

Douglass North, Nobel Laureate

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Date : Dec 7, 2018

Douglass North died three years ago, at the age of 95. He received the Nobel Prize in Economics in 1993 for his pioneering work in cliometrics and the application of rigorous neoclassical theory to the analysis of institutions. The GEM Project is most indebted to the latter, which provided foundations for modern New Institutionalism. Also compatible with the Project, North carefully grounded his model-building in rational behavior, operating within a framework of agents who act intentionally within their culture and experience.

North's taught us that institutions are designed to constrain economic, social, and political interaction. Constraints are both formal (including laws, constitutions, and property rights) and informal (including customs, traditions, and codes of conduct). His idea that formal neoclassical theory could help us understand why institutions function the way they do was a fundamental, albeit incomplete, breakthrough. The GEM Project has extended North's analysis, compatibly modeling complex, highly specialized workplaces as a nonmarket venue of rational price-mediated exchange. From North (1971): "What we need is a body of theory which encompasses the traditional models of the economist and both widens its scope and allows us to include an explanation of the formation, mutation and decay of organizational forms within which man cooperates or competes." The Project argues, along similar lines, that what macro theory most needs is the intuitive generalization of rational price-mediated exchange from the marketplace to the information-challenged workplace.

North straddled institutionalist and neoclassical schools, an uncomfortable middle ground. The former distrusted his use of rigorous, often restrictive analytical tools while the latter disparaged "loose", at times incoherent, literary analysis. Skepticism from both rigorous and institutional economists has also pestered the GEM Project. Despite GEM success in microfounding the suppression of wage recontracting, ratifying the existence of involuntary job loss, motivating causality from nominal demand disturbances to evidence-sized movement in employment, output, and income, and the derivation from axiomatic priors of powerful chronic, time-varying wage rents, mainstream macro theorists remain uninterested in modeling rational exchange occurring in workplaces restricted by costly, asymmetric employer-employee information. Why reputable scholars don't much care about the true nature of the nominal-to-real nexus that must be at the core of stabilization-relevant macroeconomics is the most puzzling, consequential questions in macroeconomics.

Willful ignorance has not always been dominant. North's Nobel-honored anticipation of important themes in the GEM Project is not a one-off phenomenon. The work of a number of Nobel recipients illustrates the deep roots of the generalized-exchange theory in the literature. In 1970, Paul Samuelson was awarded the second economics Nobel. His chief contribution to the GEM Project is the construction of the Neoclassical Synthesis, which posits nominal downward-wage rigidity in the short-run and the restoration of full labor-price market flexibility afterwards. Samuelson recognized that wage incoherence was a short-cut, allowing Keynesian macro theory to be stabilization-relevant. He committed Early Keynesian theorists to putting microfounded wage rigidity at the top of their research agenda.

In 1972, John Hicks won. In his *The Crisis in Keynesian Economics*, he forcefully argued that wage determination occurs in fix-price and flex-price sectors and that in the former "it is necessary that the wage-contract should be felt, by both parties but especially by the worker, to be *fair*." Both ideas were eventually made consistent with rational price-mediated exchange organized by general decision-rule equilibrium in the Project. In 1978, Herbert Simon won "for his pioneering research into the decision-making process within economic organizations". Simon provided a path-breaking general introduction to the corporate forms that enabled the Second Industrial Revolution and now populate the GEM Project's nonmarket venue where critical optimization and equilibrium take place. In 1979, Arthur Lewis won for one of the literature's most insightful models of economic growth. He famously divided developing economies into low- and high-productivity sectors and made sense out of their interaction. The Project generalizes the Lewis model to developed economies. Sir Arthur was a Professor of mine at Princeton; he would have been pleased with the generalization.

Franco Modigliani, once a colleague of mine at MIT, won in 1985. He put the assumption of wage rigidity at the center of stabilization-relevant Keynesian macro theory, allowing him to construct models in which periodic instability is a fact of life and activist demand-management is necessary. Robert Solow, another MIT colleague, won in 1987 for his powerful neoclassical model of economic growth. For most of his career, microfounding meaningful wage rigidity was at the top of his research agenda; and he instructed his graduate students to do

the same. In the late 1970s, he and I did original work on morale-centric efficiency wage theory in search of rational MWR. While we came close in the 1980s, the goal was not realized until the successful generalization of optimizing exchange featured in the GEM Project. Ronald Coase won in 1991 for his insightful analysis of non-market rational exchange in complex bureaucratic firms.

The 2001 Nobel was shared by George Akerlof for his analysis of market breakdowns in the circumstances of information asymmetries - a foundational idea in the GEM Project. He also was, unsurprisingly, another pioneer in efficiency-wage theory, although he too was never able to microfound meaningful wage rigidity. The 2009 Prize was shared by Oliver Williamson for his perceptive extension of Simon's and Coase's research on non-market rational exchange in complex bureaucratic firms.

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