The Role of Politics in Economic Development

Peter Gourevitch

School of International Relations and Department of Political Science, University of California at San Diego, La Jolla, California 92093; email: pgourevitch@ucsd.edu

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Abstract
How have economic historians understood the role of politics in shaping country differences in economic development? An impressive recent literature can be sorted out according to the degree of “human agency” at work. At the low-agency end are perspectives that stress geography, which is unalterable, leaving little room for human action and hence no room for politics. At the other end are arguments stressing deliberate, self-aware actions, hence choice, hence a substantial role for politics. In between are arguments where some choice occurred in the past or at a specific moment, but little since then. What drives development? Two lines of argument are vigorously debated: explanations that stress human capital and explanations that stress institutions. Within each camp can be found variance on the degree of agency and hence on the role of politics. Both vary as well on how they envisage society and its interaction with both institutions and human capital.
INTRODUCTION

What is the role of politics in shaping economic development? Economic historians have made substantial contributions to the study of economic development in recent years, work that deserves attention from political scientists because of its implications for the study of political development. The core dispute pits institutions against human capital. In the quest for an explanation of differential growth rates and levels of prosperity in the present time compared to some postulated common past of relative equality of condition, is it institutions which explain outcome [an influential argument at least since North (1981) if not Gerschenkron (1962)]. Or is the outcome the result of differences in human capital (Easterlin 1981), as expressed through education, technology, research, culture, and social capital (Solow 1956, 1957; Griliches 1957; Griliches & Jorgenson 1966; Landes 1969, 1998; Mokyr 1990, 2002; Mitch 1993; Kuznets 1966; Galor & Moav 2002)? Both arguments have strong currency among political scientists—in the McNollgast (1999) tradition, culture as explored by Almond & Verba (1965), Pye, and most famously in recent years Putnam’s (2000) discussion of “social capital.”

These rival arguments dominate debates over policy as well as research. Did the World Bank misread the Asian financial crisis of 1997, and does it apply a single institutions-driven formula to a varied world (Stiglitz 2002)? Are foreign aid and external intervention in the service of growth completely off track (Easterly 2006)? Does the Washington consensus around neoliberalism really mark the end of history? Is China continuing the Japanese model of state-led industrial policy?

Indeed, history seems to be the terrain for vigorous battles over policy. By fighting over the role of institutions since 1500 (Acemoglu et al. 2001, 2002, 2005) or culture since 1000 BC (Comin et al. 2006), the consequences of the Glorious Revolution of 1688 (North & Weingast 1989) versus Stasavage 2002) or technology and birth rates since 1800 (Clark 2007), legal family (civil versus common law) since about 1800 (La Porta et al. 1997) or interest groups ca. 1890 (Rajan & Zingales 2003a, 2006), economists address questions related to the efficacy of foreign aid, legal regulation, political institutions, education, and social structures. The debate raises interesting questions about the role of politics in economic development, what it might mean to say politics does or does not matter, and what policies would be effective. These disputes about the past are thus of great interest both to contemporary theory and policy.

The Engerman & Sokoloff essay in this volume considers this literature with a focus on the role of institutions. I address the same material with two different sets of questions: First, when economic historians look at history, what degree of human agency do they see? Are development paths chosen or do they just happen? Can people change their history, and if so, who and how? And second, what model of society and its cleavages do economic historians use? If the stress is on the mechanism of institutions that shape outcomes by structuring the aggregation of interests and preferences, who are the groups being aggregated, what are the groups who cycle, and how do the institutions interact with problems and demands? If it is human capital that influences outcomes, where does cultural capital come from, and can it be “designed” or created?

In my use of the term agency, I stress a sense of intention and a capacity for choice. All human action has some element of agency, but analysts vary greatly in the extent of awareness, purpose, choice, deliberation, and design they attribute to human behavior. Plants adapt to water and sun; animals follow food. But we do not attribute intentionality to plants and most animals, and people can respond to incentives of which they are wholly unaware and which they cannot influence. If people are like amoebae or mountains or drops of rain, we can explore the impact of the environment
on their behavior, but we cannot speak of intentionality, deliberateness of action, choices on their part. Writers diverge on this issue: Can humans design the systems in which they operate, or are they more or less passive responders to situations?

The mechanism of reward clarifies the difference. Evolutionary models (Kahler 1999) see reward or punishment: those who don’t adapt to new conditions are extinguished. Agency, in the sense used here, is low. If humans can create their environment, e.g., by changing institutions or by generating human capital, then agency is high.

The dimension of agency as intentionality and design shapes the extent to which we can speak of politics and choices. The lower the degree of agency in any outcome, the less we can speak of politics in explaining that outcome. The more unconscious the mechanisms, the more the models resemble those for evolution, and the harder it is to identify political action at work. The more behavior results from individuals and groups taking steps in pursuit of goals—the more we can link outcomes to strategic acts, purposeful action, and design—the more we can speak of politics as influencing the course of history. The more action matters, the more important it is to think about who these actors are. Who is seeking goals, and with what means? How many actors are there? Of what do they consist? What are their purposes and resources for political action?

These questions may matter more to political scientists than to economists, who often have an uneasy relationship to politics. The drive in economics to model efficiency and optimal behavior, to “get prices right,” can mean irritation when political actions “get in the way.” A good example is the economist’s attitude toward free trade: So obvious is the benefit to the whole, how come everyone doesn’t go along? But an appreciation among economists of the centrality of politics to economic outcomes has grown hugely in recent years, as economists have become interested in modeling observed behavior. In so doing, their examination of history, outcomes, social process, has increased substantially. “Local knowledge”—of customs, family patterns, social structure, etc.—was previously ignored because economics was considered universal, with no national specificity. Now such knowledge is seen as necessary, at least to make sense out of the variety of incentives people actually face. The commitment to strong analytic techniques married to an appreciation of local circumstance produces substantial tension between parsimony and applicability, and that makes for interesting work! And with this broadening of the focus among economists and economic historians, a wide range of views have developed on the two points of interest addressed in this essay, which have substantial bearing on the work of political science—the role of human agency, and the structure of society seeking to exercise that agency.

**THE DEGREE OF AGENCY: THE ROLE OF CHOICE**

To what extent can societies shape their destiny and how? We focus here on the battle between human-capital arguments and institutionalist ones. This division cross cuts the high- versus low-agency distinction, as there are high- and low-agency versions of both human-capital and institutions arguments. Each side has been using history to bash the other in a kind of Pac-Man gobble: Human-capital arguments undermine institutionalist ones, and institutions are used to undermine human capital.

Let us start with a well-known work to anchor the low-agency end of the spectrum: Jared Diamond’s *Guns, Germs and Steel* (1997). Not an economic historian, Diamond does not belong properly in this sample of authors, but his popular book provides a useful reference point for framing a typology on human agency and choice. Why, asks Diamond, did certain groups succeed in spreading their genes, language, and culture about 10,000 BC, overwhelming the rest of the human population and leaving but five
The answer for Diamond is geographical accident, or what Easterly & Levine (2003) call the “natural endowment” school, given by “God” not man in Van Young’s (2007) phrase. These groups happened to be living in advantageous locations when the techniques for deliberate cultivation of various grains were discovered; the alignment of mountains, deserts and rainforest and the type of climate interacted to favor some groups over others in growing more food. Producing more calories meant their populations spread, and thus their language, culture, and physiognomy, reducing human variety. For those who happened to live near potentially useful animal species, domesticating these animals provided protein and the equivalent of machines; it also generated immunity from diseases through animal-human disease cycles. In this process, there was little decision making. People ate and multiplied and moved when it got crowded, something like the spread of a species of trees or animals. There was some individual agency—humans had to learn the new food technology, adapt their social organization, and make mental adjustments—but they were responding to situations, not shaping them. From this process eventually emerged social institutions, cultures, and structures that make sustained decision making possible, thereby creating our analytic problem of social capital versus institutions. Hunter-gatherer societies certainly had some structure, but societies took a long step toward complexity after settled agriculture.

Diamond’s argument cannot deal with differentiation in behaviors within these settled societies. It does not explain why, say, German or British economic development took that subgroup of Caucasians ahead of Greece or Poland, nor why one region of China dominated the others. Diamond’s Collapse (2005) explores the implosion of some societies (their destruction of their habitat, or failure to cope with stress from changes in climate), but to account for it, Diamond has to enlarge the scope of inquiry to include variables not in the structural argument of Guns, Germs and Steel, such as “cultural repertoire.” The Nordic groups who settled Greenland, for example, refused to learn from native peoples the skills needed to hunt seals, so when the weather got too cold for the grains and animals around which their culture was built, they died or went back to Europe. In other places, societies failed to manage the commons to preserve trees or stop erosion. Diamond notes these failures but does not provide a general theory of why some succeeded and others did not.

At the other extreme of agency, we can locate “great man” or leader theories (Jones & Olken 2005): explanations of Singapore’s vigorous growth rate based on Lee Kwan Yu’s leadership, or shifts in Chinese growth rates attributed to the change from Mao Zedong to Deng Xiaoping, or the role of “enlightened despots” in eighteenth-century Europe, or the leadership of Mandela versus that of Mugabe. A more structuralist analysis granting high agency is that of Bates (1981) on African economic development. Leaders based in cities require approval from urban residents whose rioting could overthrow the regime; therefore, such leaders pursue policies that keep food prices low, even though this hurts the agrarian masses and hinders economic development. Thus, to hold power, elites pursue antigrowth policies to placate interest groups. At the firm level, Hermalin (1998) explores the role of leadership and how it induces compliance.

The interest in geography, a low-agency variable, goes back to Montesquieu, Tocqueville, and the Greek philosophers before them. A contemporary version of the geography hypothesis associated with Sachs & Warner (1995, 1997) revives the earlier interest in distance to the equator: The tropical areas near the equator and the very cold regions around the poles have done less well economically than the temperate zones in between. The fact is not disputed, but much fighting occurs about the mechanisms at work. The low-agency version stresses things people could not overcome, such as disease, soil infertility,
harsh weather (flooding, monsoons) in the tropics, and extreme cold in the north. Other authors, seeing greater human agency, argue social structure and institutions lay between the “objective facts” of geography and the human elements that influenced economic growth (Easterly & Levine 2003). Acemoglu et al.’s (2001, 2002) settler death-rate argument is an example of this viewpoint: Disease in the tropics induced the creation of political institutions whose policy outputs inhibited growth (discussed below in the section on institutions) (Rodrik et al. 2002).

An important indicator of how the analyst handles human agency is time frame. When did countries or regions diverge in their trajectory to the present day? The farther back we locate the starting point of differentiation, the smaller the role of agency. Diamond starts more than 12,000 years ago in the timing of settled agriculture; his key variable is geography, and agency is low. Economic historians interested in “long durée” are engaged in an arms race over pushing the date backward, trumping each other by finding a prior moment. The “common versus civil law” argument of La Porta et al. (1997) uses ca. 1800, the foundation of the civil law by Napoleon; Acemoglu et al. (2001, 2002) push the critical date back to 1500 and the beginning of Europeans’ settlements outside their continent; Comin et al. (2006) go to 1000 BC, measuring the geographical distribution of cultural artifacts; and Galor & Moav (2002, 2004), along with Olsens & Hibbs (2005), go back with Diamond to the origins of agriculture.

The choice of settled farming over the life of hunter-gatherers was a great watershed in human history, as it marks the beginning of known civilizations. It also demonstrates an element of agency in the distant past. Why did people make this change? Farming produced more calories, hence more people—but also more inequality, as well as more disease due to a less diverse diet, crowding, and greater work stress. Olsens & Hibbs (2005) suggest that the regions that first undertook agriculture are the ones that remain richer today.

The shift, argue Galor & Moav (2002), came because of changing social structure and incentives. Instead of extended families hunting together, individuals were now rewarded for their particular efforts. Once some families took up farming, evolutionary selection favored them. Although there may be some level of individual agency in placing self over family, the larger process at work is one of low agency and awareness, with little social or institutional design.

**Human Capital**

Going very far back in time has the effect of undermining institutions as an explanation. Comin et al. (2006) go back to 1000 BC. Focusing on human capital, they measure the density of artifacts and evidence of cultural creation as these are distributed geographically. They find that the greater the density in 1000 BC, the greater the level of economic development in 2000 AD. The institutions in these lands have varied greatly over 3000 years, so if some effect persists over that length of time, it cannot be caused by institutions. The level of agency is low: Whoever happens to live in culturally rich territory “picks up” the benefits of being there, without any clear election or mechanism of doing so.

Looking at a somewhat closer time frame, since 1300 AD, Clark (2007, p. 12) offers a strong statement on the importance of human capital as a challenge to institutions arguments:

> Despite the dominant role that institutions and institutional analysis have played in economics and economic history since the time of Adam Smith, institutions have little direct role in the story told here about the Industrial Revolution, and about economic performance since then. This is because already by 1300 societies such as England had all the institutional prerequisites of economic growth now emphasized by the World Bank and the IMF. These were indeed societies that were more incentivized
than are modern high income economies. Approached from the Smithian perspective the puzzle is not why medieval England had no growth, but why modern day northern European countries, with their high tax rates and heavy social spending, do not suffer an economic collapse. The institutions necessary for growth existed long before growth.

Prior to about 1800, population growth ate up productivity gains, so countries were stuck in a Malthusian trap. After 1800, advancing technology and human capital combined with falling birth rate, allowing countries to break out and grow. People developed habits of thrift, savings, and work; these spread because families who had these values had more survivors than the poor who died out. Clark argues that institutions of the kind stressed by policy makers at the great international agencies, by many writers (e.g., North 1981, North & Weingast 1989), and by strong currents of modern theories in economics and political science, were not the driving force. At the same time, Clark pays serious attention to social and political stability in England but does not explain it. Are institutions really marginal to that stability? Does the comment on social spending in the quotation above reflect an assumption that political choices could never be economically efficient, and thus that spending on education, health care, retirement plans, and child care are not large collective insurance solutions to problems in private markets? Agency seems low in Clark’s argumentation: Breakthrough happens when the accumulation of human capital and the masses of separate private decisions to limit birth coincide; no social choices are made by specific individuals at any specified point in time.

Human-capital proponents divide along degrees of agency depending on what part of a causal channel attracts their attention, while institutions arguments tend more frequently toward higher agency as few economists are “Burkeans” (see below). On the low-agency side of the human-capital category are arguments that derive behavior from the attributes of individuals or groups, such as education, time horizons, and values. Higher agency arises if these attributes are problematized to inquire about their origins, and even more agency if they are seen as potential targets of policy or human design.

A very large literature examines the consequences of cultural attributes but not their origins. People are born to a group, and through socialization either do or don’t acquire a particular attribute. There may be agency in the socialization process, but generally in political economy, acquiring the feature is treated as a given. For many years, slow growth in East Asia was attributed to Confucian culture, with its deference to authority and inhibition of risk taking; but when growth there took off, that too was attributed to Confucian culture, with its respect for education, hard work, and strength of family ties in solving problems of moral hazard.

Human-capital arguments have higher levels of agency if they explore the origins of the cultural attribute, or the social and policy mechanisms that encourage groups to acquire it. Becker & Woessman (2007) probe Weber’s famous theory about the impact of the Protestant Reformation on the growth of the capitalist economy. They agree that there was a link but think Weber got the mechanism wrong. Where Weber stressed the impact of religious belief itself as motivating people to strive in order to prove they were among the elect, Becker & Woessman stress the effect of Protestantism on literacy and education. Luther translated the Bible and encouraged familiarity with it. They correlate the spread of Protestantism, literacy, and economic growth, and conclude that the change in education proves more powerful than the religious explanation of Weber. They do not consider an alternative argument that relies on neither mechanism: The Protestants changed the structural position of the church in their countries by dissolving the monasteries, giving or selling church lands to their supporters, and turning out the monks. This contributed to the already ongoing development,
of a land market. It also weakened considerably the autonomy of the church as a political actor, as ministers were dependent on private contributions from their congregations or on state assistance that was politically determined. Human capital becomes less important here than political and social institutions. Walzer’s (1976) earlier argument also stressed a political consequence to the impact of religion: Belief motivated people seeking their place in a rapidly changing society to engage in political action. By influencing the conflict with the Crown, religion helped bring about the long-run institutional changes that shaped economic development. This is a social-institutions argument, not a formal political-institutions one or a human-development one.

This argument involves an intermediate level of agency. It turns on Luther’s translation of the Bible (high agency at a single point in time) and the spread of education from that point on (the agency of each parent), and only much later, state education policy. One could ask what caused the Bible to be translated at this point. With the recent invention of the printing press and the drive for items to print and sell, as well as the growth of education and trade associated with the Renaissance in the century before Luther and the Protestant Reformation, translation of the Bible into the vernacular seems to have been inevitable. This development could be explained by great man theory with high agency, or it could be made more sociological with lesser and indirect agency by asking why literacy started to spread.

Another argument linking human capital to religion explores the historical link between Judaism and high educational attainment. Jews, along with other diaspora or immigrant groups (overseas Chinese, for example), loom large in explorations of the human capital/education account of economic attainment, as they disproportionately populate the data on high achievers. Botticini & Eckstein (2006) focus on what is usually missing from such discussions: Why is there a link between a religious/ethnic group and an attribute (e.g., Jews and education) in the first place? A common argument sees in education a solution to blocked opportunities in other modes of life. Limited by diaspora conditions or prejudice, Jews became peddlers, merchants, accountants, lawyers, and bankers because they could not rise in the traditional firm, as landowners, at court, in the church, or in the army.

By contrast, Botticini & Eckstein ask what gave them the skills and cultural capital to respond to discrimination in that way. They explore a moment in Jewish history in about 200 BC, when Jews were divided theologically between “ritualists” and “readers.” For the former, religion meant the performance of various rites and practices associated with the synagogue; for the latter, religion meant reading the Torah, and as this required education, they required that their sons learn to read. The destruction of the Temple shattered the first group, so the readers prevailed. Education was costly, however, requiring resources. Jews split: Where conditions of political stability allowed economic growth, those with skills could make use of them. Where conditions supported only basic agriculture, the skills of the readers had little practical use, and in that environment substantial conversions away from Judaism occurred. Where conditions supported the use of skills, the learning-oriented Jewish communities flourished, and they often moved to where these skills were useful. It is this reading group that has survived to populate contemporary studies of achievement-oriented cultures. An early decision (toward education in the first millennium) became, centuries later, an advantage when the role of technology in the economy favored education.

There is substantial agency in this argument, at least at times. More than two millennia ago, individuals were choosing between different forms of religious expression in their own culture. Other actors chose to invade the area of Jewish settlement and destroyed the Temple, which disrupted the preferences of one group, shifting the religion toward
learning. Individuals then chose between a costly investment of education and abandoning the religion. The educated made choices as they sought to follow opportunity and flee persecution. With religion and culture we can problematize the attribute that leads to economic achievement: Why do people stay with the religion, especially when its adherents are persecuted? Members of a racial group cannot leave in the same way, but racial boundaries are themselves constructed in some measure, so even race is not wholly devoid of agency. We might be able to find individual choices in many “structural situations”—whether to pursue the woolly mammoth or plant grains, for example—but not many researchers have done so. There is a social context in the religion cases as well: Continued investment in learning for Jews and Protestants depended on society’s willingness to reward it.

The discussion of educational values in social groups leads to policy debates and comparisons. If attainment inheres in group attributes, responsibility for success and failure lies with them. If group attributes are malleable, influenced by incentives in social context, then there is an external influence on the outcomes and possibly room for policy to have an effect. Political conservatives opposed to policy action tend toward the former, favoring the notion of individual, and possibly group, responsibility; political liberals stress social context in the operation of discrimination and poor incentives, and support policy response.

As the economic development literature moves from cultural features of groups to issues of educational systems in society, the agency issue shifts. Many theories of economic development have long turned on skills and knowledge. That education matters is not controversial, although its importance relative to finance or other variables certainly is. More difficult is explaining why education takes place and why it becomes an object of public policy. It is not sufficient to show its macro benefit to an economy—the functionalist fallacy of imputing cause to effect. There is a collective-action problem and an interest-group one. The money has to be raised, allocated, and spent effectively, and agency issues inevitably arise in the politics of how these things are done.

Whatever the collective benefit of education, some will oppose it. They may resist paying the taxes. They may fear economic growth will undermine their privileged position in society (elements of the Russian aristocracy in the early nineteenth century opposed building railroads for this reason). Rajan (2006) explores the bargaining among social groups that may model the decision to invest in education or to block it; he examines under what conditions an upper, middle, and lower class will agree on one course of spending or another. It is clear that spending on education and research involves agency and politics. There may be a path-dependent long durée element in it: If a society reaches some equilibrium commitment to such investment and expenditure, it can persist without obvious conflict.

If high skills and research make for greater wealth, can countries create these by design? Mokyr (1990, 2002) explores the generation of science and technology as key drivers of development. The degree of agency varies in differing elements of his discussion. It is lower where the values of the general culture particularly favor or inhibit innovation, higher with specific elites or rulers threatened by change, and medium in the activities of the networks of highly educated people from whom many innovations come.

More agency can be seen in deliberate efforts to improve training and knowledge. The United States pioneered mass education. It established comprehensive public high schools in contrast to French lycées and the German gymnasia, and mass universities instead of an Oxbridge limited to the graduates of elite preparatory schools. Mass funding for research, universities competing for resources and talent—these are noted features of the US system of higher education. They were clearly the result of policy choices made
by specific actors. The decision points can be noted, charted, documented.

Why did politics produce these public goods in a country whose political system is frequently criticized for having difficulty providing comprehensive health care, mass transportation, and other public goods? The open democracy in this case made the US system more responsive to mass desires, less protective of traditional interests. Competition among the states drove them to attract settlers by lowering the suffrage requirements, to seek industry and investment—Turner’s (1949) frontier hypothesis. International competition caused other countries to broaden their educational systems, and many have caught up. The United States no longer leads the world in levels of investment in mass education. It still leads at the university level, but for children in grades K-12, the education results are skewed, with a well-educated upper class, and uneven education among much of the rest of the population. Note how quickly this discussion moves from issues of human capital and group culture to institutions and interest-group politics, which are examined below.

If human capital can be created by design, what about culture? European social policy (Esping-Anderson 1990) promotes family ties through welfare measures and job-protection legislation. These support a family-centered culture, which in turn provides support for the policies. The justification derives from pro-family views of various sources, such as religion via strong Christian Democratic parties. The social democratic justification stresses individual choice and de commodo-fication of work, separating assistance from male-centered workplace structures. Neoliberal ideas oppose intervention altogether. All three sets of views seek to engineer culture through policies, generating social relationships that promote specific cultural attributes.

In explaining the “East Asian miracle”—the rapid growth of several countries since about 1960—education has loomed large. Governments made big bets in spending money. Korea and Taiwan spread training broadly, sacrificing quality in the short run to get a broad reach; India has developed a very highly educated elite at the expense of breadth; and China has done both. All of them have built up specialized training and research institutes. Singapore offers employee training and research institutes as inducements for multinational corporations to locate there. The payoff has been considerable, as these countries moved up the value chain of the international economy.

A version of the human-capital argument that focuses on trust and private bonding mechanisms (Coase 1960) plays a substantial role in debates about growth and institutions. Where formal legal protections are weak, cultural ties such as ethnicity and religion can provide the functional equivalent in credible commitment mechanisms (McMillan & Naughton 1992, McMillan & Woodruff 2002), and informal institutions can provide some of the information needed to verify reliability in contracts [see Greif’s (1993) work on Maghribi traders in north Africa, and on the medieval trade fairs in Champagne (Greif et al. 1994)]. Here cultural arguments and institutionalist ones cross paths, as culture substitutes for institutions and plays a coordinating role in them (Kreps 1990). Institutions can, conversely, be seen as generating culture. Tocqueville argued that the dependence of French civic culture on the state derived from Louis XIV’s centralization, a dependence which the French Revolution was not able to change and which contemporary writers see hampering French policy making to this day (Levy 1999, Culpepper 2003).

As we probe human-capital arguments, we move closer to issues of institutions, and the societies that use them, to understand why we observe the levels and types of human capital that exist. It is to these that we now turn.

Institutions

So far we have explored economic history that stresses human capital. The other main
branch of argumentation stresses institutions (the focus of Engerman & Sokoloff’s essay in this volume). Writers in this vein suggest greater agency: Institutions are rational human creations, designed to solve problems, which can be changed by deliberate action when humans are motivated to change them. Less agency exists in a Burkean view of institutions, which sees them as organic structures accreted over long periods of time by habit, custom, tradition, and interests. In this view institutions are hard to change, and indeed dangerous to change quickly, but also dangerous if totally closed to adaptation under changing circumstances. Few economists seem to be Burkeans in this sense; most write about institutions as machinery designed to achieve a goal.

Among the institutionalists, Acemoglu et al.’s (2001, 2002) widely discussed work looking at European settlers from ca. 1500 has a medium level of agency. Where settlers faced disease in the tropical climes, most of them died or departed, leaving agents in charge of authoritarian extractive institutions. This succeeded in providing a lot of wealth for an elite so long as the economy favored extraction, low skills, low levels of managerial sophistication, and command allocation. For example, it worked for economies based on sugar cane, mining, and cotton. But when economic development favored skills, markets, and flexibility with looser coordination, the advantage shifted to the areas of direct settlement. There, the settlers created “better” institutions for governing themselves than they did for ruling over serfs or slaves. It is these structures that have proved in the long run to favor growth, and caused the shift in the distribution of wealth after 1500. Thus, given environmental constraints, actors made choices in institutional design to attain goals: an institutionalist account that includes a significant level of agency.

The Acemoglu et al. argument has been attacked on the basis of its measurements of settler death rate. If we substitute for disease the treatment of labor (the use of native serfs or imported slaves versus independent family farm owners or free workers), we get the same general pattern: an initial spurt of success for the harsh-labor countries, when products favoring intensive labor methods prevailed, but then relative decline when the industrial market economy shifted the terms of trade advantage toward freer labor and markets. This is the line of reasoning in Engerman & Sokoloff’s (2005) well-known paper in which inequality is used as an indicator for good versus bad institutions. A general critique of these arguments can be found in Przeworski (2004).

The power of institutions comes across strongly in North & Weingast’s (1989) work on the English Parliament in 1688, one of the most influential and widely cited items in the institutionalist repertoire. Parliament’s defeat of the King meant that executive authority would be constrained. Creditors felt confident in protection from government seizure of property and from government bankruptcy; as a result, interest rates fell, and the foundations for economic growth and empire were laid down. Thus, institutions created a credible commitment for limited government that was binding for generations, an argument with considerable agency at a specific historical moment. Stasavage (2002) challenges this formulation for neglecting the issue of who sat in Parliament; the interests represented in French legislatures were less concerned with bankruptcy than their counterparts in England, so the formal institutional issue is confused with the social composition of representation. Rosenthal (1988) critiques North & Weingast’s omission of religion and foreign policy as key elements of division over the behavior of the Crown. Issues of society and social composition keep entering the discussion of institutions, about which more below.

Another body of well-known work, the “legal family” school for explaining the development of corporate governance and financial institutions, features “one-shot” agency. At a key moment, we can identify actors who made decisions in selecting or imposing civil
law, but after that, no choices or actions, no political processes seem to occur. La Porta et al. (1997, 1998) suggest that variance in regulation dealing with corporate governance systems derives from legal family: Civil law countries (France, Spain) offer weaker protections to investors than do common law countries (United Kingdom, United States). As a result, common law countries have diffuse shareholders, whereas civil law countries have concentrated blockholders who sit directly on corporate boards. The finding is widely cited, is widely used for many sorts of work on diffusion (one of many examples is Simmons & Elkin 2004), and has provoked numerous criticisms. Acemoglu & Johnson (2005) differentiate between “contracting institutions” and “property rights institutions,” where the former refers to the regulations that shape private interactions between citizens, and the latter to the regulations that shape the behavior of political and economic elites. Legal family refers to contracting institution. When pitted against property rights institutions, the effects of legal family wash away. The authors raise similar objections to arguments that stress financial institutions, rather than property-protecting institutions (Levine 1997, 2005; Glaeser et al. 2004; Laeven & Woodruff 2004).

For our purposes, the most relevant criticism of the legal family argument has to do with the immutability of the driving mechanism of causality. Once a country has picked its legal family, at one moment of agency, it seems locked in and cannot change the rules that affect corporate governance or other outcomes. After that initial move, agency is quite low. Yet empirically we see changes in corporate governance patterns within countries over time. In their essay on “The Great Reversals,” Rajan & Zingales (2003a) show that country patterns of equity and bank debt changed over time (they give data from 1890 to 1999). France (the creator of modern civil law with the Code Napoleon) and Japan in 1910 had rapidly growing stock markets, but events led to policy change: World War I, the depression of the interwar years, and the wartime economies of the 1930s and 1940s. Both countries saw a dramatic increase in government intervention, which shifted credit allocation toward banks and government ministries. France and Japan did not change legal family in the twentieth century, but they did experience change in policies that influenced corporate governance regulations and outcomes. Musacchio (2007) explores change over time within Brazil, a civil law country, and Berkowitz et al. (2003) show how local factors alter law imported from elsewhere in the “transplant effect.”

The United States offers a similar case of change within a legal family, this one in a common law country. In the late nineteenth century, American corporate governance patterns resembled those of Germany. JP Morgan took large stakes in companies to which he was funneling capital (largely European) and placed his agents on boards to reassure his largely foreign investors (DeLong 1991). American politics intervened, shows Roe (1994). Prairie populism, labor radicalism, small property owners’ resentment against the trusts, and Progressive Era reformism generated a series of legislative acts at the state and federal level, including the Sherman Anti-Trust act, insurance reform in New York, the Securities and Exchange Act of 1935, and laws on accounting and labor regulation. Such legislation pushed the American firm from the German model toward the type of corporation famously analyzed by Berle & Means (1932), the corporation of diffuse shareholders, managerial autonomy, and arms-length relationships among firms.

If, contrary to the legal family theory, country policy and practice on corporate governance varies over time within countries, what explains the variance? One stream of writing stresses interest groups. Roe (2003) extends his analysis of the United States to a comparative analysis of OECD countries and finds strong relationships between partisan-ship, minority shareholder protection (MSP), and shareholder diffusion. The longer left governments have been in office, the weaker
is MSP and the more concentrated is blockholding (and the greater is equality in GINI coefficient and strength of job protections in labor law). Pagano & Volpin (2005a,b) suggest cross-class coalitions of management blockholders and labor allying to protect the firm against outsiders (minority shareholders and hostile takeovers). Cioffi & Hoepner (2006) explore a “transparency coalition” of workers and minority shareholders with assets in pension funds and institutional investors such as TIAA-CREF or CalPERS allying to press for greater MSP. This flips Roe’s model, so that inside investors, allying with conservative groups, oppose MSP, while the left supports it. Cioffi & Hoepner find evidence for this in debates over reforms in the United Kingdom, United States, Germany, and France, as well as at the EU level.

Which coalition prevails? Those that have substantial resources for political action, such as money, votes, and organizational clout. With resources for action held constant, institutions can influence the outcome. Pagano & Volpin (2005a) find that corporate governance variance correlates with electoral law: Countries with proportional representation have more blockholding than do countries with majority voting systems. Gourevitch & Shinn (2005) find similar results contrasting majoritarian versus consensus institutions (Lijphart 1999). This research fits into the well-known literature on veto points and veto gates, showing the impact of formal institutional arrangements on outcomes (Levi 1988, Tsebelis 1990, Carey & Shugart 1992, McNollgast 1999, Persson & Tabellini 2000, Haggard & McCubbins 2001, Grossman & Helpman 2002).

Haber et al. (2003) apply institutions analysis to examine the differences between financial development in Mexico and the United States. In Mexico, closed political processes allowed the government to favor key supporters, limiting development of the financial sector and inhibiting growth; in the United States, federalism and competitive elections made for open capital markets and growth. Lamoreaux & Rosenthal (2005) show variance in organizational forms within countries. Hoffman et al. (2007) explore the impact of institutions on financial crises.

Political instability could itself be a major variable shaping the development of markets. Looking at countries without strongly rooted democratic institutions over four decades, Roe & Siegel (2007) find a causal channel that runs from political instability to financial backwardness. Stability creates the conditions that allow private bonding mechanisms among owners to develop; this generates the desire for regulation to solidify the bonding mechanisms, which in turn leads to the law and structures that enable further diffusion. Thus the law comes after, not before, diffusion. (Cheffins 2001). The history of firms and national trajectories is providing valuable material on the role of policy, private bonding mechanisms, and families (Morck 2005).

The institutionalist arguments vary with the location and extent of agency. Is agency located in the creation of the institutions? If so, it may be distant, leaving little discretion in the hands of contemporaries. Or is the agency in the people who are operating through the institutions, making strategic calculations about how to make them work for their benefit? Do the contemporaries have much choice, or are the institutions fully constraining, fully binding? If fully binding, as the founders of the institutions must have sought, there is little agency left; if not, if contemporary office-holders could defy or change the structures, the institutions cannot be fully binding. Current agency rises, and the historical agency of framing fades. This raises to the forefront the agency issues involved in explaining the mechanism of path dependence (Pierson 2000) and brings to the center the social issues of agency.

“GETTING SOCIETY RIGHT”

If there is agency, in which case we can speak of social choices, we need some notion of who is making the choices. The institutions
literature has called attention to the importance of formal political structures in shaping the outcome, and the literature on those structures and their impact is quite rich. At the abstract level, institutionalists impute high agency because of their emphasis on design. However, without a strong sense of who is acting through these institutions to produce outcomes, the agency fades. Narrative history is clearer on agency, at the cost of more generalized causal mechanisms and a sense of structure.

We need to understand the social elements that are engaged in the aggregation of preferences that institutions perform. Madison’s *Federalist 10* is a famous example of institutional design being applied to solve the problem of faction, but citations of it generally neglect the Framers’ model of American society (Kernell 2003). Economic historians vary in how they conceptualize society on several dimensions. They disagree about the number of social actors, the composition of social actors, and the resources actors have for influencing political action.

**Number of Actors**

Acemoglu & Robinson (2005) model a bargain between rich and poor, thus two actors, as does Boix (2003). They explore the conditions under which rich and poor bargain to produce democracy. By contrast, Moore (1966), from whom Acemoglu & Robinson claim inspiration, imagines three actors—aristocracy, middle class, and peasant—whose pattern of alliances and conflict drive the trajectory of political development in each country toward democracy, fascism, or communism. If the middle class allies with the aristocracy, authoritarian outcomes are likely, as happened in Germany; if it allies with the working class, a democratic outcome is more likely, as in the UK case; and a peasant-worker combination supports communism. In their treatment of actual cases, Acemoglu & Robinson use a more complex pattern of social elements combining in various ways, but their lean model strips the number of actors to two. Like Moore, Rajan (2006) models three actors—in his terms, oligopolists (or oligarchs), the educated (or a middle class), and the uneducated (or the poor)—in order to examine what combination will produce, or block, investment in education.

The issue of two versus three actors is important because it shapes the range of bargains and coalitions that can be examined. The two-actors version has a zero-sum quality, as we see in discourse about labor versus capital or rich versus poor, and is usually thought of as a horizontal cleavage of society. With three groups, more combinations are possible, and thus a more complex game. If sources of division internal to each group develop, the situation becomes open to more political possibilities; a horizontal division [upper versus lower; upper, middle, and lower; or, in terms of factors of production following Stolper & Samuelson (1941), land, labor, and capital] can thus become split by a vertical cleavage, dividing the “class” elements internally.

A vertical split can be politically dynamic because it mixes different sources of stratification and power. Class structures confer privileges in access to political institutions, or cultural status, or economic position. When these overlap and reinforce each other, the upper-class domination is stable. When these sources of stratification conflict, a range of combinations opens up, and stability is threatened. Many studies of revolutionary periods suggest this process: Upper classes divide, whether for economic, social, status or religious/ideological reasons; and as they conflict, they seek allies from below. This creates an opportunity for considerable change.

Much writing on the English Civil War implies that the two sides were not aristocracy versus bourgeoisie, or rising versus falling bourgeoisies, but rather rival combinations of several social groups, divided by different positions in relationship to economic change. They can be seen, using contemporary language, as the Old Economy (on the side of the King) and the New Economy (on
Parliament’s side). Each side was heterogeneous, with plenty of opportunity for internal conflict (landowners pushing their tenant farmers over the returns from the growing wool trade; merchants in tension with artisans over wages), but each hung together against their also heterogeneous opponents. Religion may have helped each side manage these internal divides, by unifying the allies around some common ideology (Puritans and dissenters on the Parliament side, high establishment Church advocates on the Royal side). After the constitutional bargain of 1688, at the time of the key democratizing moment of 1832, the social structure again split into Reformist and Anti-Reform elements, slicing through the class system from top to bottom. As industrialization began, the English aristocrats were heavily involved in this latest round of “new economy” through land ownership, share purchases, and finance; large blocs of them supported the Reform Bill of 1832 and the key move in economic policy, the repeal of the Corn Laws in 1846 (Schonhardt-Bailey 2003). Change came because the “modernizing elements” of the upper class supported it, in alliance with important segments of other social groups.

This complex coalition of modernizers versus defenders of the status quo is common to civil wars, revolution, and periods of policy conflict. The modeling challenge is to combine parsimony with a way of viewing the combinations of groups that reflects social reality. The larger the number of groups, the greater the range of equilibrium outcomes and hence the more difficult the modeling. The more complex the pattern of who wants what, the greater the range of possible outcomes, and thus the harder it is to simplify observed reality into prediction.

A classic locus of these issues is the political economy of trade. Following Stolper & Samuelson (1941), abundant factors of production support free trade, while scarce factors support trade restrictions. Viner (1948) relates the split to fluidity of asset allocation, or asset specificity: Those with high asset specificity are vulnerable to economic shocks and opposed to free trade, whereas those with low specificity can be more flexible, thus open to free trade. High asset specificity invites cross-class alliances within vulnerable sectors (e.g., steel workers pushing for duties or anti-dumping regulation), whereas low asset specificity facilitates horizontal cleavages over the return to each factor. Hiscox (2002) explores the fluctuation between factor-based alliances and sectoral ones as the degree of asset specificity changes over time. Rogowski (1989), Gourévitch (1986), and Brock et al. (1989) apply these ideas to historical cases.

Most of this writing on society imputes agency to the groups: classes, interest groups, producers, consumers, workers. It often infers their utility function from revealed preferences, or a deductive model taken from economics, or some other theory. Economic sociology has been challenging this view, arguing that the preferences and the strategic behavior are constructed (Dobbin 2004).

Composition of Actors

Many discussions of society and policy focus on the number of groups and neglect composition—the different flavors within the same label. In Moore’s (1966) analysis, the alliance patterns between the aristocratic and middle classes in England and Prussia differed because each had already evolved distinctive relationships to the economy and institutions; many of the commercialized English aristocrats blended more easily with the merchants and were already supportive of constitutional government before democratization got under way. Hall & Soskice (2001) show how groups combine differently according to the type of “production” system in which they operate. In coordinated market economies (CMEs), capital and labor cooperate to preserve high-investment, high-skill structures; in liberal market economies (LMEs), the two groups conflict, as capital prefers low-commitment strategies toward labor and subcontractors. Germany is the classic...
example of the former, the United States and the United Kingdom the archetypes of the latter. In the CME countries, capital supports job security, welfare support and training built around the workplace, and the taxes to go with them; in the LME countries, capital opposes these restrictions on its freedom and increases of its tax costs. A factor conflict model cannot account for these differences (Mares 2003a,b, Streeck 1984, Thelen 2004, Esteve-Abe et al. 2001, Iversen & Wren 1998, Berger & Dore 1996). Milgrom & Roberts (1995) explore these interconnections as “institutional complementarity,” where one aspect of the economy reinforces another.

Iversen & Soskice (2002) and Cusack et al. (2007) explore the influence of early socio-economic forms on the choice of institutions. Proportional representation and consensus structures seem more likely to have been chosen by countries that had traditional guild, business network, and other communitarian structures when industrialization began in them. Those groups designed institutions to take advantage of and preserve what they had (Manow 2001).

The agency in these sorts of arguments is structurally shaped incentives. The action of individuals and groups responds to the rewards or punishments they get from the structures in which they operate. The analytic energy of research goes into probing the structures; why people respond to them is left mostly to other disciplines, albeit with growing interest in both economics and political science.

**Political-Action Capacity of Actors**

Apart from their number and composition, the capacity of social groups for political action is important. Acemoglu & Robinson (2005)—known as institutionalists—unleash a strong critique of the institutional model by arguing that de facto forms of power can override all the restraints imposed by de jure power. De jure power is that created by formal structures of political authority (parliament, president, courts, etc.), whereas de facto power lies in social organization (e.g., control of guns, money, media). Repeatedly, in countries around the world, de facto power undermines de jure power, so that constitutions are eroded. The ability of one generation to bind those that follow by the design of institutions is thus constrained. For centuries, landowners, those who controlled private armies, those who controlled knowledge, and more recently those who controlled finance, industry, and other realms of the economy have been able to burst whatever institutional chains have been imposed on them.

This leads us to want an understanding of de facto forms of power—a very different agenda from the careful analysis of de jure power in much of the research on institutions by economists and political scientists. Rajan (2006) reinforces this critique, pushing for an inquiry into the social foundations of the kinds of power that are effective in the political arena. Rajan & Zingales (2006) explore the creation of constituencies to support reform. Morck et al. (2005) examine the problem by exploring the connection between concentration of economic power via blockholding and political power.

Social structures do comprise a type of institution, different from “parchment” or de jure institutions. Some theorists apply the word institution to norms and other elements of social communication that influence strategic action. The growth of interest in these other meanings should be welcome (if the distinctions can be distinguished), and each has different implications for agency. De jure institutions have high agency, typical of explicit design arguments, with the “immutability” problem noted above. The other meanings of institution vary in agency depending on how they are used.

Social structure may have a substantial impact on political and economic reform. Moore (1966) sees the distribution of property rights to peasants at the time of the French Revolution as among the factors that knocked France off the trajectory toward...
authoritarianism along which other aspects of its history were directing it. Peasants became a mass of small property owners, vulnerable to economic pressures and so available for radical action, but conservative in other ways. The Revolution generated ideological traditions hostile to concentration of wealth and power. In Japan, small farmers acquired title to their land as a consequence of the US occupation following World War II. This may also have contributed to democratization, creating an independent group with an interest to defend. It also created a lobby for protectionism, and the foundation of the conservative but activist Liberal Democratic Party. By contrast the Philippines did not have land reform and was unstable politically after 1945. Germany was socially transformed by World War II; the foundations of Junker power were wiped out by Soviet occupation and participation, and the divided West was far more Catholic, with fewer strong areas of traditional Communist and Socialist power. These changes had a lot to do with the ability of Japan and Germany to use effectively the democratic institutions encouraged by the occupiers.

Throughout this discussion, there has been recurrent reference to an important driver of development: war. Economic historians of course know about it, and at times explore its consequences. For Rajan & Zingales (2003a) World War I started the “great reversals” that deflected some civil law countries from building important equity markets. But war and interstate rivalries do not find pride of place in most of the institutionalist or human capital analyses. In contrast political fragmentation in Western Europe. In Europe, Anderson (1974a,b) argues, a key variable was the breakup of a unified Christianity with the Reformation (Gourevitch 1978).

CONCLUSION: IMPLICATIONS FOR POLICY AND RESEARCH

The issues of agency and social cleavages in the literature on economic development bear directly on policy debates. The smaller the role of agency in the analysis, the less policy can make any difference. The longer the durée (the farther back the discussion extends), the less deliberate human action seems to impact outcomes, and the less governments or other actors can do to alter outcomes.

The strong geography arguments (e.g., Diamond’s mountain alignments, or distance from the equator) are low agency, low policy. And yet from the beginning of human civilizations we can think of deliberate actions that bend nature to human will. The Fertile Crescent, which relied on irrigation from the Tigris and Euphrates Rivers, required extensive collective action. California produces most US fruit and vegetables thanks to federal and state water investment; Hong Kong was built on public infrastructure development; the state of New York financed the Erie Canal even before solving all the technological problems the project would face.
The more agency, the greater the challenge to provide accounts of how the action came about.

The human-capital arguments divide on agency. Those that explore the impact of cultural attributes often downplay the notion of choice by not asking where the values come from or why group members comply. Others, such as the papers on Jews and on Protestants, see greater agency by examining historically specific moments when a norm emerged as the result of actions taken. If human capital can be affected by policies toward education, research, intellectual property, culture, and the way firms spend on worker training, then the role of agency is quite large.

Institutional arguments vary on agency according to how malleable they find the institutions to be. Laporta et al. (1997, 1998) have a single decision point in the creation of legal institutions, so agency is limited. Looking at interest groups, as do Rajan & Zingales (2003b) and others, reveals a political process with continuous agency. If institutions are held constant as the frame of preference aggregation, agency can be examined as strategic interaction within that frame. Policy debates then involve institutional design to improve or inhibit policy outcomes.

As institutions themselves become problematic, as exemplified by the distinction between de facto and de jure power (Acemoglu & Robinson 2005), the agency and policy issues broaden. Institutions cannot be designed separately from the social sources of power. Understanding this linkage requires more research on the social power resources and how they work. Measuring resources is difficult; furthermore, institutionalist research fits the dominant culture of the political economy literature in economics, law, and political science, so we should not be surprised that it is far more advanced. But some social power resources can be studied: land holding, diversity of economic activity in a country or region, education, media diversity. Acemoglu et al. (2007) examine whether political power in late-nineteenth-century Colombia led to wealth, or wealth to political power. The policy implications of a social model are explosive. Can we engineer changes in the distribution of power? It has been done (land reform in Japan; the revolutions of France, Russia, and China), but often in situations of revolution and war.

Progress toward a fuller account of the political economy of development certainly involves linking together a theory of institutions, a theory of human-capital development, a theory of the distribution of incentives by the condition of the world economy, a theory of international politics noting the impact of war and military rivalry, and a theory of the social components of political power. We have seen substantial advances in each of these and some exploration of the interaction among them. A stronger attention to issues of agency would sharpen the discussion about politics and policy. No agency, no politics, no policy. With some agency, there can be politics, and policy could matter—for ill as well as for good.

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

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