Contemporary Capitalism

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PART I

THE VARIETY OF INSTITUTIONAL ARRANGEMENTS AND THEIR COMPLEMENTARITY IN MODERN ECONOMIES

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For many years, social scientists have had a division of labor in studying the key institutions constituting a modern economy. Political scientists have given privileged attention to power and have focused major attention on the state as the key institution for coordinating or coercing individual behavior. For them and for many other social scientists, the market was the basic coordinating mechanism of an economy and should be investigated by an economist. In the case of market failure, some public intervention was supposed to occur in order to restore the optimality of an equilibrium, and ideally this should be one of the functions of the state, along with the enforcement of property rights. This issue too drew the attention of political scientists. However, the concerns of political scientists and the economists were generally quite different. In contrast with both, many sociologists argued that the nature, role, and emergence of social norms was the starting point of any investigation about the viability of any political and/or economic system.

In recent years, however, social scientists have begun to challenge this division of labor (Coleman, 1991). First, a few theoreticians have applied rational choice axioms to some basic issues in political science, thus developing some of the same methods as have many economists. Other political scientists, using different theoretical tools and methods, have argued that variation in the mobilization of interest groups explains divergences in macroeconomic performances among industrialized countries (Hollingsworth and Hanneman, 1982). Clearly, economists no longer have a monopoly on the study of macroeconomic issues. Second, the discipline of economics in the Anglo-American world is no longer so preoccupied with the study of markets. Some economists now recognize that organizations such as firms are more efficient than contracts and markets, and that labor and credit markets behave differently from typical product markets of standardized manufactured goods, due to fairness issues or moral hazard (Coase, 1988). The challenge then is to understand the institutional forms that deliver viable, if not necessarily the best, economic performances. Third, a number of sociologists have investigated how such core social relations as family, religious, and ethnic ties contribute to the development of the most essential but volatile ingredient in market relationships: trust and cooperation (Granovetter, 1993; Hamilton and Kao, 1991; Hamilton, Orrù, and Biggart, 1987). Furthermore, the coexistence of alternative types of coordinating mechanisms in the same product market area has rejuvenated the old issue of industrial diversity and its persistence through time (Campbell, Hollingsworth, and Lindberg, 1991)

This concern with economic issues in most of the social sciences has implications for understanding changes in institutions that have been taking place during the last two decades. Has the nation-state been losing its autonomy as it confronts the forces of globalization? How is the social science community to explain the phenomenon that more market-oriented societies have frequently had less desirable economic performance in terms of growth, innovation, employment, and competitiveness than some less market-oriented societies? What is the rationale and significance of the surge in networking, joint ventures, and strategic alliances across the globe? More particularly, how is the social science community to interpret the shift

taking place in various institutional arrangements which coordinate relations among economic actors: Are they mainly governed by market selection – as some economic theory would suggest – or is this to be explained in sociological and political terms?

This section of this book attempts to shed light on these issues. Here, it is important to understand how various institutional arrangements are related to one another and their common principles, if any. Let us recall the basic typology proposed in Chapter 1: All institutional arrangements are classified in terms of how they relate to the pursuit of individual self-interest with the principle of coordination. The concerns of economics and sociology provide strategies for the study of a whole spectrum of actors who are driven either by the pursuit of individual self-interests or moral sentiments, and this delineates a first axis along which institutional arrangements can be analyzed. But institutions organize their interactions among individuals along a second axis which describes their behavior as taking place at a decentralized level according to horizontal relations among equals or, on the contrary, according to relations in which a principal has the power to structure the behavior of agents.

Consequently, the first and central message of the following chapters is clear: There is more than a single optimal institutional arrangement for organizing modern societies. Indeed, there is a large array of institutional arrangements for effectively organizing modern societies, depending on the larger environment in which economic activity is embedded and the problem to be solved. Thus, the market should not be considered as the ideal and universal institutional arrangement for coordinating economic activity in most circumstances. Numerous problems result when efforts are made to organize the world exclusively in terms of markets (e.g., the problem of public goods, spillover effects, uncertainty about quality, indivisibilities, etc.), and a confrontation with these problems usually requires some form of external intervention in order to restore a minimal efficiency. For example, professional associations or public authorities frequently have to devise, implement, and enforce new rules of the game. Thus markets are embedded in a nexus of obligational rules and/or public interventions, in the absence of which they could not properly function (see Chapter 2).

Thus, this book provides a complex vision about the economic institutions of capitalism: Not only do they exhibit a large variety of objectives and tools which are not at all minor variants of a single cardinal mechanism, but they complement one another and cannot generally operate in isolation from one another. The pursuit of individual self-interest in order not to be destructive requires a minimal set of obligations, i.e., an alternative institutional order. The same demonstration holds for private hierarchies, such as firms. From Adam Smith to Ronald Coase, scholars have learned that the division of labor within and among firms is linked to the size and the stability of the market. More recently, Alfred Chandler (1962, 1977, 1990) has provided considerable evidence about the importance of the relationship between the size and organizational structure of firms and the size of markets. In the 1980s and 1990s, firms have become increasingly interdependent. Firms seem less motivated to develop vertically integrated relationships, conglomerates, or holding companies but more concerned with pursuing strategic alliances and joint ventures for specific and delimited purposes. Thus the viability of private hierarchies increasingly depends on their ability to enter into such horizontal relations as networks, which blend self-interest and social obligation in order to deliver individual and collective outcomes that overcome some of the limits of private hierarchies (slow reaction to technical change) and of spot markets (the inability to internalize the spillover effects associated with innovation). This framework enlightens one of the most impressive transformations in contemporary manufacturing: When uncertainty is large and information is strategic, and if radical innovations are expected, networking and trust building with competitors and suppliers are preferred to both vertical integration and outsourcing (see Chapter 3).

The theory of public goods assumes that the function of the state is to overcome market failures. Public choice theorists warn that bureaucrats tend to use the power delegated to them to pursue their own interests and to make public interventions inefficient. However, the dichotomy between the market and the state is spurious, and the notion that all, or even most, public interventions are inefficient is very simplistic (Hollingsworth, Hage, and Hanneman, 1991). As Figure 1-2 in Chapter 1 reveals, the state consists of a variety of institutional arrangements – regulatory agencies, sponsoring departments, and legislative bodies, just to mention a few – and there is great variation in their goals, processes, and consequences. Moreover, there are important interdependencies between some forms of state intervention and associational governance. For example, the state delegates many of its functions to the regulation and monitoring of stock exchanges, occupations, and professions, etc. The way that government delegates its functions to private interest groups is a very important consideration in shaping economic performance (see Chapter 4).

The reappraisal of the role of polity, even in a highly internationalized world, is pushed a step further if one considers one major issue in the theory of economic institutions: How could individuals behave in conformity with any given institutional order, if they were perpetually pursuing their self-interest and disregarding social obligations, which are the cement of

any stable economic and social order? In a world devoid of any deliberative body, opportunism and defection would be the rule, cooperation the exception. Modern neoclassical theory asserts that only exit is available to individuals when they are unhappy with a system, whereas political economists suggest that voice is a necessary ingredient for the cohesiveness and viability of any institution. In this respect, the notion of a constitutional order can be usefully applied to a vast array of coordinating mechanisms, both of a public and private nature. Of course, modern states are governed by constitutions which reflect certain principles in order to solve possible conflicts among various objectives of governments and/or departments and public agencies. And the principle of deliberation and reflexive analysis about the malfunctioning of a system is an efficient means of searching for alternative rules of the game, when the previous ones fail to deliver expected or desired outcomes. The access of constituents to deliberations about the amendment or transformation of a constitutional order is necessary if there is to be the trust needed for the successful functioning of a social system. Even markets express a similar logic, since they too are embedded in a set of rules, which are not natural, but are derived from previous interactions and deliberations. Thus, private and public constitutional orders are worthwhile, especially when changes have to be engineered due to emerging internal disequilibria or a rapidly evolving environment (see Chapter 5).

In spite of their diversity, the chapters in Part I explore the same vast and challenging issues in the analysis of different institutional arrangements for coordinating economic activity. What are their logics and functions? Why do they emerge, mature, and persist? As a result of these chapters, several conclusions emerge:

- The old but pervasive dichotomy between states and markets has to be discarded, to be replaced by a broader array of institutional arrangements, which mix in varying degree the pursuit of individual self-interest and social obligation, relations among equals, and power asymmetries.
- Because each type of institutional arrangement simultaneously exhibits strengths and weaknesses, its performance and viability depends on the precise context and configuration of interests within which it is embedded. No single institution can pretend to have universal or eternal superiority – even such a celebrated institutional arrangement as the invisible hand of the market.
- In the real world, as distinct from abstract mathematical models, any economy consists of a combination of institutional arrangements, all of which complement one another and thus acquire some efficiency. No institutional configuration can simply be borrowed and implemented

in any given social setting. Institutional arrangements evolve according to a distinct logic in each society.

- Institutions are not static entities defined once for all, but they continuously respond to changing contexts and emerging structural crises. This is of special importance, given the present transformations occurring in social systems of production and the changing status of subnational regions, nation-states, and the world economy.

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