Democracy, Capitalism, and Equality:

The Importance of Impersonal Rules

Naomi Lamoreaux
Yale University, University of Michigan, and NBER

and

John Joseph Wallis
University of Maryland and NBER

Acknowledgments: We have benefitted from the helpful comments of Abhay Aneja, Kenneth Ayotte, Hoyt Bleakley, Tracy Dennison, Kenneth Elzinga, Price Fishback, Martin Fiszbein, Philip Hoffman, Prasad Krishnamurthy, Robert Merges, Paul Rhode, Jean-Laurent Rosenthal, Christopher Tomlins, Francesca Trivellato, the editors of this volume, and participants in the conference on Democracy and Capitalism at the Miller Center of the University of Virginia, the Caltech Finance and History Lunch, the Berkeley Law, Economics, and Business Workshop, and the NBER 2023 Summer Institute, Development of the American Economy Group.

Democracy, Capitalism, and Equality:

The Importance of Impersonal Rules

1. Introduction

There are ways of thinking about democracy and capitalism that make them seem irreconcilable. If capitalism is an economic system that allows a considerable degree of economic freedom and enables a small number of hard working or lucky individuals to accumulate substantial wealth, then capitalism may have an inherent tendency to increase inequality. If democracies gain legitimacy by leveling the playing field for their citizens, both politically and economically, then the unequal accumulation of wealth generated by a capitalist economic system may eventually erode the foundations of democracy. Viewed from this perspective, capitalism and democracy seem incompatible.[1]

To most economic historians, however, the answer to the question "Can democracy and capitalism be reconciled?" is an obvious "Yes." A glance around the world today suggests that all the "advanced" capitalist societies are both rich and advanced democracies, and all of the "advanced" democracies are rich and advanced capitalist societies. Indeed, democracy and capitalism developed so closely together over the last two centuries that asking whether democratic development caused modern economic development or modern economic development caused democratic development has long been a foundational question in economics, economic history, and political science. Few economic historians doubt that democracy and capitalism developed in tandem. The debates are all about how and why.

[1] The idea that democracy and capitalism cannot coexist has a long history, as Goran Therborn has pointed out. See "The Rule of Capital and the Rise of Democracy," *New Left Review* (May/June 1977): 3-41 at 3.

The modifier "advanced" in the preceding paragraph is crucial: only societies with *advanced democratic polities* are associated with *advanced capitalist economies* and vice versa. If we define a democracy simply as a society that selects leaders through some form of election, or if we define a capitalist society simply as one where economic actors pursue profits, then, we show, the relationship between democracy and economic development disappears. In other words, there is a strong association between advanced democracy and advanced capitalism, but little or no relationship between democracy and capitalism broadly defined. Why this is so is the subject of this paper. In brief, we argue that today's advanced capitalist democracies began to undergo changes in the late-nineteenth and early-twentieth centuries that transformed both their economic and political systems in mutually reinforcing ways. The changes in the organization of political institutions that occurred during this period would not have been sustainable without the corresponding changes that occurred in the organization of economic institutions, and vice versa. At the root of this double transformation was the adoption of impersonal legal rules—that is, rules that treated everyone (or, more accurately, broad categories of everyone) the same. Impersonal rules facilitated the free flow of resources to their most profitable economic uses that is the hallmark of advanced capitalism. Although they did not eliminate inequality or, for that matter, discrimination, they made possible the emergence of the stable long-lived political parties that, we show, are essential features of advanced democracies.

Aside from the small number of countries that became advanced capitalist democracies, most societies around the world today have (and always have had) unstable political systems. Political elites in these societies try to stave off conflict by agreeing to allow each other privileges that create what economists call "rents." The rents are created by "identity" rules, that is, rules that treat different members of the elite differently and whose form and enforcement depend upon the social identity of the individuals to whom they apply. Because the rents will be lost if the agreements collapse, these privileges create incentives not to violate the agreements that keep coalitions in power. The incentives are imperfect, however, for members of the elite are always jockeying for better deals. Moreover, the value of the rents can never be fixed through time and, indeed, can dissipate for completely idiosyncratic reasons. As a result, this kind of political manipulation of economic interests can simultaneously be a source of short-run stability and of long-run instability, much like building a solid house on a foundation of sand. It also weakens the economy by erecting barriers to the free flow of resources to their most productive uses. Reducing the ability of the political coalitions to manipulate economic rents through identity rules, we argue, is the key to both advanced capitalism and advanced democracy.[2]

Although most writers consider it progress when countries begin to choose leaders by election, the move toward democracy can exacerbate the problem of instability by introducing considerable randomness to the choice of leaders. The greater uncertainty in turn increases the incentive for elites to improve their chances of maintaining power by distributing privileges to their supporters. Thus, the spread of electoral democracy can perversely increase the manipulation of the economic privileges for political ends, with all the distortions such rent-creating activities entail.

Although opposition parties often promise to put a stop to this kind of corruption when they come to power, they rarely follow through because they too need to reward their supporters to win elections. During the second half of the nineteenth century, however, a small group of

[2] The logic of this argument is laid out in Douglass C. North, John Joseph Wallis and Barry R. Weingast, *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History* (New York: Cambridge University Press, 2009).

countries found ways to limit significantly this kind of manipulation by mandating that the rules that governed their societies be impersonal. These countries became the advanced capitalist democracies of today. Each of them made the transition in its own way. There was no common path of change—no recipe that other countries could follow and become advanced. But in each of the countries that figured out how to do it, the adoption of impersonal rules set in motion a similar set of processes that transformed the way the economic and political systems worked and interacted. Most obviously, the resulting limits on rent creation encouraged capitalist economic development by reducing the barriers that had inhibited the free movement of economic resources. Less obviously, the same developments strengthened the organizations—political parties—that mediated between the government and the electorate, directing political competition into channels that were no longer destabilizing.

The next two sections of the paper define what we mean by advanced capitalism and advanced democracy and then document the association between these two systems using estimates of real per capita income and a widely used measure of democracy, the Polity IV/V index. Section four lays out the logic of this association. It begins by describing how societies governed by identity rules work, why they are plagued by instability, and why they constrain capitalist economic development. Next it explains how introducing democracy into such societies makes them even more unstable and factional. The final part of the section shows how mandating impersonal rules transforms these societies—how it removes the barriers that prevented resources from flowing to their best uses, allowing capitalism to thrive, and how it transforms the way the democratic political process works by giving rise to stable party systems. Finally, in section five, we review the little that is known about how today's advanced capitalist democracies adopted impersonal rules, highlighting the difficult, context-specific character of these transitions. Section six concludes.

2. Definitions and Measurement

To show that there is an association between advanced capitalist societies and advanced democracies but not between capitalism and democracy more generally requires that we be as clear as possible about our terms. There is a rich literature defining and measuring democracy that we draw on for our analysis. Unfortunately, scholars have devoted much less effort to defining and measuring capitalism.

Marx, of course, conceived of capitalism as an economic system in which labor was the sole source of value in the economy but workers did not own the means of production and had to sell their labor to the capitalists who did to survive.[3] Once the labor theory of value gave way to the idea that profits depend on the efficient combination of multiple factors of production, however, it became common for scholars to define capitalism very simply as a system where economic actors were motivated primarily by the pursuit of profits.[4] There are two problems with this definition, however. First, it does not allow us to distinguish societies that most people consider capitalist from others that most do not (like feudalism), where elites may also be motivated by the desire for economic gain. Second, it does not allow us to distinguish societies in which profit-oriented elites are able to cut rent-seeking deals that limit the free flow of

---

[3] Karl Marx, *Capital*, Vol. I.

[4] See, for example, Joyce Appleby's definition in *Relentless Revolution: A History of Capitalism* (New York: W. W. Norton, 2010), 7. Although historians of capitalism have generally been reluctant to define their terms, when pushed they fall back on a similar definition. See Sven Beckert, et al., "Interchange: The History of Capitalism," *Journal of American History* 101 (September 2014), 503-36. For an exception, see Jonathan Levy, *Ages of American Capitalism: A History of the United States* (New York: Random House, 2021).

resources into profitable economic activities. We prefer instead to categorize societies as more or less capitalist depending on the prevalence of such rent-seeking deals. From this perspective, advanced capitalist economies are those in which these kinds of barriers to entry have been largely removed and entrepreneurs are free to invest their capital, workers are free to invest their labor, and resource owners are free to invest their property in almost any kind of venture they choose. In advanced capitalist societies, any person can form an organization, access government-enforced rules to structure it, and engage in a wide variety of activities without the explicit approval of the government. The forms of supported organizations are rich and varied, the scale of organizations can range from very small to very large, and new organizations, purposes, and products appear and disappear frequently.

There is a good deal of overlap between our definition of capitalism as an economic system in which individuals are able to use their capital, labor, land, and resources however they think best and the measures of economic freedom in Vincent Geloso and Alex Tabarrok's paper in this volume. However, in our view, even though advanced capitalist societies are characterized by the free movement of economic resources, they are not necessarily laissez-faire. As the so-called "varieties of capitalism" literature has shown, such societies can differ considerably in the extent to which they regulate economic activity in the interests of health, safety, environmental sustainability, and other social goods, and in the extent to which they provide a social safety net.[5] Within the general constraints imposed by these types of regulatory policies, what matters is that capital, labor, and resources flow freely wherever their owners

[5] The foundational work in this literature is Peter A. Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001).

direct them. The key to advanced capitalism is not the absence of limits on economic activity, it is that *everyone* faces the *same* limits and enjoys the *same* freedoms.

Although one can articulate the difference between advanced capitalist societies and their more basic capitalist counterparts, there are no comprehensive indices that capture these distinctions over space and time. We have chosen for our analysis what we think is the most reasonable metric available—real per capita income—using the data that Angus Maddison has compiled for a wide selection of countries over the last two centuries.[6] Some of Maddison's estimates are little better than guesses, and coverage is spottier at the beginning of the period than at the end, but the data conveys a general picture of trends in real income over time and across countries, which is all we need for our purposes.

Scholars have devoted a great deal more effort to defining and measuring democracy than they have to capitalism. According to the simplest definitions, democracy is a political system that selects leaders through elections. Joseph Schumpeter defined democracy this way in *Capitalism, Socialism, and Democracy*, contrasting it with the classical notion of democracy as a pure "ideal" type of political system in which elections somehow express the will of the people.[7] But democracy involves much more than elections. David Collier and Stephen Levitsky have specified a "procedural minimum" for being a democracy that presumes "fully contested elections with full suffrage and the absence of massive fraud, combined with effective guarantees

---

[6] We are using the 2010 version of Maddison's data, because there are benchmarking problems with the revised series. Angus Maddison, "Statistics on World Population, GDP and Per Capita GDP, 1-2008 AD," Groningen Growth and Development Centre (2010), http://www.ggdc.net/MADDISON/oriindex.htm.

[7] Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Brothers, 1942), Chs. 21 and 22. For a brilliant discussion of how democracy as an ideal type differs from actual democracies, see Robert A. Dahl, *Polyarchy: Participation and Opposition* (New Haven: Yale University Press, 1971).

of civil liberties, including freedom of speech, assembly, and association." An "*expanded* procedural minimum" democracy requires in addition that elected governments have effective power to govern. The expanded definition excludes political systems where elections were free, fair, and open, but the elected government does not fully control the state, as, for example, in countries where the military exercises independent power. Many countries have elections to select leaders but do not have political systems that meet even the minimal procedural definition of democracy. They are unable to guarantee the absence of massive fraud, or provide effective guarantees of civil liberties, including freedom of speech, assembly, and association.[8]

Advanced democracies exhibit all the characteristics of electoral democracies that meet the expanded minimum standard. In addition, their political systems consist of a small number of consolidated parties with durable lives. These parties neither suppress their opponents when they win elections nor disappear when they lose them, and in general, have a reasonable chance of winning elections or participating in a governing coalition. The parties or coalitions that win elections are the organizations that control the government, which means that the policies governments put into effect and the rules they promulgate depend on the outcome of elections. Advanced democracies all have this characteristic. In other respects, however, the details of their political system—the number of parties, whether they are parliamentary or characterized by separation of powers, whether representation is majoritarian or proportional, and so on—can

[8] David Collier and Steven Levitsky, "Democracy with Adjectives: Conceptual Innovation in Comparative Research," *World Politics* 49 (April 1997): 430-451. For a similar typology, see Andreas Schedler, "What Is Democratic Consolidation?" *Journal of Democracy* 9 (April 1998): 91–107.

vary differently from one country to the next. Indeed, there is a varieties of democracy literature that parallels, and feeds into, that on capitalism.[9]

Political scientists have constructed various indices that measure democracy numerically. The one we use here is the Polity Score IV/V, which ranks countries on a 21-point scale that ranges from -10 to +10. Negative numbers indicate how autocratic a society's political system is, positive numbers how democratic. The Polity Score is built up from component indices that measure different aspects of a country's governance. It gives considerable weight to how the executive is chosen and to constraints on the power of the executive, as well as to the extent of political competition, and therefore highlights features that tend to characterize advanced democracies.[10]

For the purposes of this paper, we divide the political world into autocracies, electoral democracies (that is, polities whose leaders are chosen by elections), and advanced democracies (polities that meet the expanded minimum standard and, in addition, are governed by consolidated political parties). We recognize that electoral democracies vary significantly, but our concern is to understand how advanced democracies differ from all other democracies and to explain why it is advanced democracy in particular that is consistent with advanced capitalism.

---

[9] For an example, see Arend Lijphart, *Patterns of Democracy* (2nd edn.; New Haven, CT: Yale University Press, 2012).

[10] The Polity Score is not as rigorous a definition of democracy as we would like, as many countries with scores of 10 are not in fact advanced democracies. Almost all, however, meet the advanced minimum standard. The Polity data is published by the Center for Systemic Peace. The Polity IV data is currently in the process of being updated to a revised series, Polity V. Data sets and information are available at https://www.systemicpeace.org/polityproject.html.

3. Capitalism and Democracy over Time and Space

Table 1 lists eighteen countries considered today to be advanced capitalist democracies. There are a few more countries that could be included under this label—Japan and South Korea, for instance—but the historical data for them are not complete, so we exclude them from our analysis. Spain and Portugal are included, as they are advanced democracies today and we have data for them going back to the nineteenth century, but they are problematic because of their long experiments with autocracy in the twentieth century. Hence, though we present data that includes Spain and Portugal, we focus our analysis on the "sixteen-country" sample that excludes them.

Table 2 provides information for these sixteen (eighteen countries), as well as for the entire Maddison sample for a selection of years. Row (1) gives the number of countries in Maddison's sample in each year; row (2) average per capita income across the entire world for the years Maddison calculated it (these numbers are average real per capita income weighted by population); row (3) the unweighted average of per capita income for the countries in Maddison's sample; row (4) the average income of the sixteen countries (not weighted by population); and row (5) the same average including Spain and Portugal.[11]

Real per capita income increased worldwide by a factor of 11 between 1820 and 2008, and by a factor of 22 in the richest countries. As row (7) indicates, the ratio between the richest sixteen countries and the world average grew from 1.5 in 1820 to 3 in 2008. In row (8) the ratio between the richest sixteen countries and all others started at 6.8 in 1820, rose as high as 24 in 1850, and then stabilized at around 15 in the late nineteenth and early twentieth centuries. The

[11] Weighting the 18 countries by population would produce slightly different numbers for average income, without substantially changing the message of the table.

two series began to converge in the mid-twentieth century, in part because Maddison added more countries to his sample, including oil-rich autocracies and very small countries with less than 1 million population in 2000, which are often off-shore financial hubs and shipping entrepots. But even in 2008, the average income of the sixteen countries was 3 times the world average and 3.9 times the world average excluding them.

Rows (9) through (11) provide information on the relative income rank of the sixteen (eighteen) countries at different points in time. The first number in rows (9) and (11) is always 16, and in row (10) it is always 18. The second number is the rank of the poorest country in the set of sixteen or eighteen countries. For example, the entry in row (8) for 2008 is "16/26" meaning that the sixteen countries listed in Table 1 accounted for 16 of the 26 highest income countries in the entire distribution of countries. As the table shows, the sixteen countries were already among the richest in the world in 1820, and they maintained their leadership even as the number of countries in Maddison's sample expanded. Row (11) drops both the oil exporters and the small countries. In recent years, of course, the ranks of rich countries have also expanded to include new advanced capitalist democracies such as Japan, South Korea and Ireland. Nonetheless, the sixteen countries in our sample still dominate the list of the richest countries in the world.

As the last line in Table 2 shows, the eighteen advanced capitalist countries were also advanced democracies. Row (12) reports the unweighted average of their Polity Scores, which rose from 4.5 in 1820 to 9.9 in 1990 and 9.8 in 2008. How each country's Polity Score changed over time can be seen from Table 3. For some countries there is no score early on, either because the country did not yet exist or because an estimate cannot be constructed. The symbol

“T” indicates years when a country’s political system was in transition, and a “G” signifies that the country was occupied by Germany in World War II.

Only the United States had a positive Polity Score in 1820—mainly a result of the formal constraints on the executive enshrined in the Constitution. All the other countries in our dataset were autocracies of various degrees of severity. Britain’s other English-speaking former colonies transitioned to democracy by the middle of the nineteenth century, but it was not until later in the century that Polity Scores began to rise in Britain and parts of northern Europe. Spain and Portugal were the last of the countries in our sample to make this transition. By the end of the twentieth century almost all the richest countries in the world had Polity Scores of 10.

That the top countries were both rich and had high Polity Scores suggests that there is a strong association between capitalism and democracy, but the pattern ceases to hold if one looks at countries lower down on the scale. Table 4 reports correlations between per capita income and Polity IV/V Scores for the 142 countries for which both measures are available in 2000, broken down into various sub-samples. The first two columns report correlation coefficients and their associated p-values for each of the sub-samples. Because the Middle Eastern oil exporting countries are rich despite being autocratic, the analysis is more revealing when they are dropped from the analysis. At the top of the distribution—the 25 richest countries without oil—the correlation is weakly positive and marginally significant; most of the countries in this group have Polity Scores of 10, so there is little variation on the democracy side. However, as we expand the sample from the top 25 no-oil countries to the top 70 no-oil countries and then to the whole no-oil sample, the correlation coefficient rises from .27 to .48 to .56. So long as the richest countries are in the sample, adding more poor countries increases the measured correlation, even though there is essentially no correlation between income and Polity Scores for the poorest 70 countries. The strengthening of the correlation is a result of sample selection and composition. There is no relationship between income and Polity Scores, or between capitalism and democracy, outside the set of advanced capitalist democracies.

The lack of an association between our measures of capitalism and democracy for countries in the bottom half of the distribution can be seen more clearly in Figure 1, which plots the income of the richest country in a given sample on the horizontal axis and the correlation between per capita income and the Polity Score for same sample of countries on the vertical access (the income numbers on the horizontal axis are negative to get the graph to read correctly from left to right). The first observation is the Maddison sample (excluding the specialized oil-producing countries), ranging from Norway with a per capita income of $54,040 in 2000 to Afghanistan with just $502. The second observation drops Norway and measures the correlation from the United States at $45,886 to Afghanistan. The last observation is the correlation for the poorest 27 countries (Bangladesh at $1,845 to Afghanistan). As rich countries are dropped, the correlation between per capita income and Polity Scores declines, becoming statistically insignificant around a correlation of .2 and a top income of $10,000 to $12,000 (roughly the income of the Russian Federation). Among the bottom three quarters of the countries there is little correlation between Polity Scores and per capita income, and at the very lowest levels of the distribution the correlation actually becomes negative, suggesting that poor countries with autocratic governments may have higher incomes that those that are democracies. Those results are not statistically significant, however.

The association between advanced capitalism and advanced democracy that we have documented is just that—a correlation. We have not proven anything about the effect of democracy on capitalism, of capitalism on democracy, or about the possibility that other phenomena are behind the correlation we observe. The numbers do indicate, however, that democracy and capitalism not only can coexist, but that they have persistently coexisted over the last two centuries.

4. Why Identity Rules Cannot Support Advanced Capitalist Democracies

As we suggested above, a distinguishing feature of advanced capitalist democracies is that they are governed by impersonal rules rather than identity rules. Indeed, we would go farther and assert that impersonal rules are a critical requirement for the positive association we observe between advanced democracy and advanced capitalism. In this section, we develop the logic of this claim. We first explain that autocracies and oligarchic republics always operate under identity rules because such rules create the rents that give elites an interest in preserving the social order. Societies organized by identity rules are inherently "factional" in the sense that they are dominated by small groups who form coalitions to govern and to influence what the government does. These coalitions are fluid and constantly changing, for the groups that make them up have their own, relatively narrow interests and are constantly pushing for advantage. Even in autocratic societies, where one group may control the government for an extended period, the factional interests that need to be managed are constantly in flux. In the next part of the section, we show that the introduction of democratic elections typically makes such societies less rather than more stable and thus increases elites' incentive to manipulate the economy for political ends. This effect of democratization explains why, as we demonstrated in the last section, the association between capitalism and democracy breaks down below the set of rich capitalist democracies. Finally, we discuss how the shift to impersonal rules facilitates the joint achievement of advanced capitalism and advanced democracy. Impersonal rules stimulate capitalist enterprise by removing the barriers that prevent resources from flowing to their most productive uses. At the same time, they increase political stability by making possible the emergence of consolidated political parties with the power to restrict and control factional conflict.

4.1 Identity Rules and the Problem of Social Order

The importance of identity rules is most obvious in societies where the political order breaks down frequently, where coups, civil wars, and abrupt changes in power occur with some regularity. In these societies, coalitions structured by agreements among powerful elite factions are vital to establishing and maintaining order. But these coalitions can only last if the elites involved in them have a stake in their continuance—if they earn valuable rents that will be lost if the arrangements fall apart. Identity rules that create rents and assign them strategically to key political actors are thus essential for preventing violent breakdowns. However, because the rents can never be fixed for all time—because they typically shift or even dissipate for exogenous reasons—the agreements they make possible can only guarantee stability in the short run. In the long-run, *le déluge*.[12]

Coalitions organized by identity rules necessarily include groups with competing, even antagonistic interests. They are not just made up of allies. Maintaining social order depends on inducing the powerful factions that are most likely to fight each other to agree to cooperate. To give an example, former president Mwai Kibaki of Kenya was declared the winner of the 2007 elections despite the claims of his opponent, Raila Odinga, that the election had been

[12] For the underlying logic, see North, Wallis, and Weingast, *Violence and Social Orders*. For a similar understanding, see Stephen Haber, Noel Maurer, and Armando Razo, *The Politics of Property Rights: Political Instability, Credible Commitments, and Economic Growth in Mexico, 1876-1929* (New York: Cambridge University Press, 2003).

manipulated. Violent protests broke out and Kenya seemed on the verge of civil war, but violence was forestalled by an agreement between the Kibaki and Odinga organizations that allowed the former to assume the presidency. Entitled the National Accord and Reconciliation Act of 2008, the agreement rewrote the constitution and created the office of Prime Minister, which was given to Odinga. The Accord was an intra-elite agreement between enemies, not allies, and very consciously used identity rules to quell violence.[13]

Some coalitions are well organized and persistent; others are poorly organized and short-lived. Some are autocracies, where one set of elites controls the government; some are oligarchies, where control is shared by a broader combination of elites. Although autocracies may appear to be more stable than oligarchies, they too are riven by factions. Autocrats always govern in the shadow of violence and must induce other powerful elites to refrain from using force against them. In autocracies, the person of the monarch or dictator provides a focal point that facilitates the coordination of agreements. In oligarchies, the coordination problem is more difficult. But both types of societies can only attain stability by deploying identity rules to structure the highly personal agreements among elites that keep them from disrupting the peace.

Elites in oligarchies always fear that one faction among them will gain control of the government and will use that control to dominate or eliminate the others. In the seventeenth and eighteenth centuries, this fear drove the development of the republican ideas and institutions that to this day claim the admiration of political theorists. To protect what they termed their "rights and liberties" from the tyranny that would result from such domination, republican thinkers like

[13] See Jeffrey Gettleman, "Disputed Vote Plunges Kenya Into Bloodshed," *New York Times,* December 31, 2007. See also Nic Cheeseman, "The Kenyan Elections of 2007: An Introduction," *Journal of Eastern African Studies* 2 (issue 2, 2008): 166-184. The entire issue of the journal was devoted to the Kenyan election.

James Madison advocated mixed and balanced government. They did not understand that what they called their rights and liberties were the product of identity rules; nor did they see factions as the characteristic outcome of societies structured by identity rules. To the contrary, they conceived of factions as natural phenomena—as products of human nature—and could not imagine how societies could be organized without them. The mixed and balanced governments that republican thinkers promoted did nothing to eliminate them. Instead, the goal of these thinkers was to prevent tyranny by setting faction against faction—by using them to counter balance each other in governments structured for that purpose.[14]

4.2 Identity Rules and Electoral Democracies

The republican thinkers that promoted mixed and balance government did not advocate democracy, but their ideas nonetheless provided a critical foundation for the democratic reforms of the late eighteenth and early nineteenth centuries. Although these reforms are usually considered milestones of human progress, their introduction in societies structured by identity rules had the perverse effect of making the problem of instability worse, and the same is true of countries that democratize today. Figure 2 graphs the relationship between Polity IV/V Scores and political instability, measured in several ways. The vertical axis reports the likelihood that an unstable event will occur in a given year, and the horizontal axis the country's Polity IV/V Score. The figure shows that countries with low Polity Scores (autocracies) and those with very high scores (mainly advanced democracies) are much more stable than the countries in between that mix some elements of democracy (chiefly elections) with elements of autocracy. As

[14] The literature on republican ideas is enormous. Two seminal books are J. G. A. Pocock, *The Machiavellian Moment: Florentine Political Thought and the Atlantic Republican Tradition* (Princeton, NJ: Princeton University Press, 1975); and Bernard Bailyn, *The Ideological Origins of the Revolution* (Cambridge, MA: Harvard University Press, 1967).

countries with low Polity Scores incorporate more democratic elements into their political processes, their chance of armed conflict and of backsliding into autocracy increases unless, against the odds, they manage to continue to democratize.[15]

As already noted, to keep the peace, coalitions structured by identity rules must include enemies as well as allies. Introducing elections makes putting together such coalitions more difficult. First, and most obviously, elections add a random element to the selection of governments that makes such agreements more difficult harder to reach. In addition, when the outcome of elections is determined by a majority vote (or another voting rule), groups have incentives to form coalitions of enough factions to secure victory and leave others (usually enemies) out of the rule-making process and the privileges that result from it. However, leaving a significant faction out of the agreement may doom it. The recent literature on civil wars shows that factionalized polities are more likely to be disrupted by violence when a group comes to feel that its interests cannot or will not be taken into account under the current governing arrangements.[16]

Democratization, moreover, tends to worsen problems of factionalism and, as a corollary, to encourage the proliferation of identity rules. The coalitions that elites form to compete in elections are typically called political parties, but they are really factions, and they themselves are riven by divisions and ephemeral. To bring together the different groups they need to win elections, parties must promise them benefits specific to their identities, which means that, if the

---

[15] Scholars have found that most civil wars occur in countries with Polity Scores between -5 and +5 and call these places "anocracies" to emphasize the special dangers of this middle range. See, for example, Barbara F. Walter, *How Civil Wars Start: And How to Stop Them* (New York: Crown, 2022).

[16] Walter, *How Civil Wars Start*; and Andreas Wimmer, *Waves of War: Nationalism, State Formation, and Ethnic Exclusion in the Modern World* (New York: Cambridge University Press, 2013).

party wins, it must manipulate the economy to ensure there are enough rents to fulfill the bargains. These coalitions are difficult to hold together, however, because the constituent groups always want more. Groups dissatisfied with their share of the spoils can easily defect to another party that is eager to bid them away, or they can form a competing organization and try to build their own coalition. Hence in electoral democracies characterized by identity rules, parties form, dissolve, and reform, and elites dissipate state resources and impede economic development in their ongoing efforts to hold their coalitions together.

4.3 Impersonal Rules and Advanced Democracy

In advanced democracies, this multiplicity of divided, ephemeral factions gives way to a much smaller number of consolidated, long-lived organizations that are truly modern political parties. This development was first recognized by the so-called "pluralist" scholars of the 1950s and 1960s, who argued that successful democratization required the construction of party systems in which cleavages between interests could be accommodated within well-established political organizations by compromise rather than conflict.[17] In recent years, political scientists have increasingly returned to this view, and it is common now to emphasize the importance for democratic development of consolidated political systems in which same parties compete against

[17] See, for example, Dankwart A. Rustow, *The Politics of Compromise: A Study of Parties and Cabinet Government in Sweden* (Princeton, NJ: Princeton University Press, 1955); and Arend Lijphart, *The Politics of Accommodation: Pluralism and Democracy in the Netherlands* (Berkeley: University of California Press, 1968). The preface to Robert A. Dahl's edited volume, *Political Oppositions in Western Democracies* (New Haven, CT: Yale University Press, 1966) is an excellent introduction to this literature, as are the book's case studies. For a suggestion of how the transformation may come about, see Seymour M. Lipset and Stein Rokkan, eds., *Party Systems and Voter Alignments: Cross National Perspectives* (New York: Free Press, 1967).

each other year after year, developing broad programmatic identities to cultivate voters' loyalty.[18]

The key to development of consolidated political parties is the shift from identity to impersonal rules. In a society structured by identity rules, factionalism poses two related problems to any party that seeks to become more durable over time. The most pressing problem is internal: how to ensure that the various groups in the coalition will remain committed to the collective goal of winning elections. This problem is related to a second, external one: if the party loses an election, how can it be reasonably sure that the winning coalition will not attempt to suppress or eliminate it? In a society structured by identity rules, these challenges are omnipresent because it is relatively easy for one coalition to entice a faction from another coalition to switch allegiances.

With the shift to impersonal rules, however, everything changes. The disappearance of identity rules and the rents they create means that it is no longer a simple matter for political leaders in one coalition to bid a faction away from another. Nor is it easy for new parties to form by offering those who join them a greater share of the spoils of victory. There might still be programmatic reasons for such moves, but the important point is that the gains that might come from defecting from one party to another would shrink relative to the benefits of staying within the party and working to reshape its agenda. Political stability increases as the number of parties declines and those that remained consolidate their organizations and achieve greater permanence.

---

[18] See Didi Kuo, *Clientelism, Capitalism, and Democracy: The Rise of Programmatic Politics in the United States and Britain* (New York: Cambridge University Press, 2018); Frances McCall Rosenbluth and Ian Shapiro, *Responsible Parties: Saving Democracy from Itself* (New Haven: Yale University Press, 2018); Daniel Ziblatt, Con*servative Parties and the Birth of Democracy* (New York: Cambridge University Press, 2017); Sheri Berman, *Democracy and Dictatorship in Europe from the Ancien Régime to the Present Day* (Princeton, NJ: Princeton University Press, 2019).

Regimes governed by impersonal rules are fundamentally different in other ways as well. Under identity rules, most laws are tailored to the needs of specific individuals, groups, or localities and are the result of bargains among elites. Under impersonal rules, by contrast, laws apply uniformly to everyone, or at least to everyone in the relevant categories. Although one individual or group may benefit from a proposed law, so will others, and still others may be harmed. As a result, those that may benefit and those that may be harmed have an incentive to organize for and against the legislation, and in cases where the issues involved are likely to come up again and again, to form more formal interest groups. These groups play a very different role in the political process from the factions that disrupt early democracies. In societies governed by impersonal rules, political parties respond to the emergence of these organizations by developing distinct programmatic identities they enable them to attract the support and resources of groups in sync with their agendas. These identities matter because the policies the government enacts depend on the party that is victorious. Parties that win elections then seek to establish a record of achievement on behalf of the interest groups with which they are affiliated, and as they do, they pursue policies that build the capacity of the state.

At the same time as the shift to impersonal rules makes the political system more stable and effective, it makes the economic system became more dynamic and competitive—more capitalist. Once lucrative opportunities (and the organizational tools needed to exploit them efficiently) are no longer restricted to favored members of the elite, capital, labor, and resources can flow to their most profitable uses. This is not to say that there can no longer be any restrictions on what the owners of capital, labor, and resources can do. Policy does not necessarily become laissez-faire. Governments can still regulate economic activities to promote the health and welfare of their populations, a more equitable distribution of income and wealth, or whatever goals the parties that win elections set on behalf of their constituent groups. Under a regime of impersonal rules, however, these regulations apply to all economic actors in the affected categories. Powerful members of the elite have to follow them, as does everyone else.

5. The Transition to Impersonal Rules and the Emergence of Consolidated Parties

But how could a society change from identity to impersonal rules? What could possibly induce elites to relinquish the tools they had always found so essential for holding power? And even if they gave up the use of identity rules, why would it be in elites' self-interest over the long run to maintain a commitment to impersonal rules? These questions make the transition to impersonal rules seem impossible. And yet, it happened—in at least a few places. In this section, we examine the very different ways in which two societies—the United States and Britain—transitioned to impersonal rules in the nineteenth century and contrast their experience with that of Germany, where partial reforms did not go far enough to bring about the necessary regime change. In all three cases, the beginnings of democratization made the problem of factionalism more severe and exacerbated the political use of identity rules. In all three cases, governments made initial limited efforts to reduce the extent to which politicians could manipulate the economy, for example, by enacting general incorporation laws. In the two successful cases, however, the shift to impersonal rules continued far beyond general incorporation and, as a result, had much broader ramifications.

The initial experiments with general incorporation laws had an unexpected bonus: they showed how impersonal rules had the potential to curb factionalism. In an identity rule polity, where most legislation applies to specific individuals, organizations, or localities, politically active citizens and politicians alike expect that government laws and policies will be identity based. That is the political norm, and it affects how people behave, both in the legislature and in the larger society. Although some identity rules entail grants of monopoly power with widespread repercussions throughout the society, in a democracy most are more pedestrian in their effects. Corporate charters, for example, benefit the people to whom they are allotted, and those benefits are not much affected by the number of charters that legislators give out. Other favors that legislators distribute to their constituents—such as divorces, name changes, legitimating children, and so on—are even more circumscribed in their effects, and for this reason legislators usually support each other in passing such laws. But the resulting independence of action encourages factionalism. Legislators care more about building their local power bases than about the party with which they are ostensibly affiliated; and people in their jurisdictions shift their loyalty among competing politicians as they think will best secure their needs. The enactment of general incorporation acts helped politicians see how it was possible to alter this dynamic both by reducing legislators' independence of action and constituents' dependence on legislative favors. They also learned that, under a regime of general laws, legislators could not enact the statutes their constituents needed unless they could cooperate with each other effectively. Political parties became important coordinating devices.[19]

In places where elites absorbed this lesson and took steps to broaden the scope of impersonal rules, democratic processes began to change in significant ways. Constituent-specific identity legislation declined sharply in favor of a much smaller number of programmatic bills that applied to broad segments of the population. As factionalism declined and the newly

[19] The spread of impersonal rules did not mean that politicians stopped looking out for their constituents, but rather that the form of constituent service changed to things like helping citizens navigate the bureaucracy. See Richard Fenno, *Home Style: House Members and Their Districts*. New York: Scott Foresman and Co., 1978).

consolidated parties assumed a coordinating role, the political system stabilized around a smaller number of long-lived major parties that competed against each other repeatedly for control of the government.[20] Parties that won elections knew that it was inevitable they would lose sometime in the future, and that knowledge gave them an interest in maintaining the system. By committing themselves to the new regime of impersonal rules, major parties could protect their longevity—could prevent a future victor from suppressing or eliminating them as competitors—and ensure that comebacks from losses would always be possible. The shift to impersonal rules thus did double work, stabilizing parties by curbing the factionalism that had previously torn them apart and stabilizing the political system as a whole by giving the newly consolidated parties a stake in its future.

5.1 The United States

The United States was born an electoral democracy. At the time of the American Revolution, both the number of offices chosen by election and the proportion of the population that could vote were already high by world standards, and they would quickly grow higher, so that by the middle of the nineteenth century, most legislative and executive offices and, in many states, judgeships were chosen in competitive elections in which all adult (white) males could vote.[21] At the same time, politics was becoming increasingly factionalized. Given the republican and revolutionary antipathy toward parties, it was not surprising that Americans

---

[20] Impersonal rules for forming parties allowed anyone to do so and, as a result, the absolute number of parties did not necessarily decline, but the number of major parties with reasonable expectations of winning elections, or of being in a governing coalition in proportional representation systems, declined significantly.

[21] Alexander Keyssar, *The Right to Vote: The Contested History of Democracy in the United States* (New York: Basic Books, 2000); Stanley L. Engerman and Kenneth L. Sokoloff, "The Evolution of Suffrage Institutions in the New World," *Journal of Economic History* 65 (Dec. 2005), 891-921.

initially believed they could do without them, but by the end of the 1790s, even staunch anti-party republicans like James Madison were actively organizing parties. Although textbook histories project our modern two-party system back on this early period, what they call parties were in fact little more than shifting coalitions of factions. And there were lots of them. At the height of the so-called second party system, in New York alone Democrats were divided into Barnburners, Hunkers, Hard-Shells, Soft-Shells, Free Soilers, Young Americans, Locfocos, and so on.[22]

As a quick glance at any legislative record from the founding era will reveal, identity rules played an important role in politics from the beginning, and their importance only rose as the franchise expanded and a growing number of factions competed vigorously for power, actively using the legislative process to do so. On the order of 80 to 90 percent of the bills enacted by state legislatures were identity rules. That is, they benefitted specific individuals, groups, organizations, or localities, granting them pensions, divorces, corporate charters, taxing privileges, and the like. And the volume of these bills mounted steadily. Between 1830-31 and 1850-51, the number of pages of laws enacted by state legislatures nearly doubled, increasing from 12.6 thousand in 1830-31 to 21.3 thousand in 1850-51. To give a few examples, in New York they increased from 972 to 1,968, in Pennsylvania from 1,162 to 2,022, in Illinois from 218 to 534, in Kentucky from 468 to 2,086.[23] The privileges that legislatures awarded to political

[22] Jack Furniss, "Devolved Democracy: Federalism and the Party Politics of the Late Antebellum North, *Journal of the Civil War Era* 9 (Dec. 2019): 546-568. For a trenchant critique idea that there were modern political parties in this period, see Erik B. Alexander and Rachel A. Shelden, "Dismantling the Party System: Party Fluidity and the Mechanisms of Nineteenth-Century U.S. Politics," *Journal of American History*, forthcoming.
[23] Robert M. Ireland, "The Problem of Local, Private, and Special Legislation in the Nineteenth-Century United States," *American Journal of Legal History* 46 (July 2004): 271-299; Lamoreaux and Wallis, "Economic Crisis"; and Lamoreaux and Wallis, "General Laws and the Emergence of Durable Political Parties: The Case of Pennsylvania," unpublished working paper. The

allies through these bills provoked outrage. Factions that were out of power promised to root out this kind of corruption if they were elected, but they never did and instead made similar use of legislative favors whenever they were in power.

In the 1840s, however, a major crisis in public finance in which eight states and one territory defaulted on their bonded debt jumpstarted the process of change. The crisis was a direct result of the system of private bills. In Indiana, for example, advocates of a canal across the middle of the state had loaded up their public works bill with lots of little projects to secure the political support needed for passage. These sweeteners raised the aggregate cost of the project and the amount the state had to borrow to finance it. When the bank that Indiana used to market its bonds defaulted on its obligations, so did the state, and the resulting political earthquake propelled it to revise its constitution to prevent such catastrophes from recurring.[24] Among the top priorities of the delegates who assembled at the constitutional convention was to ban private and local legislation, and they delivered on that priority. The 1851 Indiana constitution prohibited the legislature from passing private or local bills in seventeen enumerated situations, banned special charters of incorporation, mandated incorporation only by general laws, and, most significantly, required the legislature to enact general laws in all situations where general laws were possible. The change had a dramatic effect on what the legislature did. Instead of passing hundreds of laws in each session granting favors to specific individuals, groups, and localities, it concentrated on enacting a much smaller number of general laws that set

---

number of pages of bills enacted by state legislatures comes from the state session laws as listed on Heinonline, https://heinonline.org/HOL/Index?index=sslusstate&collection=ssl.

[24] Indiana had sold roughly $5 million in state bonds to the Morris Canal and Banking company on credit. The bank was to pay the state $500,000 every six months until all the bonds had been paid for, but the bank defaulted in the summer of 1839. For details, see John Joseph Wallis, “The Property Tax as a Coordinating Device: Financing Indiana’s Mammoth Internal Improvement System, 1835-1842,” *Explorations in Economic History* 40 (July 2003): 223-250.

the terms on which these privileges would be open to all. The number of laws enacted in each session fell from a range of 300 to 550 in the decade before the constitutional revision to around 150 in its aftermath. At the same time the percentage of the laws that were general rose from about 10 percent of the total in the 1840s to half to two-thirds in subsequent decades.[25]

Few of the other states that defaulted in the early 1840s initially went as far as Indiana in mandating that all laws be general, though most revised their constitutions to prohibit special charters of corporations.[26] That reform was important for the capitalist development of the economy, but it was not in itself enough to bring about the new institutional equilibrium. There was, however, another wave of constitutional revisions in the 1870s in which most of the remaining states in the union adopted Indiana's comprehensive provision or something very similar. In addition, almost all the new states that joined the United States in the second half of the century included general law mandates in their first constitutions. There were a few exceptions (mainly in New England), but by 1900 impersonal rule provisions were pervasive in the United States.[27]

Factionalized political systems are always unstable, but worries about instability seem to have reached a peak in the aftermath in the 1870s, when a resurgent South was endangering the achievements of what had been an extraordinarily bloody civil war and even threatening renewed

---

[25] Lamoreaux and Wallis, "Economic Crisis."

[26] Many also prohibited their legislature from granting divorces and the privilege of running lotteries.

[27] Lamoreaux and Wallis, "Economic Crisis." The general law mandates in these constitutions changed the norms for how legislatures should operate and affected practice in the few states that did not add general law provisions to their constitutions. There was no federal constitutional amendment mandating that laws be general and uniform, but Congress eventually codified the new norms in 1946 in the Administrative Procedures and Legislative Reorganization Acts. See Maggie McKinley, "Petitioning and the Making of the Administrative State," *Yale Law Journal* 127 (Apr. 2018): 1538-1637.

conflict. In a broad swath of states stretching from the Middle Atlantic to the Middle West, the dominant Republic Party found itself facing rising competition from Democrats sympathetic to the South and, at the same time, internal divisions so serious as to hobble its ability to respond to this threat. We have studied the turmoil in Pennsylvania and found that, by the late 1860s, Republicans of all stripes were espousing the idea that private and local bills had to be abolished—that they were fueling the factionalism that threatened their organization with collapse. Concluding that the only way to save the party was to follow Indiana's example (Indiana's Republicans were noticeably less divided), they spearheaded a move to call a constitutional convention for the sole purpose of adding a general law mandate to the state's fundamental law. Their effort to revise the constitution was successful in 1873, and they were able to use the reform to repress factionalism. Not only did they change how the legislature conducted its business, but the Republican party was able to consolidate its organization and dominate the state's politics for decades to come.[28]

Something similar occurred in other states that revised their constitutions during this period, though sometimes it was the Democrats who benefited rather than the Republicans. In almost every case the reform led to a dramatic fall in the volume of laws, as legislatures devoted their time to enacting statutes that were general and uniform in their application across the state.[29] There were, of course, fewer of these statutes than the private and local bills that were now forbidden. Because general laws were broad in their effects, it was much more difficult to put together the majorities needed to pass them. Log rolling was still possible, but because all

[28] Lamoreaux and Wallis, "General Laws and the Emergence of Durable Political Parties."
[29] Lamoreaux and Wallis, "General Laws and the Emergence of Durable Political Parties." On the emergence of dominant political parties in most states, see Shigeo Hirano and James M. Snyder, Jr., *Primary Elections in the United States* (New York: Cambridge University Press, 2019), Ch. 2.

the bills in a legislative package had to be general, the added measures were as likely to add as to reduce controversy. The key to cutting this gordian knot were the consolidated political parties that the ban on private bills made possible. Thanks to their longer time horizons, they could work out arrangements with legislative partners that would play out over the long run.

The longer time horizons of these parties also enabled them to develop programmatic identities that they could use to attract voters at the polls. Those identities in turn drew the support of interest groups formed to advocate for laws consistent with the parties' image.[30] Interest groups were another important new organizational element that maintained the political system. They were both called into being by the shift to general laws and empowered by organizational tools (like the corporate form) that general laws made available to them. Although there was always the danger that political leaders would backslide and resort to identity rules, there was now an array of forces that would mobilize against it, ranging from competitors who did not want a rival to gain unfair advantage to interest groups dedicated to upholding whatever was the general policy.[31] Moreover, the consolidated parties themselves had an interest in preserving the new system. Not only were they fearful of reviving the factionalism that they had worked so hard to overcome, but they knew it was likely they would lose some elections and wanted to make sure they had a chance to regain power. Any move they made to reinstate identity rules could be used against them at some later date.

[30] Lamoreaux and Wallis, "General Laws and the Emergence of Durable Political Parties." For a related argument, see Kuo's discussion of the shift from clientelist to programmatic political parties in *Clientelism, Capitalism, and Democracy*.
[31] What the policy was depended on the relative power of the contending interest groups, which varied across states. For an example, see Naomi R. Lamoreaux, "Antimonopoly and State Regulation of Corporations in the Gilded Age and Progressive Era," in *Antimonopoly and American Democracy*, eds. Daniel A. Crane and William J. Novak (New York: Oxford University Press, 2023), 119-167.

5.2 Great Britain

In the early part of the nineteenth century, Parliament's main business, like that of the US states, was the enactment of private and local bills. Indeed, the states had inherited this practice, along with other British institutions, from their colonizer. Over the course of the century Parliament gradually curbed the passage of such special bills. The restrictions were not constitutionalized as in the case of the US, or even explicitly formulated as a guiding legislative principle, but the change was nonetheless momentous and permanent. And it had similarly transformative effects on the economic and political systems, making the former more competitive and the latter more stable. By the late nineteenth century, the factionalized politics of the mid-nineteenth century had largely disappeared, and the political system was dominated by two major consolidated parties, the Conservatives and the Liberals.[32]

Although the transformation and its outcomes were similar in the two countries, the processes by which they occurred were very different, as was the timing of the change in relationship to democratization. The franchise expanded much more slowly in Britain than in the United States. Although a major reform bill enacted in 1832 fundamentally changed the electoral landscape by reallocating parliamentary representation to better reflect the distribution of population, it only marginally increased the franchise. A second reform bill in 1867 made

---

[32] See Julian Hoppit, *Britain's Political Economies: Parliament and Economic Life, 1660-1800* (Cambridge, Eng.: Cambridge University Press, 2017); Ramsay Muir, *How Britain Is Governed: A Critical Analysis of Modern Developments in the British System of Government* (3rd Rev. Edn.; Boston: Houghton Mifflin, 1935), Ch. 6. It is important to be aware that the word "public" was not synonymous with general in legislative records from the early nineteenth century. In the US, state legislatures often published two volumes a year—one for private laws and one for public laws, but most of the laws in the public volume nonetheless applied only to specific individuals, groups, or localities. In Britain private laws were those that originated in a petition from an external party, who often paid fees to secure passage; public laws were introduced by members. Again, most of the public laws targeted specific individuals, groups, or localities.

further improvements along the same lines, but as late as 1880, only about a third of the adult male population was eligible to vote. That proportion doubled after a reform bill enacted in 1884, but universal male (and then female) suffrage awaited the First World War.[33] Moreover, although it was generally the case that the party that won the most seats in Parliament controlled the government, that principle was sometimes contested. It became more firmly established over the course of the century, alongside the shift to impersonal rules.[34]

One effect of the 1832 reform bill was to increase the power of the business elite in Parliament at the expense of the gentry. Businesses had been chafing under the monopolistic privileges granted to a few "monied" corporations, such as the East India Company and the Bank of England, and they had long pushed Parliament to strip those enterprises of their monopolies.[35] They were eventually successful, but securing a corporate charter still required a special act of Parliament, which was very difficult to get. Although businesses often tried to operate as corporations without securing charters, this strategy potentially ensnared them in legal difficulties. Their growing clout in Parliament paid off, however, and they secured legislation that made the corporate form available by a simple registration process—without limited liability

---

[33] Peter Flora, et al., *State, Economy, and Society in Western Europe, 1815-1975: A Data Handbook, Vol. 1, The Growth of Mass Democracies and Welfare States* (Chicago: St. James Press, 1983), 91-93, 148-151.

[34] Kuo, *Clientelism, Capitalism, and Democracy*, 94-95; Gary W. Cox, *The Efficient Secret: The Cabinet and the Development of Political Parties in Victorian England* (New York: Cambridge University Press, 1987), 10.

[35] Dan Bogart, "The East Indian Monopoly and the Transition from Limited Access in England, 1600-1813," in Organizations, Civil Society, and the Roots of Development, eds. Naomi R. Lamoreaux and John Joseph Wallis (Chicago: University of Chicago Press, 2017), 23-49; J. Lawrence Broz and Richard S. Grossman, "Paying for Privilege: The Political Economy of Bank of England Charters, 1694-1844," *Explorations in Economic History* 41 (Jan. 2004): 48-72; James R. Fichter, *So Great a Proffit: How the East Indies Trade Transformed Anglo-American Capitalism* (Cambridge, MA: Harvard University Press, 2010); Naomi R. Lamoreaux, "Corporate Governance and the Expansion of the Democratic Franchise: Beyond Cross-Country Regressions," *Scandinavian Economic History Review* 64 (issue 2, 2016): 103-121.

in 1844 and with limited liability in 1856. These measures freed large sectors of industry from government controls on entry, permitting capitalist enterprise to flourish there.[36]

Identity rules still prevailed in other areas of economic and political life, however. Indeed, the effect of the 1832 reform bill, much like the expansion of the franchise in the US, was to increase the competitiveness of elections for Parliament and thus the incentives for members of Parliament (MPs) to use their office to distribute favors to constituents. MPs flooded Parliament with private bills granting constituents charters for local railroads, utilities, and the like. Control of the government seesawed between the two most important parties, the Liberals and the Conservatives, but neither organization was able to exert much discipline over its members. The period is known as the golden age of the back benchers, because individual MPs concentrated on bolstering their local bases of support and mainly voted for whatever they thought was in the interests of their district and their own reelection. After Sir Robert Peel pushed a bill repealing the corn laws through Parliament in 1846, the Conservative Party split so seriously that it faced the possibility of extinction, much like the Republicans in Pennsylvania in the years following the Civil War.[37]

By the mid-1840s, the flood of private bills was threatening MPs' ability to deliver favors to their constitutions in a timely way. In the case of railways alone, the number of bills presented for consideration jumped from about 150 per session in the late 1830s to more than 600 in 1846.

---

[36] Mark Freeman, Robin Pearson, and James Taylor, *Shareholder Democracies? Corporate Governance in Britain and Ireland before 1850* (Chicago: University of Chicago Press, 2012); Ron Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720-1844* (Cambridge, Eng.: Cambridge University Press, 2000); Timothy W. Guinnane, Ron Harris, and Naomi R. Lamoreaux, "Contractual Freedom and Corporate Governance in Britain in the Late Nineteenth and Early Twentieth Centuries," *Business History Review* 91 (Summer 2017), 227-277.

[37] Kuo, *Clientelism, Capitalism, and Democracy*, Ch. 4; Cox, *Efficient Secret*.

A series of Parliamentary committees had considered the problem, and a consensus had developed over the course of the 1830s that the solution was to enact a series of "clauses consolidation acts" to standardize the content of the private bills enacted for specified purposes. Over a short two-year period from 1845-1847, Parliament enacted many such acts: for railroads, waterworks, gasworks, companies, harbors, docks and piers, markets and fairs, cemeteries, police, and a variety of other areas in which private legislation was common. The clauses consolidation acts did not prevent MPs from doing favors for their constituents; to the contrary, they made the system of private bills more efficient. But the acts nonetheless moved the country toward impersonal rules by insuring, for example, that all railroads would operate under the same set of regulations. It was no longer easy, and perhaps not even possible, for businesses to secure especially favorable charter provisions with the help of their MPs. They could benefit from their aid in securing a charter, but the charter would be the same as everyone else's.[38]

The same press of business forced Parliament to grapple with the problem of dividing floor time between bills proposed by ministry, which was usually controlled by the party that won the most seats in Parliament, and bills introduced by rank-and-file members. Procedures worked out early in the nineteenth century allocated different kinds of business to different days of the week, which in practice came to mean that the government controlled the agenda a couple of days each week while two other days were devoted to members' business. Because members' bills were usually not of interest to anyone but the members involved, sessions on those days

---

[38] O. Cyprian Williams, *The Historical Development of Private Bill Procedure and Standing Orders in the House of Commons* (London: His Majesty's Stationary Office, 1948), Vol. 1; Sir Ivor Jennings, *Parliament* (2nd edn.; Cambridge, Eng.: Cambridge University Press, 1969), 463; James Foreman-Peck and Leslie Hannah, "UK Corporate Law and Corporate Governance before 1914: A Re-Interpretation," in *Complexity and Crisis in the Financial System: Critical Perspectives on the Evolution of American and British Banking*, Matthew Hollow, Folarin Akinbami, and Ranald Michie, eds. (Cheltenham, Eng.: Edward Elgar, 2016).

were increasingly poorly attended, and the ministry often encroached on them. The process was a gradual one, but by the end of the century MPs' access to the agenda became limited to twenty Fridays a year, and sometimes not even that.[39] Although the encroachments were not uncontested, the gradualness with which they occurred mitigated conflict and facilitated the reorganization of the political system. The factionalism of mid-century gave way two major consolidated parties, the Conservatives and the Liberals, each with its own programmatic identities. With their ability to dispense favors to constituents curbed, MPs were increasingly beholden to the central party organization for the resources they needed to secure reelection. And the voters they courted cared less about them as individuals than they did the ideas and programs that their party stood for. MPs' fate and that of their party were now tied.[40]

By 1900 private bills had almost completely disappeared from Parliament's record, and Britain had transformed itself into a society governed largely by impersonal rules without ever formally requiring it. And yet the result was as durable as the constitutional shift to general laws mandated by most the US states. It was durable for the same reason as the constitutional provisions were—because it transformed the economic and political institutions of society in ways that reinforced the new regime. In particular, the consolidation of the political system around two major political parties created organizations with an ongoing interest in preserving the regime of impersonal rules—of making sure that when the lost an election in the future, they would not also lose the chance to regain power.

[39] Jennings, *Parliament*, esp. Chs. XI and XIII; Ramsay Muir, *How Britain is Governed: A Critical Analysis of Modern Developments in the British System of Government* (Boston: Houghton Mifflin, 1935), Ch. VI.
[40] See especially Cox, *Efficient Secret*, Ch. 6.

5.3 Germany

The comparative cases of the US and UK highlight the divergent paths that even societies that shared a common legal tradition might follow as they negotiated the transition from identity to impersonal rules. In the mid-nineteenth century, both the US and UK enacted general laws that gave businesses ready access to the corporate form, and they both later expanded the scope of such impersonal rules to include most areas of law. This expansion occurred in very different ways in the two countries (and even in the various US states), but it was what made it possible for these nations to become advanced capitalist democracies. As a comparison with the case of Germany shows, merely opening access to the corporate form was not enough to bring about the political changes needed for this transformation. Germany adopted impersonal rules for forming business corporations circa 1870, but the rules did not spread into other areas of the law, and Germany's electoral democracy remained factionalized until it collapsed with the rise of Adolf Hitler and the formation of the Third Reich.

Until the late nineteenth century, businesses in the various German states needed the permission of their governments to form corporations. This system began to break down as some of the states competed to attract business investment by granting corporate charters more liberally than others, and it collapsed after 1861 when most of the states adopted a common code of business law that permitted them to enact general incorporation laws if they chose. Prussia's North German Confederation enacted a general incorporation statute in 1870, which became Reich law with the unification of Germany in 1871.[41] This liberalization did not, however, carry over to other kinds of organizations, or more generally into the legal system. Indeed, until the

[41] Timothy Guinnane, Ron Harris, Naomi R. Lamoreaux, and Jean-Laurent Rosenthal, "Putting the Corporation in its Place," *Enterprise and Society* 8 (Sept. 2007): 687-729 at 697.

turn of the century German law severely restricted residents' right to associate without explicit permission. Just holding a meeting without authorization could result in criminal penalties.[42] The dangers were very real—so much so even purely economic organizations like credit cooperatives feared harassment and clamored for the extension of organizational rights to their associations.[43] The move toward impersonal rules that general incorporation represented, moreover, was undermined by other actions the government took to legalize cartels. Germany allowed businesses to form corporations at will, but it also allowed associations of corporations to reach intra-elite agreements that the state would enforce. The cartels were essentially bundles of identity rules that enabled businesses included in the arrangements to earn rents. They could effectively limit entry in their industries, and many did. By the time the Nazis came to power in the 1930s, large swaths of the German economy had been effectively monopolized with the approval and assistance of the state.[44]

In the period following unification, Germany took steps toward democratization, and the franchise expanded to include most adult males. Although the country's chancellor was not chosen democratically, and voting was weighted to give the wealthiest property owners significant advantages, turnout for elections to the Reichstag was high.[45] But the political system

---

[42] Timothy W. Guinnane and Richard Brooks, "The Right to Associate and the Rights of Associations: Civil-Society Organizations in Prussia, 1794-1908," in *Organizations, Civil Society and the Roots of Development*, eds Lamoreaux and Wallis, 291-329.

[43] Timothy W. Guinnane, "New Law for New Enterprises: Cooperative Law in Germany, 1867-1889," *Jahrbuch für Wirtschaftsgeschichte* 61 (issue 2, 2020): 377-401.

[44] For histories of German cartels, see Steven B. Webb, "Tariffs, Cartels, Technology, and Growth in the German Steel Industry, 1879 to 1914," *Journal of Economic History* 40 (June 1980), 309-330; and Daniel A. Crane, "Fascism and Monopoly," *Michigan Law Review* 118 (May 2020): 1315-1370.

[45] Flora, et al., State, Economy and Society, Vol. 1, 112-120; Shari E. Berman, "Modernization in Historical Perspective: The Case of Imperial Germany," *World Politics* 53 (April 2001), 431-462. See also Margaret Lavinia Anderson, *Practicing Democracy: Elections and Political Culture in Imperial Germany* (Princeton, NJ: Princeton University Press, 2000).

remained factionalized and became steadily more so over time as the number of parties proliferated. By the 1890s the conservative bloc that had supported Chancellor Otto von Bismarck—itself composed of three of the larger parties—no longer commanded even a third of the seats in the Reichstag.[46] As Daniel Ziblatt has shown, the government was forced to rely for its majorities on deals with local elites who dominated their areas through a combination of patron-client favoritism and outright repression and fraud. In exchange for their support, the central government showered the local leaders with infrastructure spending and other benefits.[47]

In Germany, as in other countries where elites continued to organize themselves using identity rules, consolidated political parties failed to emerge. Instead, as factions continued to proliferate and to combine and recombine in shifting coalitions, the political system showed increasing signs of instability. Rumors of coups and threats of uprising periodically swept the country from the late nineteenth century on. Sometimes they were more than threats, and in the 1930s, the Nazis took over.

6. Capitalism and Democracy

We have written more about democracy in this paper than about capitalism. In large measure this is because we have defined capitalism in a way that makes it dependent on the achievement of impersonal rules. But it is also because this achievement was part and parcel of

---

[46] Berman, "Modernization in Historical Perspective," 446-449. Berman has argued that relaxation of restrictions on associational life in the twentieth century further contributed to this fragmentation. See Sheri Berman, "Civil Society and the Collapse of the Weimar Republic," *World Politics* 49 (April 1997): 401-429.

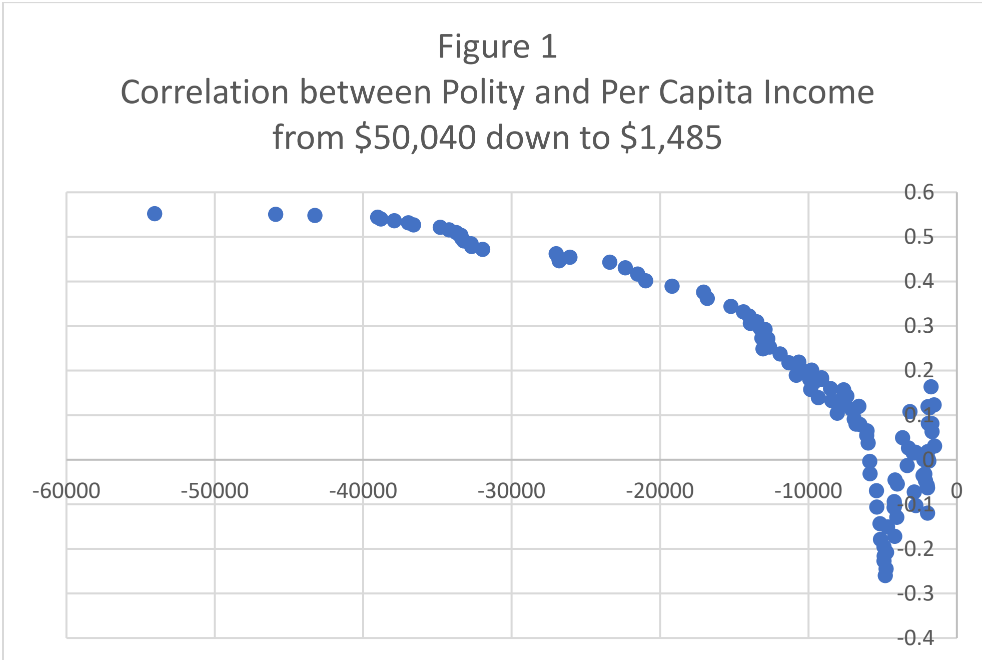
[47] Ziblatt calls these local leaders caciques to connect the German pattern with similar factionalism in Spain, Portugal, Italy, and France in the same period and also in Latin America. See Daniel Ziblatt, *Conservative Parties and the Birth of Democracy* (New York: Cambridge University Press, 2017), esp. Ch. 6.

the development of a new kind of political system that we call advanced democracy. Most political systems cannot deliver the impersonal rules that enable capitalism to thrive. In most systems political elites use identity rules to achieve short-run political stability; they deliberately manipulate the economy to create rents that they can allocate among themselves to keep the peace. And so economic development in most of the countries in the world today and throughout human history has been handicapped. Peace is essential for human welfare, and political stability is necessary to achieving peace. But if political stability can only be achieved by manipulating the economy, then while maintaining peace may be worth the cost in the short run, in the long run neither peace nor political stability is likely to last.

Introducing democratic elections in such societies is not a solution that provides peace or stability. Indeed, as we have argued in this paper, its immediate effect is usually to worsen problems of factionalism and increase the resort to identity rules and the economic distortions they entail. In such societies, therefore, the answer to the question of whether capitalism and democracy are reconcilable must sadly be no. Capitalism cannot thrive in polities where the pressure to hold factions together leads to economic manipulation—where some elites gain access to profitable opportunities that are closed to everyone else. But neither are these polities likely to remain democracies. Prone to instability, their fate is often to slide back into autocracy.

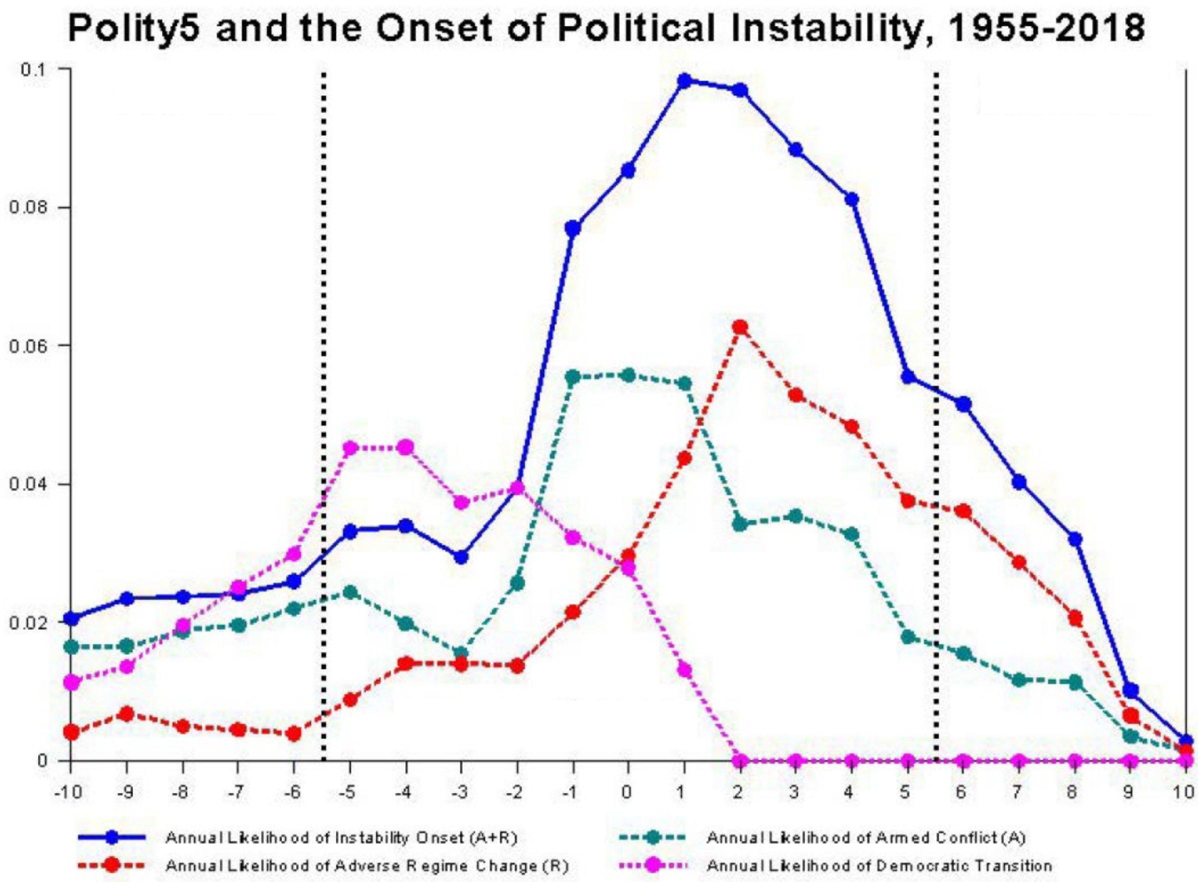
Everything changes, however, in societies where the rules are impersonal. There the answer to the question of whether capitalism and democracy are reconcilable is a resounding yes. Capitalism thrives where opportunities that are open to some become open to all. Democracy thrives as well where factions give way to consolidated political parties whose longer time horizons give them a stake in the long-run stability of the political system. Getting from one equilibrium to the other is not easy, however. Only a relatively small number of countries have managed it—the rich advanced capitalist democracies of today. Moreover, they have made the transition in such different ways that their histories do not offer any clear lessons that other countries can follow. We can say two things, however, about the two countries we have studied that successfully negotiated the transition—the United States and Britain. First, for idiosyncratic reasons, elites in these places responded to the increased instability associated with early democratization by making changes that they perceived to be in their interests but that had the effect of increasing the impersonality of the rules under which the society operated—usually first in economic realm and then more broadly. We can also say that once these changes were in place, they had effects that were not idiosyncratic but common across all the countries that adopted impersonal rules. These effects changed the operation of the political system in ways that made the new impersonal rules a sustainable political outcome.

Advanced democracies are societies in which open debate about the rules is an inherent part of the political process. One of the inevitable dimensions of debate is how "capitalistic" the rules should be—how promotional versus how redistributive. What can easily be missed in all the heat generated by these discussions is that capitalism does not require low taxes, a small government, or rules that benefit the wealthy. Identity rules that privilege some individuals and organizations over others are inimical to capitalism. Capitalism requires agreed upon rules that apply equally to everyone in the relevant categories. That is the kind of equality that matters to economic development, and it matters to political development as well. Democracy and capitalism are both threatened by identity rules. In that way, they are inextricably bound up with each other, and we are more likely to keep both if we better understand this relationship.



Note: The figure reports the correlation coefficient between real per capita income and the Polity IV/V score for 142 countries in 2000. Each point in the figure represents the coefficient for a different sample. The first point on the left is the coefficient for the entire sample from Norway to Afghanistan, excluding the specialized oil producers. Each point to the right drops the richest country from the sample. The last point is the correlation coefficient for the poorest 27 countries from Bangladesh to Afghanistan. The horizontal axis has negative numbers to get the figure to show declining income, which needs to be fixed.

Figure 2. The Relationship between Democratization and Political Instability



Note: This figure is taken directly from the Polity website. We will provide our own figure in the final draft. The vertical axis measures the likelihood that an unstable event will occur in a given year. The horizontal axis measures the country's Polity IV/V Score.

Table 1. The Eighteen Advanced Capitalist Democracies in 2022

United Kingdom
United States
Canada
Australia
New Zealand
Finland
Sweden
Norway
Denmark
Netherlands
Belgium
France
Switzerland
Germany
Austria
Italy
Spain
Portugal

Table 2: Real Income Per Capita in 1990 Geary-Khamis $ for different samples from the Maddison data, Ranks of the poorest country in the samples for 16 or 18 countries in the overall sample, and Polity Scores.

	Year	1820	1850	1870	1890	1910	1940	1950	1990	2000	2008
(1)	Count	54	28	63	37	39	47	139	163	163	163
(2)	Average Real Per Capita Income Weighted by Population Maddison	$666		$870			$1,958	$2,111	$5,150	$6,038	$7,614
(3)	Average PCY All Countries	$739	$1,216	$1,131	$1,862	$2,403	$3,037	$2,470	$ 5,519	$6,345	$8,153
(4)	Average PCY 16	$1,078	$1,561	$2,137	$2,764	$3,679	$5,122	$6,241	$17,729	$21,373	$24,158
(5)	Average PCY 18	$1,066	$1,498	$2,021	$2,610	$3,443	$4,758	$5,785	$17,030	$20,633	$23,371
(6)	PCY Countries Not in 16	$160	$64	$261	$174	$245	$428	$1,167	$ 4,070	$4,559	$6,204
(7)	PCY 16/PCY All Row (4)/Row (3)	1.5	1.3	1.9	1.5	1.5	1.7	2.5	3.2	3.4	3.0
(8)	PCY 16/PCY Not 16 Row (4)/Row (6)	6.8	24.4	8.2	15.9	15.0	12.0	5.3	4.4	4.7	3.9
	Overall Rank of the Poorest Country in sample of 16 or 18 countries										
(9)	Poorest country in 16	16/18	16/20	16/22	16/22	16/22	16/20	16/24	16/20	16/21	16/26
(10)	Poorest country in 18	18/20	18/20	18/24	18/27	18/28	18/33	18/45	18/25	18/26	18/35
(11)	Poorest country in 16 Excluding Oil and Small	16/18	16/20	16/22	16/22	16/22	16/20	16/20	16/20	16/21	16/24

	no small									
(12)	Polity Score	-4.5	-1.2	2.9	6.7	3.5	7.6	9.9	9.8*	9.8

Notes:

All dollar figures in 1990 Geary-Khamis international dollars
Row (2) is the average real per capita income in the entire sample weighted by population, reported by Maddison
Row (3) is the unweighted average incomes calculated by us. Row (4) and (5) are the average incomes for the sample of 16 and 18 countries.
Row (6) is the unweighted average of all the countries not in the sample of 16 countries.
Row (11) excludes
* 2000 Polity Score needs to be recalculated

Table 3. Polity IV/V Scores for 18 High-Income Countries, 1820-2008

Year	1820	1850	1890	1910	1940	1950	1990	2008
United Kingdom	-2	3	7	8	10	10	10	8
United States	6	9	9	9	9	9	10	10
Canada	--	--	9	9	10	10	10	10
Australia	--	--	--	10	10	10	10	10
New Zealand	--	--	10	10	10	10	10	10
Finland	--	--	--	--	4	10	10	10
Sweden	-8	-7	-4	T	10	10	10	10
Norway	-7	-7	-2	10	G	10	10	10
Denmark	-10	1	-3	T	G	10	10	10
Netherlands	-6	-3	-2	10	10	10	10	10
Belgium	--	-4	4	6	6	8	9	8
France	-1	6	8	8	10	8	10	10
Switzerland	--	10	10	10	10	10	10	10
Spain	-4	-5	5	6	-7	-7	9	10
Portugal	-2	-4	-4	7	-9	-9	10	10
Germany	-10	-8	1	2	-9	T	10	10
Austria	-6	-6	-4	-4	-9	10	10	10
Italy	--	--	--	-1	-9	10	10	10
Average	-4.5	-1.2	2.9	6.7	3.5	7.6	9.9	9.8
English Speaking	2.0	6.0	8.8	9.2	9.8	9.8	10.0	9.6
Nordic	-8.3	-4.3	-3.0	10.0	7.0	10.0	10.0	10.0
NW Europe	-3.5	2.3	5.0	8.5	9.0	9.0	9.8	9.5
Germany & Southern	-5.5	-5.8	-0.5	2.0	-8.6	1.0	9.8	10.0

Note:

"—": no data

"T": political system in transition, no Polity Score.

"G": occupied by Germany, no Polity Score.

Table 4
Correlations between Per Capita Income and Polity IV/V Scores
Various subsamples, 2000 income

	Correlation Coefficient	p-value	Average Polity Score
	(1)	(2)	(3)
Whole Sample	0.33	0.0002	2.56
no oil	0.56	0	3.11
Top 25	-0.14	0.25	6.84
Top 25/no oil	0.27	0.1	9.80
Bottom 70	0.08	0.25	0.81
Top 70	0.14	0.12	5.62
no oil	0.48	0.00001	6.72

Notes:

Correlations are for 142 countries in 2000 for which we have both incomes from the Maddison data and scores from Polity. Average Polity scores are for each group included in the correlations. Top 25 is the richest countries, Top 25 is the richest countries after the oil exporters have been excluded. Bottom 70 is the 70 poorest countries; Top 70 is the richest 70 countries; Top 70 – no oil are the richest 70 countries after the oil exporters have been taken out of the sample.