

Understanding the Process of Economic Change. By *Douglass C. North*. Princeton: Princeton University Press, 2005. xi + 187 pp. Index, references, figures. Cloth, \$29.95. ISBN: 0-691-11805-1.

Reviewed by Stanley L. Engerman

Adam Smith's concept of the division of labor is most frequently applied to the production of goods. Yet it can also be applied to the intellectual world, indicating the differing roles played by scholars in contributing to the production of knowledge. In this regard, Douglass C. North, corecipient of the 1993 Nobel Prize in Economic Sciences, has played a unique role in the fields of economic history and institutional economics. North has specialized in broadening the types of questions to be asked in studying economic development, opening up new perspectives for others to deal with. North wrote extensively on the role of institutions in influencing economic growth, extending the analysis of economic factors beyond the traditional three or four productive factors to include the evolution of the rules of economic society that direct or constrain economic behavior. The recognition of the importance of private-property rights, and of creditable commitment, for example, emerged from the work of North and those following the lines he discussed.

In *Understanding the Process of Economic Change*, North extends further the range of questions he sees as essential to the study of economic change. The questions now include the thought processes of individuals: how people learn to define the institutions that influence behavior, and how they deal with change and the need to adapt to changing conditions. The analysis of such questions draws upon disciplines not usually considered central to economists, cognitive science and psychology, disciplines concerned with how people think, learn, and change views. It is the discussion of the significance of cognitive science for the study of economic policy and for the understanding of how to help generate economic growth in the present-day world that North regards as the central contribution of the volume.

The present volume, one in the series entitled the Princeton Economic History of the Western World, comprises thirteen chapters in two parts. The first, "The Issues

Involvement in *Understanding Economic Change*,” deals with human thought processes and belief systems. The basic starting point is that “the key to improving economic performance, is the deliberate effort of human beings to control their environment” (p. 1). The chapters in this part deal with problems of accurate understanding, including risk, imperfect perceptions, the nature of culture and religion, and the existing political structure. The limits of neoclassical theory are pointed out several times, as North has done also at times in the past. While these chapters are thought provoking and provide a very useful research agenda, few specific cases and examples are described.

The second part, “The Road Ahead,” deals with several cases of economic growth, or with instances of its absence, and returns to some themes developed in previously published essays. Economic growth has reflected the advances in our knowledge of the physical world, as “the last two thousand years have been characterized by unprecedented change” (p. 88). More recently, the added years of life expectation, growth in per capita income, urbanization, and increases in international trade, are used to argue for human progress. His surveys of long-term economic growth focus on the Americas, particularly the differences between the British Empire and the Spanish Empire. He notes the importance of two key factors: the role of “the adaptively efficient institutional structure” (p. 111) inherited from the British and the instability and lack of order in the Spanish colonies. A chapter drawn from one of his classic articles, “The Rise of the Western World,” ranges from the tenth century to the onset of modern economic development and describes the critical impact of a “competitive decentralized environment” (p. 137), as differentiated from centralized empires, such as those of China and the Ottomans, and also from small but nondemocratic societies, such as those with powerful guilds. A chapter entitled “The Rise and Fall of the Soviet Union” is used to indicate what happens in the absence of “adaptive efficiency” and a flexible institutional structure. But since “there is no set formula for achieving economic development,” and as the appropriate actions will “vary with every society, reflecting the diverse cultural heritages and the equally diverse geographic, physical, and economic settings” (p. 165), specific policy suggestions remain to be determined.

As in his prior writings, North has presented important questions to be examined. While his early background was based on training as a neoclassical, quantitative

economist, he is highly critical of much current economic theory as being too static, paying insufficient attention to “complex interlinks” and the interdependencies necessary to understand real world events. We can only hope that following North’s advice regarding the study of institutions and the need to better understand human decision-making will enhance the value of economics as a policy science.

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