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Market Socialism as a Culture of Cooperation

Mieke Meurs

Introduction

> '[I] look forward to a state of society . . . different from that which now exists, in which the effort of all is to outwit, supplant, and snatch from each other; where interest is systematically opposed to duty; . . . and where the whole motley fabric is kept together by fear and blood. [I] look forward to a better state of society, where . . . restless and anxious competition shall give place to mutual co-operation . . . '
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> William Thompson to Anna Wheeler, 1825[1]

Socialism requires more than an allocative mechanism. It requires a culture, specifically a culture of cooperation and generalized reciprocity among diverse individuals and groups. More importantly, this culture is not something which can be added, perhaps optionally, once a feasible allocative mechanism has been defined and implemented. Recent game theoretic and institutionalist literature emphasizes that institutions (allocational and other) are themselves important determinants in the emergence of cooperative or individualist cultures. In turn, these cultures of cooperation or atomization will have a strong impact on the functioning of most allocative mechanisms, and therefore on economic performance.[2]

John Roemer's model offers an allocative mechanism which he suggests could serve as a basis for feasible socialism. The model is a significant advance over earlier market socialist models in that the author takes seriously the problem of motivating managers in the absence of concentrated ownership.

Much less attention is directed to the problem of guiding and monitoring the state, however. Roemer notes the importance of democratic elections which can serve to hold planners accountable for their actions. But no mechanisms are suggested to ensure that elections effectively promote accountability; nor does Roemer address how the

state will aggregate conflicting interests into an efficient program of guiding markets and correcting their failures.

Without adequate attention to these issues, the market socialist model is likely to be plagued by rent seeking and other allocational distortions. These, in turn, will prevent the model from achieving the desired equality in opportunities for self-realization and reduction in public bads.

Recent literature suggests that institutional forms, particularly those based on regular, participatory interaction among relative equals, may promote *cultures of cooperation*. These cultures, in turn, may facilitate the resolution of conflicting interests and reduce collective action problems in monitoring the state. Cultures of cooperation have also been shown to mitigate other forms of market failure unrelated to state intervention.

The allocational institutions which Roemer has proposed to promote efficiency in the economy are likely to undermine the development of such cultures, however. The economic mechanisms, as designed, are more likely to create a culture of atomization than one of cooperation. This culture of atomization is likely to generate behavior inimical to the development of institutions which can effectively aggregate citizen interests and promote efficient monitoring of the state.

Rent seeking and atomization are, of course, also characteristics of capitalism, and their persistence might not reduce economic performance of Roemer's model below levels achieved by capitalism. I will argue, however, that in addition to perpetuating inequality of opportunity and excessive production of public bads, these characteristics reduce the performance of Roemer's model below that of another feasible alternative: one which actively develops the beneficial cultures of cooperation.

While recent research suggests that cultures of cooperation can contribute to economic performance, the evidence also indicates that the development of such cultures may itself be highly problematic. Their development will depend greatly on previously existing socio-historical conditions. The complexity of developing monitoring institutions compatible with market socialist goals undermines Roemer's claim that the market socialist model offers more general feasibility than social democracy. In addition, it implies that expectations of the market socialist model's applicability to the transforming, former centrally planned economies (CPEs) are misplaced.

The Market Socialist State

In his treatment of the state, Roemer adds little to earlier models of market socialism. Although Roemer mentions the possibility that rent seekers may bias state policy, state behavior remains seriously under-theorized. Planners are meant to smooth market failures and implement social welfare policy. At least two kinds of monitoring problems may arise in this process: the state may fail to implement the democratically chosen maximand or to do so efficiently; or the state may fail to disaggregate the maximand in a manner which promotes both economic efficiency and equality of opportunity. Nothing is said, however, about what kind of institutions might address these problems.

Historical experience suggests that planners may, in fact, use their power to promote their own interests, making monitoring essential. Moreover, theoretical work on the problem of monitoring firm managers indicates that periodic elections are unlikely to provide a satisfactory mechanism for monitoring. In the absence of large individual shareholders, collective action is needed for effective monitoring of firm management.

At the level of the state, large 'share holders' are precluded in democratic systems based on the principle of one person one vote. Collective action is thus necessary to assure effective monitoring of the state. Unfortunately, the individual returns to monitoring the state (change in profit income/population) are likely to be small compared with the organizing costs any one individual will bear, since non-participating individuals cannot be excluded from benefits of improved state performance. Free-rider problems among the atomized electorate will result in an underprovision of monitoring, unless countervailing mechanisms exist.

A second set of problems arise from the fact that the relationship between citizens and planners is much more complex than between managers and shareholders. Rather than implementing a unique maximand, such as maximizing returns, planners will be expected to protect a wide variety of citizen interests about which the citizens will disagree.

Disagreements stem from differences in preferences, but also from the continued possibility of concentrating the benefits (or costs) of planners' decisions, while costs (or benefits) are dispersed. Concentration by class will be eliminated, but other forms of concentration will persist, including concentration in relatively well-defined subsets of the population, such as those based on ethnicity, gender,

and place of employment or residence. Preferential interest rates in a particular industry, for example, will provide income benefits concentrated on workers and managers in the industry, whereas the reduction in investment that this implies for each of the other industries will be small. Thus while inadequate incentives are generated for monitoring in general, incentives will exist for certain social groups to seek rents due to concentration of benefits among well-defined groups.

In addition to affecting income distribution and capital allocation, this rent seeking may perpetuate the production of public bads. Roemer's model shows how the concentration of profits results in an increase in the level of public bads over the levels chosen when profits are diffused, but a concentration of wage income may have a symmetric effect. When the wage benefits of a public bad are concentrated and the costs are diffuse, incentives are created for successful rent seeking to reduce regulation and increase the production of public bads.

The monitoring institutions proposed by Roemer are insufficient to address these problems. Democratic elections are subject to free riding, while organized minorities are more likely successfully to influence planners. Agency problems between citizens and the state, like those between workers and employers, and between shareholders and managers, are, of course, endemic to capitalist market economies as well. The centralization of investment decisions in the hands of planners is likely to *increase* incentives for rent seeking, but reductions in income inequality will *decrease* the concentration of resources available for such activities. On balance, the change may not be significant.

If the market socialist model is to achieve the desired equalization of opportunity and reduction in public bads, and not risk replacing one set of capital market failures with another, additional attention to institutional design is necessary. Institutions are needed to promote collective action in monitoring the state, while at the same time reducing the likelihood of particularistic rent seeking.

Cultures of Cooperation

Recent literature, highlighting the relationship between agency and structure, emphasizes the impact of institutional form in successfully overcoming these problems. Formal game theoretic models indicate that institutions affect outcomes in multiple ways: by changing agents' perceptions of their own interests, their expections of others' behavior, their expectations of the likelihood of meeting other agents again (and therefore the likelihood of effective retaliation against uncooperative action), and by promoting empathy.

Robert Bates, for example, shows if others' preferences are not known with certainty, certain institutions can permit signaling and other soft behavior which allow players to 'rationally gamble on cooperation'.[3] Paul Seabright[4] argues that repeated interaction may form habits of cooperation, because of the increased potential for effective retaliation in the case of repeated interaction, and because of the impact of successful cooperation on expectations of others' behavior.

These findings indicate that certain institutional structures may promote cultures of cooperation which could contribute significantly to overcoming principal-agent problems between citizens and the state. The cooperative culture may reduce free riding in general monitoring, and also increase the likelihood of compromise when conflicts of interest exist regarding investments and other economic policy.

Recent empirical work supports these findings. In his research on institutional evolution in contemporary Italy, for example, Robert Putnam[5] finds a strong relationship between institutional structures, perceived conflicts of interest, and the way in which interested parties respond to these conflicts. Specific changes in institutional structure (to be discussed below) successfully reduced ideological polarization. Parties were less likely to perceive conflicts as zero-sum, and accommodation was facilitated. Institutional structures also influenced the prevalence of rent seeking, and the efficacy of government in implementing the chosen policies.

Elinor Ostrom's survey[6] of institutions of collective resource management also reveals that institutional design can have a strong impact on the level of conflict between agents. In her many cases, institutional structure consistently affected agents' perceptions of their interests and their willingness to participate in monitoring of agreed upon rules and distributions.

John R. Freeman,[7] building on a large body of research on the political-economic impact of democratic, corporatist institutions, compares the functioning of corporatist (cooperative) and pluralist (competitive) political structures in Western Europe. He finds that the presence of cooperative versus competitive institutional forms has a strong impact on the potential for compromise among distinct social groups and the generation of greater policy stability. The empirical

work of both Putnam and Freeman[8] also confirms that reduced conflict is correlated with increased economic efficiency (measured by economic growth rates) and commitment to equity.

These studies indicate that beneficial cultures of cooperation are created by institutions which promote ongoing interaction and are horizontal ('bringing together agents of *equivalent* status and power' and thereby increasing the potential for effective retaliation).[9] In Ostrom's study, institutions which successfully overcame coordination problems were those in which individuals interacted closely (reducing anonymity), were relatively equal, shared a past and expected to share a future (allowing reputations to be formed and making them matter). Successful institutions were also participatory: individuals affected by rules could participate in modifying those rules.[10]

Putnam's study also finds that repeated interaction is important, creating a 'virtuous circle'[11] of increasingly dependable cooperation. In addition, the study highlights the importance of horizontalness in promoting cooperation. Effective cooperation increases the rationality of a future 'gamble on cooperation' which, in turn, permits the generation of a web of generalized reciprocity, reconciling self-interest and solidarity.

'Denseness', or frequency of occurrence of institutions of 'social exchange' also promotes cooperation. By increasing the likelihood that individuals will be organized along more than one axis of interest, denseness exposes individuals to a greater range of perspectives and priorities, increasing knowledge of others' preferences and thus of potential common ground. Moreover, denseness broadens the webs of both enforcement and reciprocity. To perform their role in attenuating political-economic conflicts and promoting effective monitoring of the state, organizations need not be explicitly economic or political. In the Italian case, increased activity in organizations as diverse as sports clubs, professional associations and trade unions was strongly correlated with increased cooperation in the political sphere.[12]

Vertical networks show less potential to promote the trust and cooperation needed to effectively and efficiently monitor the state. In vertical relations, subordinates may not be able to credibly threaten sanctions against those higher up. In addition, they may cause subordinates to withhold information 'as a hedge against exploitation'.[13] Ostrom's cases similarly illustrate the way in which horizontal structures encourage use of locally available information and increase the effectiveness of monitoring and enforcement.[14]

Horizontal structures may provide some additional contributions to economic efficiency, beyond those involved in the reduction of rent seeking and improved monitoring of the state. Putnam[15] finds that complex systems of markets evolve and perform more effectively in the context of trust and social bonding, as these reduce opportunism. Freeman finds that the climate of policy stability created by cooperative policy making lengthens time horizons, permitting better investment planning and further reducing incentives for rent seeking.[16]

Market Socialism as a Culture of Cooperation

Unfortunately, the economic mechanisms proposed in Roemer's model appear more likely to promote a culture of atomization than the needed culture of cooperation. Under the structures for monitoring management, firm management will need to bargain vertically with banks and planners in order to protect firm interests. Firm workers, likewise, will bargain vertically with firm management, in order to elicit management support in bargaining with banks. Management is likely to have an ongoing relationship with banks; but workers, between decisive moments in which they mobilize to defend a particular interest, are encouraged to leave management to profit-maximizing managers.

In the monitoring of planners, too, periodic, vertical organization is proposed. The relationship between individual voters and planners involves a great inequality of power. In addition, the electoral mechanism on its own invites only very periodic interaction between the two parties. In the interim, voters have no role to play. Voters in capitalist countries with similar electoral structures and few supporting institutions have become apathetic.

One might argue that in Roemer's model voters will have a lot at stake, increasing the payoffs to active monitoring; but voters in Eastern Europe have even more at stake, as the national economic wealth is being divided and the rules of future accumulation are being written. In the absence of supporting horizontal institutional structures, their high stakes have not kept them involved: voter participation dropped to well below 50 per cent in the second round of elections. Sweden, with its highly developed, dense networks of social exchange, has historically done much better at promoting effective voter participation.

Finally, the heavy reliance on competitive markets as an allocative mechanism in Roemer's model contributes further to atomization and thereby to a proliferation of cooperation failures.[17] While increased income equality may foster some increases in feelings of shared condition, the dominant form of interactions will continue to tend

toward anonymity and occasionality and rely on self-interest for motivation. These are precisely contrary to the type of social relations needed to foster cooperative outcomes.

Market socialists could address principal-agent problems more effectively by promoting dense sets of horizontal institutions. Our understanding of the relationship between institutional form and the creation of cultures of cooperation is still in its early stages. Nonetheless, a few easily implementable possibilities suggest themselves.

Roemer notes that worker-managed firms could also be used to monitor managers, but suggests that worker management could be optionally added, once the new, market socialist allocational mechanisms are in place. Rather than being an optional, separable aspect of successful market socialism allocation, however, I believe worker management to be part of a set of cooperation-inducing institutions necessary to elicit adequate monitoring of planners.

Worker-managed firms, instead of reinforcing the atomizing, capitalist traditions of vertical relations, would create a relative equality of power between workers and managers. At the same time, the participatory management structures would build in ongoing interaction. Both changes could be expected to increase the efficiency of solutions to coordination problems at this level, while at the same time contributing to the development of dense horizontal networks.

Worker-managed firms could create the same problem of firm-based factionalism that Roemer's model creates. In this case, alliances would be horizontally, as opposed to vertically, organized, but rent seeking might still be encouraged. Cohen and Rogers[18] have suggested some institutional designs to reduce factionalist outcomes. Additional denseness will also serve to mitigate this problem.

Institutions for discussing national macroeconomic policy, perhaps based on the democratic corporatist model could also contribute to the development of cultures of cooperation and to a reduction in firm-based factionalism. With the emergence of worker-managed firms, bargaining between workers and banks or workers and planners would replace the traditional corporatist bargaining between workers and employers. The tasks of national bargaining would remain much the same, however: to generate agreement on levels of wage growth and investment.

Open, public bargaining increases pressures for solidaristic wage policy. Horizontal national structures for bargaining national macroeconomic policy also increase the likelihood of high, stable levels of employment. Both factors would do much to build trust and solidarity and reduce wage benefits to rent seeking.

The national bargaining structures would also provide a forum for generating compromise on a program of market interventions. In place of the heavy emphasis on profit maximizing, bargaining organizations could elaborate a more complex set of goals, including programs to overcome market failures, smooth market adjustments and select desired growth rates.

Such interventions will, of course, introduce 'distortions' into the competitive market equilibrium, but democratic states (and all but the most terrifying undemocratic states) always face pressures to intervene in the face of market failures, uneven development and market adjustments. The point here is not to replace markets as the most widely used allocative mechanism, but to create a set of institutions which will allow people to define the limitations on markets in a way which reduces rent seeking, wasteful conflicts and other public bads. Unfortunately, it may not always be possible quickly to create these necessary institutions. Social scientists know even less about the way people create institutions than they do about the way people respond to varying institutional forms. The government may, if properly motivated, intervene to promote the creation of certain types of institutions.[19] Putnam's study suggests, however, that the success of such intervention will depend greatly on the historical context and existing social structures. Other West European experiences suggest similar conclusions.[20]

The importance of institutional design to the performance of the market socialist model, combined with our limited ability to implement our designs, suggests that market socialism may have few practical advantages over social democracy. It is certainly true, as Roemer argues, that social democracy has flourished only under very specific historical conditions and is subject to erosion in response to voter dissatisfaction. There appears little reason to believe that the successful implementation of market socialism (one which satisfactorily resolves problems of monitoring the state) requires any less particular social-historical conditions. If both models have the potential to equalize income and opportunity, then adequate reasons for preferring one to the other remain to be developed.

Market Socialism for Transforming CPEs?

In view of the above discussion, Eastern Europe would seem a poor prospect for developing market socialism along the lines Roemer proposes. Clearly, certain aspects of the current situation make the

region a good candidate for the proposed system. The problem of altering property rights would be minimal, since many East European countries are currently experimenting with a system of share distribution quite similar to Roemer's 'clamshell economy'. In addition, the prospects for economic growth under a capitalist market economy appear dim in many countries, opening the way for serious discussion of an alternative.

Other characteristics of former centrally planned societies are less well suited to the implementation of market socialism, however. In particular, the behaviors necessary to ensure adequate monitoring are weakly developed. While the absence of such behaviors will also have a negative impact on the development of a capitalist market economy, the concentration of investment decisions and extensive power of banks in the market socialist model is likely to exacerbate the danger of inadequate monitoring.

Over the decades between World War II and 1989, social relations in Eastern Europe were consciously and massively restructured along vertical lines. The highly centralized Communist Party strove to control everything from industrial production to religious behavior to sexual practices among married couples. Horizontal organizations without a vertical component were essentially illegal, and horizontal relationships of all kinds were subject to information leakage to vertical organizations (through spying; witness the East German experience).

A number of authors have documented the impact of this change on interpersonal relations among the members of East European populations.[21] The resulting attitudes have been characterized as those of extreme individualism (an interesting outcome for a collectivist society), widespread distrust, and apathy and cynicism regarding political participation. In short, this is a culture, despite a number of apparently feudal aspects, of extreme atomization.

At the same time, people have little experience with meritocratic evaluation. The 'corporate culture of competitive bidding in the market' necessary to motivate the bankers and managers in Roemer's model[22] is absent, as are the feelings of efficacy which contribute to a population's willingness to monitor state officials. (In recent elections, with the very rules of the new economic game at stake, East Europeans turned out at rates well below 50 per cent.) In any case, information is thin and markets weakly developed, making effective evaluation extremely difficult, even where motivated monitors exist.

In this context, the prospects for successful resolution of principal-agent problems are not good. These problems will also plague efforts to organize capitalist production, of course, but the concentration of power implied in the monitoring role of large powerful banks and the investment-guiding role of planners in the market socialist model creates prime targets for rent seekers.

Conclusions

The lack of mechanisms for monitoring the state reduces the ability of Roemer's market socialist model to increase equality of opportunity and reduce public bads. Recent literature suggests that cultures of cooperation could contribute to the generation of effective monitoring. Unfortunately, the institutions Roemer proposes for promoting economic efficiency are more likely to reinforce cultures of atomization than to create the beneficial cultures of cooperation.

While our understanding of the relationship between institutional structure and agent behavior is far from complete, certain well-known types of institutional structures promote the ongoing, horizontal relations which contribute to cooperation. Among these, the development of worker-managed firms and national bargaining over economic policy (on the corporatist model) hold particular promise for promoting cooperation and efficiency.

It is less clear, however, that the desired institutions can be generated at will. Studies reviewed here indicate that sociohistorical context plays a significant role in the formation of institutional structure, and attempts to manipulate institutions in line with externally imposed criteria have met with limited success. These considerations shed doubt on market socialism's claim to be a more generally applicable alternative than social democracy and a viable systemic alternative to the struggling countries of Eastern Europe.

Notes

1. Barbara Taylor, *Eve and the New Jerusalem*, London: Virago Press 1983.
2. Perhaps this will appear tautological. The relationship between institutions and culture clearly involves a great deal of (dialectical? overdetermined?) interaction, but my claim here is not to assert a particular causality. Instead, I wish to emphasize the central role cultures of cooperation can play in economic performance.
3. Robert Bates, 'Contra Contractarianism: Some Reflections on the New Institutionalism', *Politics and Society* 16 (1988), pp. 387–401.
4. Paul Seabright, 'Is Cooperation Habit Forming?', in P. Dasgupta and K.-G. Maler, eds., *The Environment and Emerging Development Issues*, Oxford: Clarendon Press, in press. See also, H. Sabourian, 'Repeated Games: A Survey', in F. Hahn, ed., *The Economics of Missing Markets, Information and Games*, Oxford: Clarendon Press 1990, pp. 62–105.

5. Robert Putnam, *Making Democracy Work: Civic Traditions in Modern Italy*, Princeton: Princeton University Press 1993.
6. Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action*, Cambridge: Cambridge University Press 1990.
7. John R. Freeman, *Democracy and Markets: The Politics of Mixed Economies*, Ithaca: Cornell University Press 1989.
8. Putnam, *Making Democracy Work* and Freeman, *Democracy and Markets*.
9. Putnam, *Making Democracy Work*, pp. 172–73. Mancur Olson (*The Logic of Collective Action*, Cambridge, MA: Harvard University Press 1965) is well known for arguing that collective action problems (of the sort involved in monitoring the state) are best overcome through vertical relations. Since actors are incapable of organizing themselves, monitoring and other collective action depend on the leadership of a few, powerful actors. In any case, since members of the population will organize only to protect their particularistic interests, these are seen as dangerous lobbyists for special treatment (Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities*, New Haven: Yale University Press 1982). Once the relationship between structure and agency is introduced, however, the argument breaks down.
10. Ostrom, pp. 88–90.
11. Putnam p. 170.
12. Ibid., ch. 4.
13. Ibid., p. 174.
14. Ostrom, p. 186.
15. See Putnam, *Making Democracy Work*.
16. See Freeman, *Democracy and Markets*. Some descriptions of corporatism emphasize its 'vertical' aspects, due to its pyramidal structure. If the corporatist institutions are relatively democratic, however, at each level they will promote horizontal relations. Most importantly, at the national level, bargaining structures afford parties relative equality.
17. Michael Taylor, *The Possibility of Cooperation*, New York: Cambridge University Press 1987, p. 150 and Douglass North, *Structure and Change in Economic History*, New York: Norton 1981, p. 182, make similar arguments.
18. Joshua Cohen, and Joel Rogers, 'Associative Democracy', in Pranab Bardhan and John E. Roemer, eds, *Market Socialism: The Current Debate*, New York: Oxford University Press 1993, pp. 236–49.
19. For example, by directly funding institutional development, as suggested by Cohen and Rogers, *Market Socialism*.
20. For an elaboration of these points, see Freeman, *Democracy and Markets*, and Putnam, *Making Democracy Work*.
21. Istvan Rev, 'The Advantages of Being Atomized', *Dissent* (1987), pp. 335–50 and Elemer Hankiss, *East European Alternatives*, Oxford: Clarendon Press 1990.
22. Pranab Bardhan, and John E. Roemer, 'Market Socialism: A Case for Rejuvenation', *Journal of Economic Perspectives* 6, no. 3 (1992), p. 106.