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Abstract

How does institutional change take place? This question poses a number of challenges for scholars working in the New Institutional tradition. We first discuss how institutions have been conceptualized as either “rules of the game” or as “equilibria.” The rules of the game perspective suggests that institutions perform useful functions and change when circumstances make these functions obsolete except when transaction costs render this change too costly. The institutions as

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equilibria perspective, in contrast suggests that both cooperation and conflict drive institutional change and that institutional change need not be efficient. We propose a framework for simultaneously depicting institutional change driven by both cooperation and conflict. Finally, we discuss the role individuals can play in shaping institutional change.

Keywords

Institutions · Institutional change · Conflict · Cooperation · Efficiency

31.1 Introduction

Institutional analysis was a core part of economics (or political economy) for Adam Smith (1776) and his contemporaries. Then in the mid-twentieth century, institutions largely fell out of the corpus of economic theory taught to graduate students or published in leading journals. Since the 1990s, this trajectory has been reversed. Multiple Nobel Prizes and John Bates Clark awards have been awarded for the study of institutions. The work of Douglass North and his various collaborators re-established the importance of institutions for understanding economic history and economic development. Institutions are mainstream again.

Nonetheless, the question, “How do institutions change?” remains an open one. Indeed, it is perhaps the most challenging question facing those who study institutions. In this chapter, we provide a survey of various approaches to the topic of institutional change.¹

We first outline the challenge posed by the topic to scholars of institutions. Our central claim is that the tools involved in studying the effects of institutions are not always appropriate for studying how institutions change. We go on to analyze a prominent set of hypotheses of how institutions emerge and why they disappear that we group under the label “institutional functionalism.” Institutional functionalism provides a useful set of tools for studying institutions. However, distinguishing between a strong and a weak version of the institutional functionalism hypothesis, we argue that it does not provide a fully satisfying account of why and how institutions change. In its place, we argue for a more game-theoretic approach to the study of institutions that both complements existing functionalist perspectives and provides greater insight into why institutions change over time.

We provide several examples drawn from the recent literature in economic history: the emergence of the state; Magna Carta and the gradual emergence of constitutional government; the decline of serfdom; and the Glorious Revolution. We go on to discuss the role of critical junctures and individuals in institutional change. We discuss how in our preferred framework individuals can act both as vehicles for

¹See Ménard and Shirley (2022), ► [Chap. 8](#) for a related discussion of how institutions change, though one with a different emphasis.

exogenous change and in helping select between multiple equilibria. Finally, in our conclusion, we discuss the scope for future work.

31.2 Defining Institutions and Institutional Change

The purpose of this chapter is to review competing theories of institutional change. Different theoretical frameworks serve different purposes, and, as we will go on to show, provide more or less insightful accounts of how institutions change over time.

The first challenge we face is in defining institutions. There are competing definitions of institutions. Different definitions are more or less useful depending on the application.

Many scholars and practitioners work with Douglass North's definition: institutions as rules of the game (North, 1990).² However, as we argue in this chapter, while this definition has been fruitfully employed by applied scholars examining the *effects* of institutions, it poses problems for the study of *institutional change*. To study institutional change, we prefer Greif's perspective (2006) which involves viewing institutions as equilibrium outcomes, jointly determined by the beliefs, strategies, and payoffs of the relevant players. This game-theoretic framing can account for why institutions are sometimes stable and sometimes subject to change.

Nonetheless, the institutions-as-rules (of the game) framework provides a useful starting point for institutional analysis. Describing institutions as rules means that they provide incentives that structure individual behavior. The analogy here is with sports. Different sports have different rules, and these different rules incentivize different behaviors. From the perspective of any individual, who is responding to these rules, they are effectively given or exogenous. Private property rights or the laws that support a system of private property rights are rules that structure individual behavior, such as the decision to invest or to improve a piece of land, in a particular way. A different set of rules, say communal proper rights, provide a different set of incentives.

North's work was predominantly historical. But beginning in the 1990s, many scholars became interested in the contemporaneous relationship between institutions and income per capita. When taking the institutions-as-rules framework to the data, it is natural to think about institutions as explanatory variables. The researcher is typically interested in the "effects of institutions." In the context of a standard regression framework, placing institutions on the right-hand side of a regression equation, suggests that institutions be interpreted as "exogenous variables." Recognition that institutions are not exogenous led to an influential stream of research, notably the classic Acemoglu, Johnson, and Robinson paper on colonial institutions (2001), and Dell's study of the Peruvian Mita (2010). These papers introduced causal methods to the empirical study of institutions. However, the aim of these papers was to obtain causal estimates of how institutions shape incomes. They are not set up to study the process of institutional change itself.

²See, for instance, Koyama and Rubin (2022), ► Chap. 3.

Naturally this institutions-as-rules framework is not designed to study institutional change: if the rules of the game are *given*, how do they change? Indeed, this criticism is not new. Greif (2006) argued that the “rules of the game” perspective was limited precisely because it struggled to explain how institutions change over time. The alternative approach, developed by Aoki (2001) and Greif (2006), suggests viewing institutions from an equilibrium perspective. Greif cautioned against reliance on a single definition noting that “[i]t is sometimes appropriate when examining the issue to consider institutions as exogenous structures; other times they are best considered as endogenous to the interacting individuals. In yet other cases, it is appropriate to study them as reflecting the actions and interests of some individuals but not others” (Greif, 2006, p. 13).³ The definition Greif provides is a general one: “An institution is a system of social factors that conjointly generate a regularity of behavior” (Greif, 2006, p. 30).⁴

In an influential paper, Greif and Laitin (2004) provide a specific explanation of endogenous institutional change. In contrast to the rules-of-the-game perspective, they develop an alternative view of institutions as equilibria (developed further in Greif (2006) and Greif and Kingston (2011)). This perspective emphasizes changing beliefs, motivations and behavior. Institutions cease to be in equilibrium when they induce behavior that is inconsistent with the equilibrium; that is, when they are no longer self-reinforcing. This can be due to exogenous shocks or changes in what Greif and Laitin (2004) call “quasi-parameters,” variables which evolve due to the operation of the institution itself.

Related to this criticism is the idea that institutions can comprise different institutional elements or components. Take, for example, Timur Kuran’s work on Islamic institutions (2010).

Kuran argues that a nexus of interlinking economic and legal institutions combined to delay the transition from personal to impersonal institutions in the Islamic Middle East. For example, he argues that the individualized nature of Islamic law made it difficult for an organizational form like the corporation to emerge. This legal individualism was complemented by the highly egalitarian Islamic inheritance system. By limiting the proportion of an estate that could be passed onto a single heir, Islamic inheritance laws made it likely that most businesses would be dismantled after a single generation. These institutional elements, and others such as the prohibition on charging interest, interlocked and complemented each other. Institutional change in the Islamic world after 1800, (when the potential gains from adopting Western technologies and organization forms became evident) was difficult to achieve, therefore, because it did not involve simply adapting or reforming a single institution but instead, changing a whole set of them.

The question of institutional change is also related to long-standing questions of “persistence” in economic history. This literature has considered both the persistence of institutional legacies and cultural traits (see Voth, 2021, for a review). To inquire: how do institutions change is also to examine those factors that prevent them from changing and cause them to persist.

³For Greif, viewing different definitions as mutually exclusive limits “the advancement of institutional analysis” (Greif, 2006, p. 13).

⁴For additional discussion see Greif and Kingston (2011).

Acemoglu and Robinson (2012) point out that institutions are “sticky.” Attempts to change institutions are often just nominal, but nonetheless institutions do change. To explain this, Acemoglu and Robinson (2012) introduce the concept of critical junctures. In the case of serfdom in Western Europe, for instance, the Black Death can be thought of as introducing one such critical juncture: “a major event or confluence of factors disrupting the existing economic or political balance in society” (Acemoglu & Robinson, 2012, p. 101). The problem, however, is that the authors do not make explicit what constitutes a critical juncture in history. Can the assessment of whether or not a given episode constitutes a critical juncture only be made *ex post*?

North and Thomas (1973) was also an influential contribution to the study of institutions within economic history. More recently, North, Wallis, and Weingast (2009) developed a highly insightful taxonomy of how institutional arrangements within societies cohere. The authors distinguish between various forms of what they call the “natural state” and open-access orders. Both the natural state and the open-access order should be understood as configurations of institutions and as equilibria. In a basic natural state there are no long-lived institutions outside of the state itself which may itself be indistinguishable from the personal identity of the ruler. Natural states therefore are fragile and unstable. Open-access orders, by contrast, permit a wide array of organizational forms.

North, Wallis, and Weingast (2009) do not, however, provide a theory of institutional change. Rather they outline “doorstep conditions” that characterize the threshold at which societies transition from being natural states to being open-access orders. This typology is informative but it does not provide explicit guidance about what factors determine whether a society passes over this threshold. The absence of a compelling account of institutional change was widely noted by commentators. Robert Bates in his otherwise extremely positive review commented that “Concepts, such as ‘double balance’ or ‘door step conditions,’ seemed disembodied and, therefore, unable to provide an intuitively satisfying or logically compelling explanation of why some societies have developed while others have failed to do so” (Bates, 2010, pp. 755–756).

Another conceptual challenge stems from North’s distinction between formal institutions and informal institutions (see Hodgson, 2023a). North often argued that formal institutions had to be complemented with informal constraints (see North, 1990). But this raised a number of questions, in particular: Are informal constraints or informal institutions really institutions? Or is it more productive to bracket them under the heading “culture”? In this chapter, we predominantly focus on formal institutions. It goes without saying, however, that cultural beliefs can act as constraints on what institutional change is possible and that cultural beliefs can co-evolve with institutional development (see Bisin, Rubin, Seror, & Verdier, 2024).

The pace and nature of institutional change are another topic. Institutional change can be gradual and evolutionary, or it can be abrupt. The decline of serfdom in Western Europe was a gradual process that took many decades to unfold. The Glorious Revolution was a distinct and abrupt episode of institutional change (even if we allow that it took several years for aspects of it to be solidified—the Bank of England had to wait until 1694 to be established). Similarly, the institutional changes brought by the French Revolution and subsequent Napoleonic Wars were

confined to a discrete period of time (c. 1789–1815) (Acemoglu et al., 2011). The end of slavery in the United States following the Emancipation Proclamation in 1863 and subsequent Union victory was another important and abrupt institutional change, though the legacies of this victory were contested for decades.

There are also examples that fit the idea of “exogenous” institutional change, that is, institutional change imposed from outside. The imposition of Western colonial institutions is often viewed in this light, for example by Acemoglu, Johnson, and Robinson (2001, 2002) (though it was in fact more complex than this).⁵ However, institutional change is often a highly endogenous process with multiple causes and feedback loops. This makes causal inference challenging.⁶ Of course, many instances of institutional change combine exogenous and endogenous elements. For example, the demise of the serfdom (discussed in Sect. 31.4) is often thought to have been an endogenous response to the exogenous shock of the Black Death (see Jedwab, Johnson, & Koyama, 2022). Dittmar and Meisenzahl (2020) note that before the Reformation period, plague shocks did not directly impact local institutions or politics. However, in the wake of the ideological competition opened up by the Reformation, local plague shocks did lead to institutional change because they discredited the response of local religious establishments.⁷

In what follows, we argue for a game-theoretical approach to institutional change. We will focus on formal institutions, rather than the evolution of informal norms. We will ask what factors led to particular institutions disappearing and new institutional forms emerging. As this is a dynamic and rapidly evolving field of study, we are selective in the literature we review, and focus on recent contributions that are especially relevant to our concerns in this chapter. Before proposing our framework, however, we first discuss an alternative approach found in earlier literature.

31.3 Institutional Functionalism

One way of thinking about institutional change is functionalism. The term functionalism comes from cultural anthropology. Functionalism was perhaps the dominant paradigm in cultural anthropology for several decades after World War II before falling from prominence. It was used as a lens to study both cultural beliefs and

⁵There was no single model of colonialization. While it was true that the initial character English colonies settled in North America were driven by the profit-seeking motives of the Virginia or Plymouth Companies, later imperial settlements, and conquests were often responses to local political conflicts.

⁶This is Przeworski’s criticism of the new institutional economics (2004). Specifically, Przeworski argues that institutions cannot be the primary cause of economic development if they are themselves caused by other factors. He concludes that “Institutions and development are mutually endogenous and the most we can hope for is to identify their reciprocal impacts.” We believe that the approach outlined in this chapter addresses his criticisms.

⁷Desierto and Koyama (2024b) find that (pre-Reformation-era) plague shocks functioned as labor market shocks. They induced elites to pass more sumptuary laws but did not otherwise affect political institutions.

social structures. It allowed scholars to explain the prevalence of particular institutional arrangements, e.g., prohibitions on incest, human sacrifice, slavery, or marriage norms in terms of those factors that would make these institutions functional at a societal level (Radcliffe-Brown, 1952). While it was not always specified, functionalism was understood in terms of improving overall societal welfare. The institutions did not have to be understood in those terms by the individual agents who enacted and enforced them—for example, widespread incest taboos are not necessarily justified by a concern for the viability of offspring; but these “functional” reasons can account for the success and stability of the norm.⁸

Within anthropology, functionalism was criticized for its emphasis on equilibrium. By portraying cultures and social institutions as static, functionalism does not account for how cultural beliefs and social structures form or evolve. Although now largely disregarded by anthropologists, functionalism has had a major impact on how economists think about institutions.

Functionalism approaches offer powerful explanations of why particular institutional arrangements are stable. But can they also provide insights into the process of institutional change?

One angle is evolutionary theory. Alchian (1950) discussed the idea that more efficient institutional arrangements would be selected over time through a quasi-evolutionary process. This idea is also prominent in the later work of F.A. Hayek (e.g., Hayek, 1976, 1982, 1988): history can function as a sieve, eliminating inefficient institutional practices. According to Hayek, it is no coincidence, for instance, that institutions like private property and marriage are so common across human societies, whereas communal property arrangements or forms of “communism” appear rare, transitory, and dysfunctional among large-scale societies whenever they emerge. At the same time, Hayek’s appeal to evolutionary arguments was seen as overly teleological, even by friendly critics (see Vanberg, 2014).

Coase (1960) also influenced how economists thought about institutional formation and institutional change. He focused attention on the critical role of transaction costs in determining the outcome of economic cooperation. When transaction costs are high, the institutions that determine the initial allocation of property rights, shape the outcome of any economic arrangement. Gary Becker, Richard Posner, and Harold Demsetz were responsible for applying these insights to institutions such as the law, property rights, marriage and family law, and even belief systems.⁹

⁸For example, in explaining why in some societies, a sister’s son was allowed privileged relations with a mother’s brother, Radcliffe-Brown set aside the explicit, mythic, or pseudo-historical explanations provided by his interlocutors and instead advanced an “alternative method of dealing with the institution” which was to look “for a theoretical understanding of it as a part of a kinship system of a certain type, within which it has a discoverable function” (Radcliffe-Brown, 1952, p. 13).

⁹Posner (1980) laid the foundations for the economic analysis of many cultural beliefs that we would label superstition. This line of analysis has been fruitfully developed by Leeson (2017). Posner (1980) provides an “equilibrium” analysis and does not consider the problem of institutional change.

An early and insightful application of these ideas was Demsetz (1969) who argued that property rights only emerge when land becomes sufficiently valuable that it pays to enforce these property rights. Hornbeck (2010) provided empirical evidence for Coase and Demsetz. He examines the impact of barbed wire—a technology that lowered the costs of enforcing property rights. Prior to the invention of barbed wire, it was particularly costly to fence and protect land and thus to enforce property rights in areas lacking adequate material for fencing. In these areas, he finds that the introduction of barbed wire had a differential positive impact on land use and productivity.

The formal political economy literature has also provided analyses of endogenous institutional change. Kroszner and Stratmann (1998) argue for, and test, a theory for how interest competition led to the formation of long-standing committees within Congress in the twentieth century US. Special interest groups and legislators face a principal-agent problem because they cannot write binding contracts (as this would be bribery). Kroszner and Stratmann (1998) argue that the development of the committee structure within Congress solves this problem by making interactions between interest-groups and legislators repeated games.

North and Thomas (1973) espoused a form of neoclassical institutional functionalism. They were particularly interested in the question: “why property rights which cannot profitably be established at one point in time will later be economically justified.” Since it was obvious that “the benefits from developing new institutions and property rights must have risen relative to costs,” they sought to answer this question in “an analysis of those parameters which influence the relationships between benefits and costs” (North & Thomas, 1973, p. 8). Institutions that provided the right incentives, particularly what North and Thomas (1973, p. 157) called “efficient property rights,” were critical for economic growth. But these institutions themselves evolved in response to underlying parameters such as technology, transaction costs, and population.

economic growth will occur if property rights make it worthwhile to undertake socially productive activity. The creating, specifying, and enacting of such property rights are costly, in a degree affected by the state of technology and organization. As the potential grows for private gains to exceed transaction costs, efforts will be made to establish such property rights. (North & Thomas, 1973, p. 8).

Implicitly, this argument suggests a one-for-one mapping between underlying economic parameters and institutions. It assumes a world where institutional equilibria are unique.

Institutional functionalism fits naturally with much standard neoclassical economic reasoning. For this reason, many institutional studies take an implicitly functionalist approach. For example, the medieval and early modern craft and merchant guilds were interpreted by many scholars as emerging to solve market failures in the economy. These institutions were local monopolies that restricted entry and usually had some kind of legal or quasi-legal exclusive control of a given industry or trade in a city. Adam Smith had condemned guilds as monopolies, but

institutional functionalism suggests that, to have been so pervasive and long-lasting, they must have solved some important problem or sets of problems.¹⁰

Allen (2011) studies a host of pre-modern institutions through the lens of constrained efficiency. His thesis is that many seemingly odd or corrupt practices such as the sale of offices, dueling, and the patronage system made sense in a world where measuring performance was very costly. Because payment could not be made on the basis of measured output (or input), incentives had to be aligned through other means. For Allen “the major problem of the pre-modern world was the enormous role nature played in the ordinary business of life. Keeping time, measuring distance, and relying on a power were once problems of a first order. Once these problems were solved, new institutions were developed that characterize the modern world” (Allen, 2011, p. 21).

To be clear, there was considerable evidence in favor of such functionalist interpretations. Many of the practices of craft guilds could be rationalized as guaranteeing quality in the face of severe asymmetric information problems (Richardson, 2008). They also helped to incentivize investment in industry-specific human capital (Epstein, 1998). Merchant guilds could be rationalized as providing defense against banditry, as in Hickson and Thompson (1991), and as resolving credible commitment problems with the state, as in Greif, Milgrom, and Weingast (1994).

The claim that institutions that are no longer fit for purpose, perhaps because underlying economic conditions have changed, will be reformed, appears unobjectionable, at least as a necessary condition for institutional change. We call this the weak version of institutional functionalism. Greater conceptual challenges arise when scholars infer efficiency from existence. We label this the strong version of institutional functionalism. It is the working hypothesis that an observed institutional change is an efficient solution to a change in the underlying parameters. The reason why this may not be the case is the existence of multiple equilibria. Ogilvie (2007) similarly criticizes functionalist approaches to institutional analysis (which she brackets under the label “efficiency approaches” in her article “Whatever is, is right?”). She distinguishes between a strong version of the efficiency approach whereby only institutions that are efficient (subject to transaction costs) endure over time, and a weaker version, which allows for path dependency, so that institutions which were initially efficient solutions to social problems persist even after they have lost their initial rationale (Ogilvie, 2007, p. 656).

To take the example of the medieval and early modern craft guilds, simply proposing a functionalist explanation for medieval and early modern guilds does not guarantee that that is the actual reason for their prominence and longevity. Ogilvie (2011, 2019) argues that the practices of both merchant and craft guilds can be alternatively explained with a conflict-based framework.

The prevalence of multiple equilibria means that there is no one-to-one mapping between parameters, or economic fundamentals, and institutional outcomes. Many settings resemble coordination games. Therefore, inefficiency is quite possible. Societies can be “stuck” with inefficient institutions.

¹⁰For a broader discussion, see Koyama (2020).

This is clearly explicated by Young (1998) who offers an evolutionary theory of institutions.¹¹

Young begins with a bottom-up or spontaneous-order view of institutional formation and change: for “a great variety of social and economic institutions—language, codes of dress, forms of money and credit, patterns of courtship and marriage, accounting standards, rules of the road ...no-one willed them into being: they are what they are due to the accumulation of precedent; they emerged from experimentation and historical accident” (Young, 1998, p. 4).

In some settings, for example in bargaining games, there is a tendency for adaptive learning to select “efficient institutions” that is, institutions whose payoffs lie along the Pareto frontier. But more frequently, it is the risk-dominant equilibrium rather than the Pareto-dominant equilibrium that is selected.

A related problem to that of multiple equilibria is that too many social phenomena can be rationalized by rational choice theory if we allow individuals to care about things beyond, say, consumption (see Murphy, 2019). If rational choice theory can justify a wide array of institutional arrangements on efficiency grounds, then it also does not provide much guidance about why certain societies select certain institutional arrangements above others.

Albrecht, Hendrickson, and Salter (2022) argue that many apparent inefficient institutions only appear inefficient if one neglects to examine the costs of changing them. They distinguish between Kaldor-Hicks, or planner inefficiencies, and political inefficiencies, i.e., policies or institutions that are inefficient if we do not include the costs of reform. Evolutionary forces constrain these political inefficiencies: in the long-run even political inefficiencies will be eliminated by a process akin to natural selection (i.e., a society that is rife with political inefficiencies may be conquered or absorbed by a neighbor). This will push institutional change in the direction of greater planner efficiency.¹²

Taking stock, institutional functionalism clearly has its place. As a working hypothesis, it can generate testable predictions that can be taken to the data. As a theory of institutional change, however, it is at best incomplete and often tautologous. Understanding how institutions change requires moving beyond functionalist explanations. In the following sections, we then sketch what we believe is a more complete framework for understanding how and why institutions change over time.

31.4 Conflict and Cooperation as Drivers of Institutional Change

Having considered functionalism as a set of explanations for institutional change, we now consider alternative approaches. Critics of institutional functionalism or efficiency-based explanations often posit conflict as an alternative approach.

¹¹ The underlying logic was already understood by Schelling (1960).

¹² A related discussion about the normative implications of the efficiency perspective is Leeson (2020).

Because rules determine how resources are distributed, they are subject to conflict: “Which institution (or set of institutions) results from this conflict will be affected not just by its efficiency but by its distributional implications for the most powerful individuals and groups” (Ogilvie, 2007, p. 662). Ogilvie (2007, p. 663) argues that

... a ‘conflict’ approach which incorporate institutions into its analysis without assuming such activities to be efficient can explain many facts about pre-modern institutions that ‘efficiency’ views cannot. A conflict approach would agree, for instance, that there is a good economic reason for the long existence of serfdom. But this was not that it efficiently solved market imperfections in public goods, agricultural innovations, or investment. Rather, serfdom created an economy of privileges that hindered efficient resource allocation in labour, capital, and output markets.

An important insight that underlines the conflict theory of institutions is the absence of a political analogue to the Coase theorem (Acemoglu, 2003). The Coase theorem is typically interpreted as saying that in the absence of transaction costs, efficiency will obtain regardless of the initial allocation of property rights (Coase, 1960). Acemoglu (2003) argues that this reasoning cannot usually be generalized to the political setting. The main reason for this is that contracts that are enforceable across all states often cannot be written. Agents in the political arena cannot make credible commitments.

Acemoglu and Robinson (2000, 2006) applied a game-theoretic framework to study democratization. Democracy emerges in the context of political conflict between the rich elites and the masses. Elites concede democratic rights in response to the threat of revolution from below because otherwise their promises of economic redistribution would not be credible.

While the role of conflict has received attention in the literature, it is not the only driver of institutional change. While individuals and groups can fight over the distribution of resources and surplus, they can also cooperate to preserve and grow that surplus.

Indeed, scholars have theorized about the origins of the state and political order more generally through two distinct analytical frameworks—contractual theories, and approaches based on predation or conflict.

Contractual theories focus on the cooperative nature of institutional change in that they explain how a particular political organization could be justified by *voluntary* consent. However, as they are typically intended as normative theories, they are not accurate descriptive accounts of how states arose. Hobbes’s version of the state of nature and his contractual justification for absolutism is merely the most famous of these (Hobbes, 1996). Locke used a similar framework to articulate a constitutional regime, as did other seventeenth and eighteenth century social contract theorists such as Pufendorf and Vattel (Tuck, 1979).

Conflictual accounts provide purported positive theories for the emergence of the state. Karl Marx developed such a conflictual account, as did Friedrich Nietzsche and Franz Oppenheimer. Oppenheimer saw the genesis of the state in the act of violence such as “subjection of peasant folk by a tribe of herdsmen or sea nomads” (Oppenheim, 1922, p. 29). Indeed, as a positive description of state formation it

seems accurate: many and perhaps most actual cases of state genesis involve violent conquest. This is inscribed in the formation myths of the Romans, many of the polis of ancient Greece and such modern nations as England and France (formed by the Germanic invaders in the fifth and sixth centuries).

Of course, we do not have historical accounts of the rise of the earliest states, so to understand cases of pristine state formation, we remain reliant on rational reconstruction as informed by both theory and whatever archaeological evidence can be brought to bear on the question.

The idea that both cooperation and conflict are critical to understanding state formation was already noted by North (1979, p. 251):

The contract approach may explain why the state potentially can provide a framework for economizing on the use of resources and therefore can promote wealth. But as both the third party to every contract and the ultimate source of coercion, the state becomes the field on which the battle for control of its decision-making power is fought. All sides wish to be able to redistribute wealth and income in the interest of their own group. This was Madison's main point in Federalist Paper No. 10, written 200 years ago. The contract theory explains the gains of initial contracting (in comparison to anarchy) but does not explain the subsequent maximizing behavior of constituents with diverse interests. The predatory theory ignores the initial gains of contracting and focuses on the extraction of rents from constituents by those who gain control of the state.

In other words, cooperation generates surplus, which can then be expropriated through conflict.

We selectively survey some recent scholarship that demonstrates the forces of conflict and cooperation during important historical episodes of political and economic development.

31.4.1 Early States

A key idea for coercion-based theories of the state is geographical circumscription—the idea that geographical features such as deserts or mountain ranges surrounding a piece of fertile land limited the outside options of would-be subjects (Carneiro, 1970). Allen (1997) used this argument to examine state formation in Egypt. Egypt's early state formation is suggested by its geography. Agriculture first developed along the fertile Nile valley, and this area of lush farmland was surrounded by inhospitable desert. Geographical circumscription was thus possible earlier than elsewhere as its geography helped rulers corral tax payers. Early statehood in Egypt brought stability, but may have made the average Egyptian worse off, as the surplus created by agriculture could be extracted by the political elite.

Mayshar, Moav, and Neeman (2017) and Scott (2017) both emphasize the importance of the ability of a state to ascertain and appropriate agricultural output. Standard accounts of the emergence of the state, link this process to agricultural productivity. As agriculture developed and became more productive, a surplus emerged that could be used to support political elites. Mayshar et al. (2017)

challenge this account. They argue that the ability of political elites to extract a surplus from the farming population depended on their ability to expropriate. In other words, it relied on their military superiority and their ability to accurately observe how much output had been produced.

What about an efficiency-based explanatory for early state formation? According to this perspective, the emergence of states can be rationalized as a response to a collective action problem. Allen, Bertazzini, and Heldring (2023) study the formation of early states in Mesopotamia (modern day Iraq). As agriculture in this region (and period) was dependent on natural irrigation from rivers (rather than being rain-fed), they argue that a shift in the location of a river created an exogenous source of variation in demand for public goods provision and hence a “state.” They find that a shift of a river away from a location is associated with a three percentage point increase in the probability of that location being part of a city state. This, the authors argue, provides support for cooperative rather than conquest-based theories for the origins of the state.

31.4.2 The Demise of Serfdom in Western Europe

In 1300, 50% of people in England were servile and 50% of the land was held on villein tenure, but by 1500 serfdom had largely disappeared. Land was held through a variety of different forms of copyhold (Bailey, 2014, p. 28). Restrictions and feudal duties associated with the possession of land had also mostly gone.

Serfdom was a long-standing legal and economic institution. It was characterized by a coercive relationship between lord and serf. Villeins were legally obliged to hold land and pay labor service and customary dues. Lords had corresponding obligations to their serfdoms but these could be breached and, at least in theory, lords had the discretionary power to impose additional incidents and fees (Bailey, 2014, p. 37). How serfs were actually treated varied locally (“Sale of serfs, and arbitrary punishments and restrictions upon them, were unusual”). In theory, lords were able to extract the entire surplus beyond that required for subsistence in the form of labor dues or fines. In practice, however, many labor dues were commuted.

The disappearance of serfdom in England was part of a wider European phenomenon that has attracted considerable scholarly attention. Domar (1970, p. 21) outlined a simple economic model of serfdom that generates a trilemma: one cannot have abundant land, an aristocracy that lives off labor income, and free labor. Which combination prevails depends on political factors or institutions. Domar believed that his story fit Russia fairly well but he recognized that it did not explain Western Europe. Domar (1970, p. 28) noted that

...when we come to the depopulation caused by the Black Death after 1348, my hypothesis is of little value in explaining the subsequent cause of events. Why did serfdom fail to come back after such a sharp increase in the land/labor ratio? ...I have none to offer and have to fall back on political factors

Historians writing in the Marxian tradition did offer an explanation based on political factors.

Rodney Hilton emphasized class conflict and the growing self-assertiveness of peasants following the Black Death (Hilton, 1969, 1985). While the initial response of lords was repression, in the long-run peasant resistance brought about an improvement in labor market conditions. The Peasants Revolt of 1381 was decisive in this development according to this perspective.

The timing of this account seems incompatible with what Bailey (2014) observes from the study of 28 English manors from East Anglia, Oxfordshire, and Buckinghamshire. Bailey finds that serfdom began a sharp decline immediately following the Black Death. Labor services were already being commuted from 1300 onwards but the rate at which this occurred accelerated after 1350. Soon after 1400 labor service mostly disappeared (barring seasonal work requirements which lasted until the 1450s). He concludes that villein tenures disappeared between 1380 and 1420 while personal serfdom disappeared between 1380 and 1450.

The question then is what caused this decline? North and Thomas (1973), North (1990) suggested an important factor: changing relative prices. But they noted that the effects of changing relative prices might be complex. Acemoglu and Wolitzky (2011) propose a principal/agent model that addresses this topic. In their model, coercion increases effort by the agent. Greater demand for labor (because the value of marginal land has increased or perhaps because of the invention of a new technology) increases coercion. This model, therefore, recovers Domar's logic that greater labor scarcity can lead to more labor coercion (a labor demand effect) but it embeds it in a richer framework. Specifically, Acemoglu and Wolitzky (2011) allow for an outside option effect. If greater economic scarcity also increases outside options for workers (by raising per capita income and hence demand for manufactured goods), then this causes labor coercion to fall. According to this framework, therefore, if the outside option effect dominates the labor demand effect, then a negative demographic shock can cause a decline in labor coercion.

These predictions are broadly consistent with what historians observe happening after 1348. Nonetheless, they abstract away from the interplay of cooperation and conflict among elites.

The demographic shock of the Black Death provided a crucial background condition. Figure 31.1 depicts the collapse in population that took place after 1348 and its subsequent failure to recover until after 1500. Real wages initially did not rise (because prices rose faster than nominal wages). But as Fig. 31.2 also shows, from the 1380s onwards, wages began to grow, peaking in the early or mid-fifteenth century. Many economic historians have viewed this period as a golden age for workers. The evidence for this is mixed as we have to consider the decline in international trade and a decline in hours of work available. Bailey (2021, p. 254) cautions "against highly optimistic claims for the living standards of workers c. 1400" nonetheless he notes that it "seems reasonable to suppose that the average annual income within the lower orders of society rose by c.40 percent."

Nonetheless, the effects on the allocation of land were immediate. Black Death mortality increased the turnover of free peasant land: "the epidemics increased the

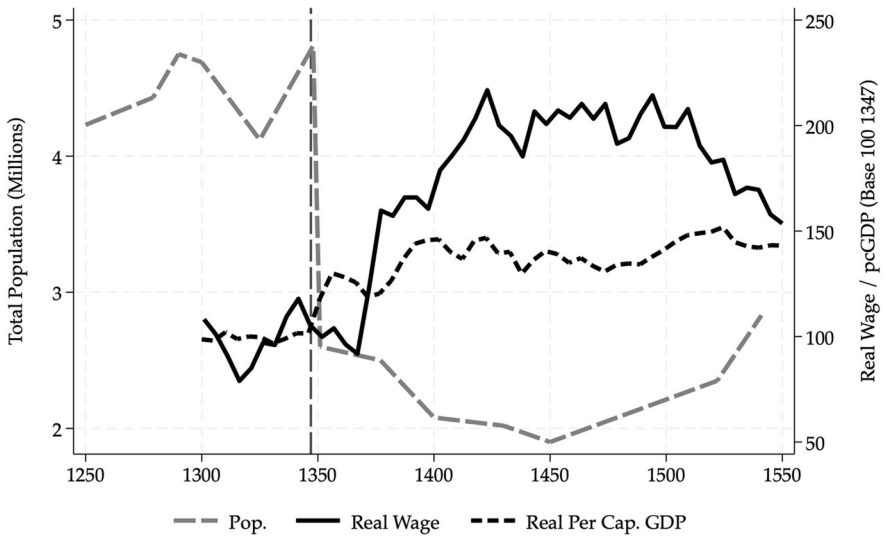


Fig. 31.1 The demographic shock of the Black Death. Population estimates are from Broadberry et al. (2015)

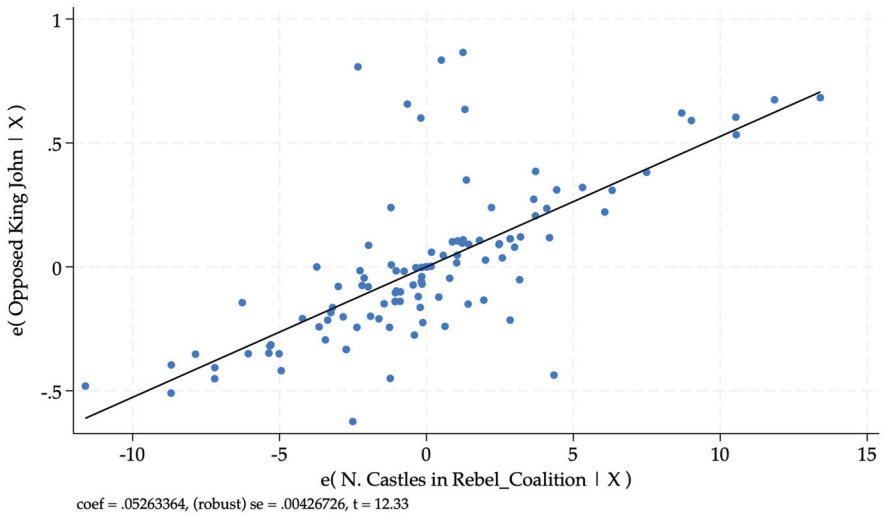


Fig. 31.2 The positive relationship between the number of castles owned by rebels in a baron’s family network and that baron’s probability of rebelling against King John. (Data source: Desierto, Hall, and Koyama 2024)

incidence of the failure of heirs, and the length of time land remained in the lord’s hands without a tenant, creating even more opportunities and incentives for land-lords to change the terms of tenure” (Bailey, 2021, p. 305)

Rather than being a response to conflict between peasantry and lords, Bailey argues that the evidence is consistent with labor scarcity inducing workers to move.

Peasants abandoned farms where conditions were unsatisfactory and moved where conditions were better. This rather than manumission—the contractual lifting of servile obligations—or peasant resistance drove the decline in serfdom.

The decline of serfdom was also linked to the rise of the state (Peters, 2022).¹³ Palmer (1993) argued that the late fourteenth century saw a dramatic increase in the scope and in particular the legal capacity of the English state. He argued that “Governance after the Black Death was qualitatively different, exhibiting a government intent on using the law to control society, to preserve as far as possible the status quo.” Crucial to Palmer’s argument were the attempts by the English state to regulate labor markets. “The enforcement of labor regulation was still primarily local, but local power was now more effectively exercised by lords representing central authority over all available workers instead of by lords exercising their own inherent authority over their unfree tenants” Palmer (1993, p. 5). In a similar fashion, Bailey (2021, p. 300) argues that individual lords were not well equipped to respond to the new challenges posed by the radically altered land/labor ratio.

This example reiterates the importance of political and institutional factors. Had landlords been a sufficiently cohesive class, they could have coordinated on limiting this movement. Indeed, they attempted to do so for some decades in the late fourteenth century. But ultimately the incentives to defect were too great and attempts to restrain peasant demands collapsed.

31.4.3 Institutional Change in Early Modern England

Since North and Weingast (1989), scholars of institutions have focused on England as a canonical example of institutional change (e.g., Pincus, 2009; Pincus & Robinson, 2014; Cox, 2011, 2015; Acemoglu & Robinson, 2012; Hodgson, 2023b). We revisit this episode from the perspective of recent contributions to the literature and from the broader sweep of English history.¹⁴

Historians caution that the Glorious Revolution should be seen in the context of a gradual process of institutional change in which Parliament became more integral to the governance of England over time. Its origins go back to the thirteenth century (Butt, 1989). Angelucci, Meraglia, and Voigtländer (2022) examine the consequences of grants given to certain towns to govern themselves and collect their own taxes in the twelfth and thirteenth centuries. They find that towns that received such grants went on to obtain parliamentary representation. Moreover, it was these towns that in the seventeenth–nineteenth centuries played a role in strengthening Parliament and pushing for more inclusive institutional change (for example, by raising regiments to fight for Parliament in the Civil War or voting for the Great Reform Act of 1832).

¹³ Belich (2022) also emphasizes the importance of the plague for the development of Europe’s warfare states.

¹⁴ A vast literature emerged in response to North and Weingast (1989). The majority of this literature, however, focused on whether the consequences of the Glorious Revolution were as dramatic and discontinuous as North and Weingast (1989) originally argued.

The Reformation was another decisive shock to England's political institutions. Rubin (2017), Greif and Rubin (2024) argue that since the Tudors had come to power during a civil war, they could not rely on heritage and tradition, while the Reformation removed the Catholic Church as a source of legitimacy. In response the Tudors relied increasingly on Parliament. This is one concrete instance of how cultural change, in this case religious change, could bring about institutional change.

According to Greif and Rubin (2024), different principles of legitimation and different legitimating agents after 1520 set England on a particular institutional trajectory. Besides relying more on Parliament to enact laws, the Tudors increased the number of Members of Parliament and increased the number of constituencies. This set in motion the conflicts that would occur in seventeenth century England and result in civil war and ultimately in the Glorious Revolution.

Other factors also played an important role. The growth of Atlantic trade empowered merchants and their allies in Parliament, as argued by Acemoglu, Johnson, and Robinson (2005). Jha (2015) examines the role of financial markets in facilitating institutional change. He argues that access to shares in colonial trading ventures allowed a subset of elites to coordinate in opposing King Charles I during the English Civil War. This is part of a broader research agenda in which Jha proposes that financial instruments can help foster broad political coalitions that favor peace and beneficial reforms (see Jha, 2018; Jha & Shayo, 2019). Political parties also emerged in this era (see Jones, 1961; Pincus & Robinson, 2014) and as argued by Desierto and Koyama (2024a), they played an important role in allowing elites to coordinate on specific policies.

The Glorious Revolution was undoubtedly an important landmark in the institutional development of England. It placed lasting limits on the discretionary authority of the Crown and established parliamentary sovereignty. But it was itself the product of many decades of conflict and political deals (cooperation) between members of the political elite and the Crown.

31.5 A Theory of Cooperation and Conflict

Our historical examples demonstrate that some institutional changes result from conflict, and some from cooperation. But under what conditions do individuals voluntarily come together, or else fight with one another, to bring about institutional change? We think that existing scholarship struggles to answer this, because it has yet to provide a clear theoretical framework that *simultaneously* depicts cooperation and conflict. The problem is primarily methodological. Conflict is naturally modeled within a non-cooperative framework, while cooperation fits within a cooperative, game-theoretic framework. To depict both conflict and cooperation thus entails finding a way to merge these two distinct frameworks.

A promising avenue is found in Ray (2007), in which the process by which players come to an agreement is modeled as a non-cooperative game. The cooperative game approach tends to focus on coalitions as fundamental units that can block or approve proposals. Ray (2007) instead focuses on the formation of such coalitions as a result of non-cooperative bargaining among proposers and responders.

Desierto and Koyama (2024) and Desierto, Hall, and Koyama (2024) use this framework to depict the political economy of feudalism and the emergence of the Magna Carta in England. We summarize below.

31.5.1 Feudalism

The rise of feudalism can be seen as involving a form of secondary state formation as new types of polities were fashioned in the wake of the barbarian invasions of the early Middle Ages. The feudal system provides an illuminating illustration of the importance and simultaneous interplay of both cooperation and conflict in establishing order. A key feature of the feudal world is that there were no political institutions that confer power to a ruler and guarantee the stability of their rule. Instead, the ruler had to continuously hold together a coalition of elites, each of whom has their own resources and can, at any point, withdraw from the coalition, peacefully or violently (through rebellion).

Desierto and Koyama (2024) thus depict a feudal order as a coalition of elites held together by non-binding agreements, which may be completely voluntary or otherwise backed up by the threat of violence. Individual elites each have their own economic and military resources which they can pledge to a ruler in exchange for some share of the entire realm. This however, need not always be a peaceful affair. The ruler can forcibly take those resources, and bring its owner into the ruler's coalition through conquest. Any elite can also exit the coalition by withholding or removing their resources from the ruler's jurisdiction through rebellion. It is the forging and re-forging of the ruler's coalition of elites that describes how a feudal realm expands and consolidates into larger territories, or fragments into smaller units. One important result is that consolidation is more likely when the resources of elites are difficult to appropriate by any ruler, e.g., when an elite has a castle that can defend their surrounding lands and therefore keep them away from the ruler should the elite rebel. This makes rebellion more costly to the ruler, which makes the ruler more likely to prevent rebellion by sharing more wealth with elites. The elites then remain loyal, and the realm is consolidated.

31.5.2 Magna Carta and Institutional Change in Medieval Europe

Constraining the grabbing hand of the state is a key theme in institutional economics. With some exceptions, less attention has been paid to the early growth of these institutions in medieval Europe.¹⁵ The issuing of Magna Carta in 1215 was one of the important early instances of institutional change in English history, a critical juncture in the language of Acemoglu and Robinson (2012). While it by no means fully succeeded in its own time, as King John reneged on the initial agreement, and

¹⁵For example, Salter and Young (2023). There is a rich empirical literature on medieval city-states, see for instance, Stasavage (2014). Puga and Treffer (2014) considers the case of institutional change in medieval Venice as it moved from being a relatively open oligarchy to a closed one.

further baronial wars were required to make subsequent kings respect the limitations on their authority, Magna Carta did lay down the foundation for the subsequent development of Parliament as a forum for the king to ask for taxes and consult with the realm (Koyama, 2016). Desierto, Hall, and Koyama (2024) study the baronial coalition whose rebellion brought about the Magna Carta.

Their analysis is both theoretical and empirical. Using the coalition-formation framework in Desierto and Koyama (2024), the authors consider how an exogenous shock to the power or legitimacy of the king can generate the formation of a sub-coalition of rebel barons, who then propose a new arrangement that limits the extractions by the king. Specifically, the rebels propose a new institution like the Magna Carta, which restricts the king's discretion over resources and ensures that barons receive equal rights. The king can agree to the proposal, or reject it, in which case he gathers his loyalists to fight the rebels. The victor thereafter implements their preferred arrangement—either the status quo or the rebels' proposal. An agreement like Magna Carta is thus obtained in equilibrium if it is an optimal contract between parties (e.g., the king and the barons) who are each capable of violence. The authors show that this equilibrium is more likely to occur when the king is highly extractive; when the barons have resources that are non-appropriable by the king and therefore easily withdrawn from the king's coalition; and when the initial distribution of resources among the barons is fairly egalitarian.

Underlying these results is a key theorem stating that any one baron is more likely to join the rebel coalition when the total (non-appropriable) resources of that rebel coalition are large. Desierto, Hall, and Koyama (2024) demonstrate whether this theorem holds empirically, as a test of the plausibility of the theory. To do this, they build a unique dataset comprising the universe of all English barons in the early thirteenth century and each of their family networks. They match each baron to their barony and thus have a measure of each baron's resources. The relevant resources are those that are non-appropriable, that is, those resources a baron can take back from the king should the baron rebel. One measure of the non-appropriability of resources is its defensibility. The authors thus count the number of castles held by every member of the rebel coalition to serve as proxy for the non-appropriable resources of the rebel coalition. The theorem predicts that this should increase the likelihood that any one baron joins the rebel coalition.

One obvious challenge in identification is to find variation in the resources of the rebel coalition across baronies, as there is only one rebel coalition. The authors then prove a stronger theorem stating that the resources of a *subset* of the rebel coalition—specifically those who are in the baron's social network, would increase the likelihood that the baron joins the rebel coalition.

To proxy for the baron's social network, the authors construct the family network of each baron. They then identify all the rebels in the network, and count all the castles held by these rebels.

The authors find that the number of castles held by the rebels in the baron's family network is positively associated with that baron also joining the coalition against King John (Fig. 31.2). To address possible endogeneity concerns, the authors instrument the number of castles held by rebels in the baron's family network with the number of castles held by the ancestors of those rebels within the baron's (current) family network.

31.6 Critical Junctures and the Role of Individuals

Functionalist explanations of institutional change, whereby institutions change when circumstances render their functions obsolete or inefficient (subject to the costs of changing institutions), leave little room for individuals. Institutions emerge to eliminate social waste because as Olson put it “big bills aren’t often dropped on the sidewalk” (Olson, 1996, p. 3). In contrast, the role of individuals in pushing institutional change is explicable in the game-theoretic framework we outlined above.

Individual actors can be conceptualized as potential sources or vehicles of exogenous change. Such individuals are rare, though as we discuss below, there are credible examples of such individuals, including Martin Luther or Napoleon. Alternatively, specific individuals can be thought of as playing a role in solving collective action problems such as coordination games. We provide examples below.

There are, however, many examples of institutional change that do not rely on the characteristics of specific individuals. In the case of the Magna Carta crisis, no single rebel baron appears to have been pivotal. The nominal leader of the rebellion, Robert FitzWalter was not himself critical as there were several other potential rebel leaders. Similarly, while some individuals were prominent in the English Peasant’s Rebellion such as Watt Tyler, serfdom would have declined in England regardless of any individual. On the other hand, other instances of institutional change seem to have been driven in part at least by specific individuals.

Martin Luther is often seen by historians as a decisive figure in sparking the Reformation.¹⁶ Becker, Hsiao, Pfaff, and Rubin (2020) provide evidence for the critical role of Martin Luther in diffusing Protestantism. In particular, it was Luther’s network of correspondents that facilitated the rapid spread of his ideas after 1517. Luther’s ties to local elites help to explain how the Reformation became instituted across Germany within a short time period. Luther can be seen as performing a dual role. He delivered an external shock to the legitimacy of the medieval Church. He also served to coordinate and articulate previously disparate dissatisfaction with Church practice.

We touched upon the importance of the Reformation for institutional change in England above. Many historians suggest that Henry VIII was decisive in the Reformation’s success in England. Had he not wanted or needed a divorce from Catherine of Aragon, it seems unlikely that the small Protestant movement in England would have succeeded.¹⁷

In some cases, groups of individuals may have played an important role in driving institutional change. Another celebrated instance of institutional change was the French Revolution. The majority of work by economists on the French Revolution has considered its consequences (see, for example Acemoglu et al., 2011) and less attention has been paid to its causes, though of course a vast historical literature has investigated this topic.

¹⁶A case could be made that Frederick the Wise, the Elector of Saxony who backed and sheltered Luther was in fact an individual who made a decisive difference to history.

¹⁷Henry VIII of course did later expropriate large resources from the monasteries (Desierto, Koyama and Shera 2024). This, however, was not part of his initial incentive to begin the Reformation.

Jha and Wilkinson (2023) study one of many intriguing links between the American and French Revolutions. Specifically, they examine the idea of revolutionary contagion among French soldiers who served in the American Revolutionary War. The argument is that exposure to liberal and revolutionary ideas in North America radicalized these soldiers and helped them to organize and that they then played a critical revolution during the Revolution in France.

To identify these effects Jha and Wilkinson (2023) exploit quasi-random variation in which regiments were sent to America and which served elsewhere in the war. Specifically, from Comte Rochambeau's original force, two regiments the Neustrie and Anhalt regiments were not sent to America. Comparing local areas with Rochambeau's veterans (i.e., those who actually served with him) with those from these regiments allows the authors to estimate the impact of serving in America. They find that places with more Rochambeau veterans were more in favor of democratic institutional change on the eve of the Revolution, more likely to have political clubs, and experienced more riots and unrest after 1789.

A final example of how individuals can matter for institutional change comes from the US Civil War (1860–1865). Dippel and Heblich (2021) look at the impact of the “Forty Eighters” on antislavery and pro-Union sentiment in the United States. The Forty-Eighters were individuals involved in the liberal 1848 revolutions that shook central Europe and who subsequently migrated and settled in the United States. Many of them became involved in antislavery mobilizing after the Kansas-Nebraska Act of 1854 and many were involved in encouraging enlistment in the Union Army.

Dippel and Heblich (2021) put together a dataset of almost 500 Forty Eighters. Using a matching approach, they find that the presence of the Forty Eighters increased enlistment into the Union army by around 2/3. They find evidence that the Forty-Eighters were also associated with civilian leadership and that their presence helped to deter desertions. While Dippel and Heblich (2021) frame their argument in terms of how individuals can help form social movements, we prefer to interpret it as speaking to the role individuals can have in bringing about institutional change.

31.7 Concluding Comments

This chapter has provided a survey of how recent scholarship has approached the question of institutional change. Institutional change is a challenging topic for social scientists to study. Many of our empirical tools are intended to study the effects of institutions; they attempt to isolate an exogenous component of institutions in order to estimate causal effects. By design, they cannot speak to the endogenous forces that cause institutions to adapt and change over time.

We have argued that the most fruitful way to approach the question of institutional change must allow for both conflict and cooperation and that game-theory offers a particularly useful framework. Interpreting institutional change through an efficiency lens has provided numerous insights but it is limited in cases where there are multiple possible equilibria, not all of them efficient.

Understanding institutional change also requires detailed institutional and historical knowledge. Each empirical setting is distinctive. Many of the papers we survey

introduce novel, highly disaggregated, datasets to provide much more granular analysis of how institutions change than were possible previously.

The topic of institutional change is of critical importance for understanding economic history and economic development. Recent work, particularly empirical work, has allowed us to make significant progress in explaining certain important episodes of institutional change, such as the decline of serfdom, Magna Carta, the Reformation, or the French Revolution. Nonetheless, much work remains to be done and many aspects of institutional change remain to be uncovered.

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