what they produce, which in turn leads to more incentives to labor and invest and thus to higher per capita income. This, of course, presumes that people with higher potential income will demand more goods for themselves or their family members, rather than opt for increased leisure or other nonpecuniary benefits, including children. These would increase welfare but not measured income. The broader the political participation, the more individuals can benefit from positive incentives, and the greater the number whose behavior permits benefits from market opportunities. This basic argument linking democracy and economic growth does, however, have some counterexamples. One, related to earlier debates on generating investment in less developed nations, concerns the impact of inequality on savings rates. If higher relative income leads to more savings, inequality presumably can lead to higher rates of savings and investment than would equality, so inequality could be expected to generate more savings and spur growth (Przeworski et al. 2000, pp. 1–7, 142–46). Similarly, majority rule in making policy decisions could lead to a set of policies less favorable to growth than policies that provide opportunities to only a limited part of the population. This argument has a long history and has posed numerous problems for political scientists. Writing in the late nineteenth century, the English jurist Henry Sumner Maine noted some of the problems of democracy. Among these are the prospects of a lower rate of innovation if workers could make decisions about the introduction of new machinery or new sources of labor, and the contention that majority rule could mean reduced rights for many minorities (Maine 1885, pp. 86–87, 112, 147–49).

To understand the impact of institutions as the outcome of individual decisions, and to see what individuals wish to accomplish, it is important to look at their motivations. At one level, the major motivations are the love of reward in contrast with the fear of punishment (and negative sanctions). Rewards can be financial improvement or social approval, or else present or future benefits promised by the current religious or ideological system. Individuals may pursue self-interest (financial or otherwise) or seek broader social goals such as efficiency, power, or an equal distribution of rewards. How individuals decide what goals to seek and whether they will be influenced to change motivations by present or expected future outcomes remains a major puzzle, as is understanding the role of changing motivations in exploring past as well as present growth.

Results of empirical work on the relation of democracy to equality are not clear-cut, since much depends on the years and countries studied as well as the details of model specification and variables included. Przeworski’s detailed surveys of the relation of democracy to levels of income and the related question of the relation of growth to democracy find that “economic development does not tend to generate democracies, but democracies are more likely to survive in wealthy societies.” In general, however, “the type of political regime has no impact on the growth of total national income,” although “per capita incomes rise more rapidly in democracies because populations increase faster under dictatorships” (Przeworski et al. 2000, front matter). An analysis by Acemoglu & Robinson, however, concludes that during the time period analyzed, although richer countries tend to be more democratic, there is no relation between changes in democracy and rates of economic growth (Acemoglu & Robinson 2006, pp. 15–30).
LIMITS TO PREDICTABILITY
For reasons of complexity and the number of variables to be considered, any predictive value regarding the origin and impact of institutions can be rather uncertain. [A related point is discussed by Greif (2006, pp. 10–11, 209–11, 352–57).] It is difficult to predict what institutions society will choose, or even to anticipate whether similar environments and conditions will lead to the same institutions. Similarly, variations over time and place, with or without changes in circumstances, are not always predictable. The role of past institutions in influencing current institutions can serve as a constraint on what will happen, but it need not determine exactly what institutions will emerge. Transitions are not always easy to anticipate or understand.

There are further complications in trying to analyze the choices made regarding the desired institutions. There can be several alternative solutions to some particular set of economic problems, with different benefits and costs for each of the different possibilities. Even if there is only one optimal policy, a number of others may provide benefits, though not all possible benefits. Is there only one specific type of rule or institution that can promote economic growth, or are there several possibilities to choose from, and how sensitive are these choices to what might seem to be minor changes in circumstances?

There is also the issue of the time-path of benefits from the choice of institutions, based on the rate of time preference of the decision makers. If policies provide large gains in the short run but smaller gains (or losses) in the long run, are they to be preferred to policies that may achieve little in the immediate future but more in the distant future? At times, this pattern of variation over time may not be known to decision makers, but it is generally agreed that electoral politics makes desirable actions that yield benefits quickly even if these are not the best for long-run purposes.

Another issue requiring attention is that of the optimal size of the decision-making and policy-implementing unit. This concerns differences between federal and unitary forms of government, and the degree of decentralization in setting taxes, expenditures, and regulatory mechanisms. The possibilities of such varying political forms will constrain the choices of institutions.

The range of important choices goes beyond choosing one specific appropriate institution as the basis for implementing policies. If, for example, it is desired that the government utilize resources obtained from the private sector, there are alternative means of acquiring resources. Resources can be acquired by purchase, tax and transfer policy, confiscation, borrowing, use of law and legal interpretations to seize assets, or the sale of rights to purchase assets. Clearly these different means of acquiring resources have quite different implications for members of society, and these can influence the rate of economic growth and the distribution of income.

Given the large number of institutional choices that must be made by a society, some combination of institutions may be necessary to provide the basis for economic growth. In ongoing work, we have distinguished several key institutions to evaluate: suffrage, education, land policy, banking, industrial policy, market controls, patent policy, tax and expenditure policy, and monetary policy. A choice 

\[132\] For example, the United States had a number of different financial and banking systems, with apparently somewhat limited impacts on growth. Perhaps these reflected changes in conditions that made adaptations desirable.

\[15\] Much of the revisionism concerning New Deal economic policies relates to what some see as its successes at the time that had negative impacts on the economy in subsequent years (see Bordo et al. 1998). Also important is the expected time horizon over which a decision will have an impact. The shorter the expected horizon, the less likely the policy chosen is to be concerned with the benefits to other members of society.
that is appropriate in regard to one policy area may, however, be offset by negative effects in others.

**CONCLUSION**

The recent study of institutions by economists and political scientists has had a large and beneficial impact on these disciplines. These studies have provided a greater understanding of the interactions among individuals and of the consequences of various economic and political systems. The gains may come more from the framing of questions and the enhanced awareness of the forces involved than from a precise forecast of future developments, or a guaranteed prediction of the link between political and economic systems or of the outcome of power relations. Nevertheless, a concern with the impact of institutions should be seen as an important step forward for both economists and political scientists.

**DISCLOSURE STATEMENT**

The authors are not aware of any biases that might be perceived as affecting the objectivity of this review.

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