SOCIETY, COMMUNITY AND ECONOMIC DEVELOPMENT[1]

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Contents

Abstract

Studies of economic development and economic history have long been concerned with the relationship between the transparent and supposedly anonymous forces of markets, states and bureaucracies, on the one hand, and the particular local and national forms of social organization in which actors' daily lives are embedded. Economists are quite divided about these latter forces: for some, they are necessary underpinnings for the market, providing trust and social capital which in turn reduce transactions costs and moral hazards and hence promote development; for others, they are seen as archaic, leading to nepotism, rent-seeking and institutional rigidity. Sociology, too, has long debated the respective roles of *gesellschaft* and *gemeinschaft* in societal development, and has recently revived this through research on social capital. Indeed, throughout the social sciences, there is a tension between the roles assigned to what we might call the "societal" and the "communitarian" bases of social and economic development. Each position in this theoretical standoff underestimates the contributions of either society or community to economic development. This is because the interaction of society and community define critical incentives for actors in the process of economic development. Society and community act as mutual checks and balances on their potentially negative effects, while allowing the positive contributions of each to the economic efficiency. This analysis leads to a reconsideration of some of the foundations of comparative economics and institutionalism, by placing them in a more realistic sociological framework.

0. SOCIETY OR COMMUNITY?

California's Silicon Valley, the heart of the world's microelectronics and internet industries, is described by some analysts as a tightly-woven community, whose economic performance depends on informal networks of entrepreneurs and techno-nerds (Saxenian, 1994). But by others it is described as a set of overlapping markets, with research universities, government financing, venture capitalists, law firms, stock options, high labor mobility, brutal competition, and "accountability" (reputation) rather than trust underlying its business networks (Cohen and Fields, 1998). In the latter version, Silicon Valley takes American commercial culture to its limits; in the former, it is a high-technology version of the networked entrepreneurialism and strong social capital commonly associated with European small-firm clusters (Piore and Sabel, 1984). Is it society that leads to success, or is it community?

Failure stories in the economic development literature share this ambivalence. We frequently hear criticisms (in the Western press, at least) of "crony capitalism" in Asia. Family-based production networks -- certainly a form of cronyism -- work well in Taiwan, and are often cited as one aspect of the "good" communitarian structures found in the Third Italy, but they are deplored when they become clannish, as in the Mezzogiorno (Gambetta, 1988; Leonardi, 1995). In the garment, toy, and jewelry industries in Los Angeles, by contrast, ethnic and family networks of small firms do not seem to lead to long-term development, but rather to lock-in to a vicious circle of cheap products, very low wages, and Third World competition (Scott, 1993). France has been viewed by some economic historians as owing her successes in economic modernization to a strong State which had the strength to “tame” strongly localist, family-oriented capitalism: society triumphed over community by neutralizing the latter (Grémion, 1976; Kuisel, 1981). But others complain

that this same State has left an institutional void, with weak spontaneous associational capacities – i.e. weak communities -- making it impossible for France to have a vibrant entrepreneurial economy (Reynolds et al, 2001; Levy, 1999; Rosenvallon, 2004).

Underlying these debates is the classical sociological question of society and community as different types of social order – rule-bound and anonymous exchanges between individuals versus customary social bonds within groups -- via which social life gets organized. In place of this pitched debate between partisans of society or community as key to development, we shall argue that both societal and communitarian bonds between economic agents shape long-term economic development, and it is the specific nature of their interrelations that matters.

To consider the importance of societal and communitarian forces to economic development is to think about institutions. “Institutions” refers not only to the formal private and public sector organizations and rules which influence how agents interact, but also to the relatively stable collective routines, habits, or conventions that can be observed in any economy. Institutions have many functions, including the redistribution of wealth, definition of property rights, governance of firms and labor relations, the rule of law, and resolution of disputes. These kinds of institutions vary greatly among countries and have significant impacts on economic performance and socio-economic structures.

The argument of this paper is that relations between societal and communitarian forces shape these institutions. They do this by shaping the conventional forms by which individuals can participate and interact in the economy. It then argues that these patterns of participation and their associated incentives critically affect the amount of long-term economic development which takes place, as well as the evolutionary self-selection of economies into particular mixtures of strengths and weaknesses.

1. WHAT DO WE MEAN BY SOCIETY AND COMMUNITY?

Sociologists invented the analytical distinction between community and society as a way of considering different forms of social integration. A century later, most theories of the "social foundations of development" still rely on the fundamental concepts of sociology -- *gemeinschaft* (community), and *gesellschaft* (society) -- derived from the classical formulations of Weber and Tönnies, or from Durkheim's cognate notion that there are two different kinds of bond between people, *solidarité mécanique* and *solidarité organique* (Durkheim, 1893). These distinctions have largely been retained, with "community" conventionally used to refer to forms of collective life in which people are tied together through tradition, interpersonal contacts, informal relationships, and particularistic affinities, interests or similarities, while "society" generally refers to collectivities held together through anonymous, rule-bound, more transparent, formal, and universalistic principles.

From the late 19th to mid-20th centuries, sociologists for the most part fell into line with the other social sciences in seeing community largely as an obstacle to modernization.[2] Starting with Max Weber, community was held to be inimical to the expansion of formal, distanced, rule-bound, transparent social linkages, necessary for achievement of a successful market economy and industrial society (Weber, 1921). This idea is strongly compatible with formal notions in contemporary economics and political science that communities are groups which engage in rent-seeking and are beset by principal-agent problems for their members; hence, they reduce both freedom and efficiency (Olson, 1965; Buchanan and Tullock, 1962).

From Durkheim onward, there have also been opposite fears, that too much society and too little community could be problematic to individuals, if not for societal development

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[2] Although Le Play and others from certain European historical schools were dissenters to this general trend.

itself. From the 1940s through the 1960s, there were regular warnings to social science about the importance of community, and not merely its dysfunctional progress-blocking nature (K. Polanyi, 1957; M. Polanyi, 1966). Daniel Bell (1976), among the most prominent of these voices, warned about alienation and excessive anonymity, rekindling old Durkheimian themes. There is today a debate as to whether large-scale, rational, bureaucratic principles – along with the individualization, ephemerality, and mobility they seem to call forth – have not gone too far, weakening forms of community necessary to social order (Putnam, 2000; Sandel, 1996; Etzioni, 1996; Levy, 1999; Bellah et al, 1995). Among the many concepts deployed in the contemporary debate are "social capital" (Putnam, 2000; Coleman, 1990); "civil society" (Douglass and Friedmann,1997); "hypermodernity" (Giddens, 1990), and a wide variety of reflections on the recrudescence of religious, spiritual and identity politics in the advanced countries (Fogel, 2000).

This type of reasoning has also become centrally involved with questions of economic development. In one of the most explicit efforts along these lines, Fukuyama (1995) argues that low-trust, highly communitarian societies are less likely to generate successful large enterprises than are high-trust societies, and low-trust societies typically have lower long-term rates of growth than do high trust ones. Intriguingly, Fukuyama holds that capacities for direct, spontaneous or informal association of persons facilitate the establishment of large-scale, transparent and bureaucratic form of economic life, such as the large corporation. Rather than the two forms of association being mutually incompatible, the one is precondition for the other.

Giddens (1990) and other sociologists extend the field of potential positive effects of community in the modern economy. They start from a general point that contemporary modernization cannot be merely bureaucratic, whether Statist or corporate, because this tends to downplay individual autonomy and responsibility. He comes to the conclusion that in

order to avoid the pitfalls of a rigid, administered society and economy, on the one hand, and a chaotic "jungle" on the other, intermediate levels of association are critical. Giddens and others specifically refer to communities as means to improve the functioning of labor markets, generate entrepreneurship, and organize the provision of the public goods which alleviate both private and state burdens in creating prosperity and social integration. Along these lines, success in small-firm based industrial clusters or districts, ranging from the most famous cases of Italy to examples drawn from Taiwan, Denmark, Mexico, or Germany, are also said to depend critically on the existence of communities which regulate complex inter-firm and firm-worker relationships through shared norms, reputation effects, and mutually-aligned expectations.[3] Most prominently, Putnam (2000) claims that "social capital" -- which he defines specifically to mean levels of voluntary participation and civic engagement -- is good for economic development and social integration. Social capital creates positive externalities for the members of the societies that have high levels of it, so that even those who do not actively create it benefit from its existence. They concern such things as limiting moral hazards (e.g. less cheating in the economy, less crime in neighborhoods) and encouraging unpaid efforts (which then create benefits that spillover to others).

A closer look at Putnam's theoretical argument allows us to see some of its limits, but also how it may be adapted to a richer analysis of the institutional foundations of economic development. Putnam argues that there are two components of social capital: "bonding" among similar types of persons (class, ethnicity, background, interests) and "bridging" between different such groups or what he terms "people unlike ourselves." Bonding, in other words, operationalizes the classical notion of community, and bridging that of society. Moreover, Putnam argues that bonding is much easier to come by than bridging, and that

[3] There is a vast literature on this subject. For extensive reviews, see, inter alia, Storper, 1997; Storper and Salais, 1993, as well as the papers in Becattini and Sforzi, 2002.

where many different groups are present, it is much more difficult to achieve high levels of social capital than in more homogeneous societies. This suggests that bonding and bridging spring from different sources, and that they have complex relationships to one another.

Putnam's concept of bonding bears obvious similarity to the standard notion of *gemeinschaft*. In their study of the Third Italy, Putnam Leonardi and Nanetti (1993) argue that social capital, embodied in group life of local, family networks and civic associationalism, emerges through long historical processes. Actors trust each other because of their common cultural background, shared values, and strong reputation effects stem from dense interpersonal networks. This notion can also be found in many other empirical studies of regional economic development (Becattini and Sforzi, 2002).

Nonetheless, these definitions may be overly restrictive, because groups can exist in many other forms. Professional associations are based on shared norms of professional performance, not on shared history or interpersonal trust, for example. Along these lines, Aydogan (2002) has shown that even in the presence of shallow corporate cultures in Silicon Valley, due to a high level of labor turnover, professional culture makes possible a high level of industry- and region-specific social capital. There is considerable bonding in Silicon Valley, but its networks of venture capitalists, technologists, and others have little to do with the trust- and tradition-based communities of the Third Italy. The bonds between members of a community can be modern as well as traditional, based on ascriptive or acquired traits, each activated through different signaling and screening mechanisms. It follows that communities should not be equated to the classical notion of mechanical solidarity or *gemeinschaft*. In the same vein, the notions proposed by Fukuyama (trust), or the "civil society" theorists, may well be valid as empirical statements about the cases at hand, but they probably cannot be seen as general foundations of all community-type bonding. In addition, groups or

communities do not necessarily express themselves as organizations or deliberate associations or Tocquevillian civic engagement.

Coleman (1990) attempted to deal with this issue by distinguishing "primordial" from organized social capital. But he considered the former to be necessarily more powerful than the latter.[4] Primordial social bonding, in our view, should not be considered synonymous with ascriptive traits; there is no persuasive reason to believe that an acquired professional identity, for example[5], cannot be as primordial as, say, a regional or ethnic identity, with neither having to assume the form of organized civic associationalism or group membership. Moreover, as shall be argued below, the acquisition of such identities or memberships can be conceived as an expression of the individual's preferences and the exercise of rationality. Thus, though the sociological distinction between community and society is just as relevant as it ever was, many of the definitions of community are overly restrictive or arbitrary. "Community" will therefore be used here to refer to a wide range of reasons and ways of grouping together with others with whom we share some part of our identity, expectations, and interests.

Much of the attention to groups has taken the form of studies of civic associationalism, and most students of associationalism have been concerned with issues of social integration rather than economics. However, there is longstanding concern with the role of voluntary association in social and economic development, of which Fukuyama and Putnam are the latest major entrants. Tocqueville (1830) thought that the Americans' capacity for association was one reason not only for their vibrant democracy, but also for the

[4] Thanks to Arnaldo Bagnasco for calling my attention to this point (see Bagnasco, 2003).
[5] The analytical basis for this argument can be found in section 2.1 below.

strength of American entrepreneurship.[6] Nonetheless, the literature is largely inconclusive about the relationship between associational life and economic development. For one thing, there are many cases of weakly associational societies that have done well as developers, including France, Singapore, the UK, Canada, and Australia. This is probably because associationalism can assume many different institutional forms, which determine its ultimate effects on economic development. Figure 1 illustrates some of the many possible combinations of these institutional forms, albeit in a highly schematic and simplified way. Some readers might quibble with the characterization of individual cases, but the illustration strongly suggests that there is no definite relationship between associationalism and developmental success or failure because there are so many different ways to bridge.

FIGURE 1: INSTITUTIONAL FORMS AND LEVELS OF CIVIC ASSOCIATION

COMMUNITY: **SOCIETY:**

LEVELS OF **INSTITUTIONAL FORMS OF BRIDGING**

CIVIC ASSN.

	Group-Oriented (groups are recognized as principal societal category in legal system, social policy)	**Group-Oriented (groups are recognized as principal societal category in legal system, social policy)**	**Individualist (groups have secondary status in legal system, social policy, constitutional framework)**	**Individualist (groups have secondary status in legal system, social policy, constitutional framework)**
	Non-comprehensive or decentralized group order: uneven corporatism or clannism	**Comprehensive, centralized or organized group order: corporatism**	**Weak or incomplete liberalism and contractualism: tendency to distrust, fragile and limited circles**	**Strong and widespread liberalism and contractualism**

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[6] The empirical indicator of these studies has always been the intensity of associational life, though there is considerable controversy over which empirical measures should be used and how to interpret them (Norris, 2001).

Strongly associational	*Third Italy* *Hong Kong* *Taiwan* *Jalisco, Mexico*[7]	*Japan* *Germany* *Denmark* *Sweden*		*USA* *Netherlands*
Weakly associational or hierarchically associational	*Italy Mezzogiorno* *Most of Mexico* *SE Brazil*	*France* *Singapore*		*United Kingdom* *Canada* *Australia* *New Zealand*

Social life is not just about the groups to which we belong, of course. Bridging is the core concern of all the social sciences interested in collective action and coordination: how can diverse agents reconcile their interests? In the presence of strong groups, how do such groups relate to each other? Can group interaction make something like "social choice" possible? This echoes a broader point made forcefully by Granovetter (2001) and Lin (2001). It is not just the density of ties that matters, but the structure of such bridges. The structure of ties is closely related to the mixture of power, compliance, sanctions, sharing, and cooperation on the part of the actors that are tied together. Thus, bonding and bridging should not be considered additive components of a single index of social capital, but rather independent and mutually shaping social forces.

In this light, it can legitimately be asked whether there are certain kinds of bonds that are more suited to certain kinds of bridges, and vice-versa. If this were the case, there would be a kind of functionalist law of institutional structure and the forms of action it shapes. But most sociologists have long ago abandoned the idea of a single, unified social order, and few empirical students of institutions would subscribe to this notion today (along these lines, see: Boltanski and Thevenot, 1987; Giddens, 1984; Fligstein, 2001; DiMaggio,1994). Rather than reflecting some kind of fixed functional compatibility ("certain kinds of communities are compatible with certain kinds of society," etc), the relationship between society and community is better thought of as a dynamic and uncertain tension between bonds and

bridges. The nature of this relationship and its effects on economic development is the principal concern of this paper.

2. COMMUNITY, RATIONALITY AND ECONOMY

Any nontrivial definition of community must define it as something more than the accidental and strictly temporary convergence of individual preferences. In the latter formulation, the analytical category of "group" or "community" is superfluous, because there is no aggregation of preferences exhibiting any significant degree of heterogeneity. To have some meaning, then, we must hold that communities or groups bring together individuals with at least some difference in preferences, who have the capacity for individual reflection about their preferences, and yet who are held together for collective action even in the face of some such differences and more than temporarily. This notion is largely rejected by contemporary analytic social science – economics, philosophy, political science – which display an extreme skepticism about any such putative social glue. In the dominant view, it is irrational for individuals to join groups because of the impossibility problem (Arrow, 1951). Groups can only sidetrack individuals from maximizing their preferences; the only kinds of preferences that matter are individual in nature; hence groups always diminish individual welfare and, to cap it all off, still cannot contribute to attaining an optimal level of overall preference satisfaction, i.e. they do not get us closer to "social choice" (Buchanan and Tullock, 1962). If we believe that preference achievement is somehow related to economic effort and coordination, and if this powerful indictment of group life is well founded, then the existence of groups must be broadly bad for the process of economic development (Olson,

[7] This is mentioned here specifically because it is one of the case studies that is reported on in other papers based on our fieldwork (see Lavinas and Storper, 1999)

1965) It will not do, moreover, to argue that groups exist for various kinds of negative reasons, among which are the fear of sanctions (including reputation effects) for deviating from group norms, or because the costs of obtaining information or individually going out on one's own (i.e. transactions costs) are so high that one just gives up and lets oneself be carried along by the group. Real world groups may indeed exist for these reasons, but they are likely to suffer from the serious disadvantages predicted by theory.

These disadvantages are at the heart of contemporary institutional economics. The positive theory of institutions (PTI) provides solid microfoundations for the notion that communitarian forms of order often lead to rent-seeking, non-transparent behavior, and are prone to overwhelming principal-agent problems that frustrate the individual members of groups, while allowing small groups with passionately-held views to have undue influence over large less passionate majorities. These properties are then argued by economic historians and political economists to lead to sclerosis and lower levels of economic growth than can be had with clear dominance by societal (market) institutions (North, 1981; Olson, 1965; Moe, 1987). This is a powerful critique of group life, and there is considerable empirical support for it. As a result, the PTI has been used to generate a dominant perspective that the only institutions we should have are those – such as property rights and the rule of law – which enforce the roles of competition and exit, and hence limit the role of bonding or communities.

2.1 Why are communities not necessarily all bad?

This is not the place to take on this vast and complex field of analytical philosophy and economics, but before going on to make some more direct observations about the potentially positive roles of communities in the market economy, it will be helpful to at least

clear some of the analytical ground with respect to this extreme skepticism about group life. This can be done by summarizing the two principal objections to such skepticism which are detailed by Sen (2002).

In the first place, self-interest does not necessarily place actors in opposition to other actors in the way described by most theory. Freedom means the possibility to reasonably value something other than one's own monetary well-being; to be self-interested is not necessarily to be self-centered. It is reasonable for actors to pay attention to the demands of cooperation, and they are not only cooperative because of fear of sanctions (tit-for-tat reasons). According to Sen (2002: 28), the problem with rational choice theory in this regard is that it rejects any possible rival understandings of what might lie behind the regularity of choices, and notably that choices that are not narrowly self-interested can be reasonably judged to be rational for the individual. Moreover, the unit of agency in choice can itself be broader than individual action: self-goal choice is not the only kind of choice. All of this leads to a view where what is to be maximized may well incorporate broader consequences, such as group actions and processes, and where this broadened maximand can be considered an "*as if* objective function" (Sen, 2002: 41). In these cases, individuals may have preferences over comprehensive outcomes (and not just discrete or "culmination" outcomes) (Sen, 2002: 45).

But can such preference-defined groups contribute to a broader achievement of coordination in society, i.e. lead us in the direction of "social choice?" It is conceivable that even if the existence of some groups can be defended as stemming from rational choices, they simply partake of the impossibility problem. The formal precondition for the impossibility of social choice to disappear is that there exist information that would make possible interpersonal comparisons of social welfare judgements and that even partial comparisons can be helpful (Sen, 2002: 96). Here, groups may be useful in two ways. We

mentioned above that true – non second-best-- groups do not exist *merely* because information on alternatives is costly;[8] but if groups make it possible for individuals better to compare preferences, for whatever reason, including lowering the costs of good information or judgements, then they do assist in achieving the possibility of social choice. In this sense, as Sen points out, "choice problems come in many shapes and sizes," and groups can help expand the shapes and sizes that actually get considered, both substantively and procedurally.

Finally, social choice theory has always based its impossibility judgements on reasoning which does not take account of distributional questions (leading to Pareto efficiency criteria). But if, as we shall suggest in later sections, groups are key to achieving satisfactory distributional arrangements in the economy which in turn contribute to higher rates of economic development, then it follows that the refusal to consider distributional issues is misplaced.

Economics has done very well in the "sophisticated analysis of how individuals pursue incentives in well-defined social spaces." (Granovetter, 2001). The problem is, of course, that more complex institutional contexts of individual and social choice drop out of that picture. Having now remarked why this might be true in a rather abstract analytical sense, we can now move on to some of the more real world ways in which groups can make positive necessary contributions to economic development.

2.2 Successful markets require communities

These contributions of society and community come about because they minimize moral hazards, reduce transactions costs and generate certain kinds of positive externalities and increasing returns effects. Some of the founding figures of modern economics – such as

[8] Or if individuals are too lazy to investigate alternatives

Alfred Marshall (1919) – intimated that community was sometimes indispensable to superior economic performance. Marshall's writings about the textile districts of Lancashire, which he so admired, are shot through with ambivalence. In some passages, he describes them as fully competitive systems; in others, he observes that "the secrets of industry are in the air," i.e. collective resources of the community of producers. Twentieth century economists, however, progressively came along to the view that perfect markets depend on the existence of *gesellschaft*, seeing *gemeinschaft* as a barrier to their full realization for the reasons adumbrated above.

It does not follow theoretically or empirically, however, that the economy would be better off entirely without communities. One can certainly question the veracity of this skepticism about communities on empirical grounds alone. As we have already noted, the continuing tendency to define groups or communities using the 19th century sociological distinction is an ongoing source of confusion. Margaret Thatcher attracted attention by her provocative declaration that "society doesn't exist, only individuals exist." From a social science standpoint, of course, she mangled the standard notion i.e. that it is society (*gesellschaft*) which is precisely an aggregation of individuals organized according to transparent, modern principles; she probably meant to criticize communities as the source of hide-bound tradition and corporatism. Nonetheless, economics is also at fault when it sees all traditional, primordial groups as anti-competitive and rent-seeking; there is a huge case study literature on economic networks which shows the contrary (e.g. Grabher, 1993; Lorenz, 1984; Lin, 2002). Moreover, as noted previously, groups or communities are not necessarily held together through tradition, interpersonal relations, and non-rational bonds between people. This is indeed sometimes the case, but other examples, such as that of Silicon Valley, suggest a different point of view.

The response to this mainstream view of institutions creating excessive transactions costs, moral hazards, and rent-seeking is not only empirical, however. Transactions costs economics, as developed by Williamson (1985) and others, points to the necessary emergence of certain kinds of non-market based coordination; for example, under some circumstances, relational contracting is more efficient than spot markets in perfect competition. The efficiency of such contracting is enhanced by interfirm networks of actors. Nonetheless, in economics there remains a great deal of ambiguity about this point. Much of the "new institutional economics" strains to find the perfectly rational character of participation in networks and governance, denying that these could be – at least partially -- dependent on group membership or that the participants could be socially "embedded" in ways important to the functioning of these groups. Many students of such networks hold that relations are not enforced merely by the threat of sanctions, but by some kind of bonding, whether primordial or acquired (Lorenz, 1992). These may be combined with the "societal" pressures of sanctions, but even sanctions may be more efficient in the presence of communitarian bonds.

The new economics of information offers a second, more fundamental challenge within economics to the society-only view of economic coordination. It shows that information-based market failures are general to modern capitalism, and other kinds of organization than markets must fill in the breach. Greenwald and Stiglitz (1984, 1986) note that when information is not complete, and it is almost never complete, markets are incomplete. The resulting market failures are not the same as the classical market failures of welfare economics, because the new ones are pervasive and difficult to identify and isolate. In turn, Stiglitz (1994) suggests that communities are one of the ways that these market failures can be efficiently overcome, and that they are often superior to bureaucracies. No

precise definition of community is given, but it is clearly intimated that groups have a necessary role in achieving optimal coordination of a well-functioning modern economy.

This critique takes on both the positive theory of institutions and transactions costs economics on their own grounds, for it suggests that there is no way for markets always to be the route to optimal reduction of transactions costs, moral hazards, and other incentive problems. In other words, it gives theoretical support to the notion which emerges from much empirical work, i.e. that communities are actually quite good, under some circumstances, at all these tasks.

But this is not all. Contemporary growth theory has shown that accumulation of human capital is the central element in growth, and that there is tight complementarity between human capital and technology. Lucas (1988) argues that human capital accumulates when the rate of return to additional increments of human capital is higher than the discount rate. This rate of return is defined via a social process and is not just the outcome of individual education or effort. The reason, of course, is that the degree to which acquired knowledge can actually be applied in the economy depends other people: it can rarely be done alone. Sometimes, the application of human or technological capital requires the bond of "matching" with those who have similiar skills or capital, i.e. where scale effects are necessary. Sometimes it requires linking up with those who have complementary skills or technologies, without which our capital cannot be used in isolation. Knowledgeable (skilled) agents tend therefore to function via selective affinities, within selected economic communities. If these affinities do not exist at all (i.e. knowledgeable people are either extremely rare so they can match up with nobody, or they are extremely distrustful), knowledge will be wasted, and have little positive developmental effect. When collective action of this type is realized, moreover, knowledge spillovers are activated and there are

increasing returns to knowledge investments (Easterly, 2001). This is why so many empirical studies have shown that intra-group solidarity facilitates acquisition of human capital and deployment of new technologies, and inter-group conflicts and rivalries slow down or even impede growth from occurring (Amsden, 2001; Easterly, 2001).

All in all then, there are secure reasons to believe that communities – as we have defined them—are essential underpinnings of the incentives to economic effort. They are not replacements for individual incentives. Moreover, as we shall now observe, the possible positive contributions of bonding are maximized, and its possible negative effects minimized, when it is married to appropriate societal forces, i.e. bridging processes.

3. BRIDGING: THE POLITICS OF DEVELOPMENT

As noted, much economics claims that sclerosis is the almost-inevitable outcome of institutionalization of inter-group relations. But even such theory does not deny that there are better and worse ways to weave particular groups together. Much recent research on economic development has demonstrated that political coalition formation is essential to the process. The principal explanations supplied for why coalitions are so important are that they provide a context in which good ideas and policies can be implemented; they allow problem-solving and conflict resolution. Much recent analytical effort has gone into theorizing how much democratic political competition, institutional checks and balances, or administrative isolation are necessary to counteract the tendency for special interest politics to extract rents and drag down efficiency, the latter being the

favorite theme of classics in political economy such as Schattschneider (1935), Buchanan and Tullock (1962) and Olson (1965).

As we shall now see, however, almost all of the research on coalitions is about intergroup relations, with relatively little attention given to underlying social forces, especially bonding, and hence to the possible interaction of bonding and bridging in encouraging coalition formation and in shaping the ways that coalitions actually function. Two main versions of this argument shall now be examined.

3.1 Democracy as a developmental community

Development economists have long speculated on a possible relationship between the long-term potential for economic development and the existence of democratic institutions, where democracy is, in the terms of the present argument, a form of society. Democracy permits the market system to function correctly, in this view, because democratic institutions presuppose the individual rights that underlie factor mobility and individual initiative, while democratic political processes encourage inter-group competition that both holds rent-earning behavior in check and encourages compromise and moderation (Lipset, 1963).

In the recent context of globalization, this argument has been refocused around the relationship between integration, democracy and development.[9] One such theory is an extension of the classical *doux commerce* thesis (Hirschman, 1997). Most cases of backwardness are attributed to an excess of community -- clannism, rigidity, and closure -- and a deficiency of societal structures capable of creating efficient markets to offset or defeat these communitarian forces. Trade brings about economic interdependency, which forces

[9] Whether of less-developed regions into their respective national economies or integration of national economies with different levels of development – as in the EU or NAFTA, or integration generally into the world economy.

places to develop institutional configurations that support such integration, in the form of markets and a commitment to transparency and property rights. This in turn necessitates certain kinds of democratic institutions, because they are the only ones truly compatible with high degrees of factor mobility, competition (instead of rent-seeking), and entrepreneurship. Commerce thus brings these latter into existence and eliminates the excesses of community.

However, all of these arguments do rather poorly in empirical terms. Thus, Przeworski et al (2000), in the most extensive statistical analysis of the relationship between democracy and development to date, show that there is nothing that can show whether democracy is the outcome of development or its precursor; there are also many examples of spectacular reversals of democracies in the face of rapidly rising trade, and of booms during authoritarian periods.

Another contemporary argument reverses the causality of the *doux commerce* thesis. Rodrik (1999) shows that there are strong relationships between the ability of a society to manage distributional conflicts when faced with shocks to the economy, and hence its ability to implement policies capable of maintaining growth. Shocks bring out latent conflicts and present strong dangers that wrong policies will be adopted, reflecting merely the interests of the most powerful (rent-seeking) agents, and this will generate ongoing conflict. The successful resolution of such potential conflicts, goes the argument, is strongly linked to the existence of democratic institutions and processes, because these provide a forum for expression and consensus-building, or at least for cooperation and acceptance of sacrifice in the name of the commonwealth. It is held that formal democracy depends on clear and transparent social interaction, very similar in form and flavor to the kinds of transactions that underpin a market economy, even if the rights and constituencies associated with each are different. Thus, the culture that underpins these two kinds of processes is a common and mutually reinforcing one, with democracy necessary to reap the full benefits of commerce.

Even if the latter argument is still somewhat simplistic in its definition of the qualities of "democracy," it does better empirically than the standard version of the *doux commerce* thesis. As Rodrik (1999:101) notes, the "voluminous empirical literature on the long-run consequences of political democracy for economic growth has generally yielded ambiguous results.....however, more recent studies show that democracies produce a better balance between risk and reward: that is, the level of aggregate economic instability tends to be much lower under democracies." Hence, economies in formally democratic countries perform systematically better when confronted with external shocks, and have higher long-term growth rates.

There is further, albeit indirect, empirical support for this point of view. Below a certain income level, some forms of dictatorship may do as well as democracy because they can centralize power and thereby control corruption and rent-seeking. Democracies, however, never fall once a certain level of development has been achieved (the threshold is set at US$6055 per capita today) (Przeworski et al 2002). This appears to be the case because wealthier democracies and dictatorships grow differently: the former are more technology-intensive and less labor intensive in the way national wealth is increased. Ultimately, this translates into higher wages in democracies, because people respond by lowering fertility, which they also do because the rule of law typical of wealthy democracies makes them more confident in a predictable future, less dependent on arbitrary power (Alesina, Ozler, Roubini and Swagel, 1996). This also explains why there are no authoritarian regimes at extremely high income levels. It is thus a short extension of this to the notion that wealthy, internally heterogeneous democracies are more flexible and efficacious at solving problems in a way which is compatible with long-term economic efficiency.

However, the arguments of both Rodrik and the standard *doux commerce* notion are fundamentally unclear about whether democratic processes succeed due to societal rules or to social forces which amount to a democratic community. One of the reasons the detailed empirical results of Przeworski et al (2002) are inconclusive is that they define democracy rather narrowly as formal electoral and legislative procedures. Lindert (2003) shows that the democracy-growth connection is very strong when democracy is defined more broadly as the substantive existence of "voice" in the economy, including not just big electoral institutions, but many small practices that organize and allow participation and political-economic competition. Lindert calls attention to the specific role of educational institutions in determining who has voice, but the general point is about the "wider distribution of voice" (2003: 30), which we have argued is in many respects indelibly communitarian.

This does not imply that democracy is unrelated to formal bridging, i.e. the opportunity to sustain formal political coalitions between groups. There is abundant evidence that religious, ethnic and regional fragmentation are strongly associated with more frequent regime change for both authoritarian and democratic regimes, and with a propensity to authoritarianism. Negotiating the bridges generally occurs when democratic principles are widely accepted, and the resulting democracies are longer-lasting and more stable than authoritarian or corporatist marriages of different groups, with better effects on long-term growth (Easterly, 2001; Przeworski et al 2001).

In this light, it seems likely that the existence and survival of democratic institutions is due to both bonding and bridging. Appealing to the mere existence of formally democratic institutions in more developed economies largely begs the question of how – politically – a society's communities are brought into an economically successful relationship with each other. Even if commerce has a role in this process, it is certainly not anything like the automatic "calling forth" of the institutions and social practices, cited above, which are

functionally necessary to markets. Indeed, much of the causality must run the other way around, with patterns of bonding and bridging likely to determine the capacity of specific institutions for solving economic problems, which in turn enhances economic development.

3.2 Developmental coalitions as bridges between communities

Political scientists and sociologists who are more interested in the classical questions of politics and interests, rather than the micro-foundations of institutions, have tried to identify the politics of successful developmental coalitions and the institutional forms of successful developmental states. Public choice theory does not share this interest in coalitions and states, holding instead that aggregation of interests can and should be generated spontaneously and temporarily. In this view, both who bonds and how they bridge with other groups emerge from rational action under a condition of full information transparency and low to nil transactions costs. Such "Coasian" bargains assume away precisely the conditions which, we have argued in section 2.2, are defining features of the modern economy and which create necessary and efficiency-enhancing roles for groups. More promising, in our view, political economists observe that certain political opportunity structures allow for creation of developmentally-effective political coalitions and the containment of rent-seeking, non-competitive behavior. Sociologists deal with this issue by emphasizing relations between institutions (especially States) and their societies, in determining whether states have the societal support to organize good development strategies.

Along these lines, a wide body of detailed, close-to-the-ground research has shown that the long-term upward spirals of the East Asian, Irish, Israeli (until recently) and even Mauritian economies -- to name just a few -- have been made possible by intelligent developmental strategies (Wade, 1990; Evans, 1995; Amsden, 1992, 2001; O'Malley, 1998).

These strategies have been implemented by well-trained and honest bureaucrats[10] with significant long-term public sector policy involvement; they depend on successful regulation of capital markets and channeling of foreign investment; and they rely on institutionally-nurtured long-term entrepreneurship as a principal source of efficiency and competitiveness.

The question then is: Why have these places been able to develop the institutional wherewithal to succeed, aside from large doses of good timing, good luck, and good training of their bureaucrats? The economic practices favorable to development[11] emerge when they can be made to prevail in domestic politics, through formation of coalitions which back these practices (Amsden, 2001; Evans, 1995). Where do such coalitions come from? One response is to claim that success has come from the establishment of political coalitions whose interests, fortuitously, corresponded to "good economics," while less successful places are dominated by coalitions whose interests correspond to bad economics (Haggard, 1990). However, even Haggard admits that all such coalitions cannot simply be based on a fortuitous coalescence of the interests of each member. This is because they involve distributional tradeoffs, and short-term sacrifices from certain members.

This modifies the question, from searching for perfect convergence of interests, to asking how such coalitions can emerge on the basis of short- to medium-term sacrifices of interests, and development of a common vision of common potential long-term interests. Haggard claims that, in part, the insulation of political elites from certain kinds of interest-based pressures allows them to formulate policies with high long-run payoffs. There is substantial mediation of political choices by institutions and ideas, not just by interests (or at least that ideas transform the time horizons used in defining interests).

[10] The New Comparative Economics emphasize, in this regard, the very long run of “law and order” and the “rule of law,” defined respectively the extent to which a rule-bound state is in place, and the extent to which actors are obliged to follow the rules that are established (Schleifer, 2002).

If this were the case, however, then successful development would simply require the right political opportunity structures, i.e. appropriate formal institutions that respect the independence of technocrats (see, for contrasting positions, Amsden, 2001 and Grossman and Helpman, 2002).The two principal doubts about this argument are, on the one hand, that countries with similar political opportunity structures do very differently with their experts; in some, isolation seems to manifest itself, while in others it does not. On the other hand, isolation does not lead to universally intelligent economic decisionmaking, any more than does total immersion in the rough and tumble of society.[12] For these questions, no purely institutional explanation of public policy will do: some deeper set of forces affects the actual functioning degree of isolation of decisions and their intelligence. In this vein, Aghion et al (2002) argue that the degree of underlying social polarization or fragmentation[13] is positively associated with the insulation of decision-making from day to-day-politics.[14] Hence, potentially conflictual societies "choose" insulation, while more unified ones choose more "democratic" systems. Yet this view has a difficult time accounting for the high level of insulation in Japan and Korea (relatively homogeneous societies), the low level in the USA (another homogeneous country according to their definition), and the evident fact that

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[11] Amsden (2001) calls them "control systems," consisting of good mutual obligations and the respect of these obligations.

[12] Along these lines, the coalitions brought into being by such political opportunity structures must in any case have means of surviving. One could argue, simply, that they either survive in the successful cases because of their success with development, while in the other cases, they survive by providing rents to the powerful. But all development processes generate ongoing potential for conflict, and require internal adjustments. Are these adjustments achievable simply through the inertia of political opportunity structures (intelligent insulated elites in the successful cases, or powerful rent-seeking coalitions in the others)? This seems more plausible for developmental blockage than success. Successful coalitions must ultimately be good at resolving the real conflicts engendered by development, by drawing on the real communities of interest in existence and maintaining them in some viable societal relationship to one another. In other words, successful political coalitions depend for their formation not only on fortuitous institutional set-ups and good ideas; they also respond to ongoing interactions of communities which make up the society in question. This brings us full circle to the existence of law and order and the rule of law, but these do not exist as abstract societal forces; they exist as concrete practices that different communities use to bridge their interactions with other communities.

[13] The sources of such fragmentation might be ethnic, regional or class-based.

[14] But this relationship weakens as countries become richer, because the need for large reforms becomes smaller and losses can be compensated at costs which represent small proportions of total societal wealth. Hence, there is a generally lower need for political insulation.

developmental success can be had in low insulation political structures like those of the USA or Canada, as well as in high insulation situations such as Korea or Japan.

Still, many authors confirm that primordial bonding patterns set the basic parameters for the problem of societal bridging. These include the degree of racial, ethnic, language, economic, and geographical homogeneity or diversity of the society in question. Easterly (2001) shows that the more ethnic or racial divisions there are in a society, the more tendency there is for rent-seeking behavior to undermine developmentalist policy and efficient use of foreign aid. Amsden (2001) holds that societies with less income inequality have done better in implementing strategies for becoming major manufacturing powers. This is because equality between individuals cuts across groups and makes it more difficult to disenfranchise other groups and/or subject them to rent-earning behavior by the dominant groups. It also, as Aghion (1998) points out, eliminates the disincentive to effort that extreme inequality can generate, a point echoed by Amartya Sen (1999). Racial and ethnic homogeneity often, but not always, correspond to lower levels of income inequality and hence reinforce each other in promoting bridging, which in turn helps to achieve consensus around developmental objectives. Amsden (2001) claims specifically that such consensus manifests itself in the capacity to establish “control systems,” consisting of enforceable mutual obligations between states and firms. Alesina and Rodrik (1994) argue that lower inequality reduces the need for redistributive politics which sap growth-producing investment. In another vein, sociologists such as Pizzorno (1980) emphasized that becoming a “middle class” society was both a result of the acquiring of common values – echoing the point made in the previous section about democracy as a form of community – and because the habits of the middle class

are bridges between people with different primordial bonds, a set of practices they share, a common language.[15]

Nonetheless, the contemporary field of political economy shows that there can be no direct passage from these underlying parameters of diversity and equality to developmental outcomes, as is suggested by Figure 2.

FIGURE 2: SOCIETAL UNITY AND DEVELOPMENT REGIMES

	HIGH EQUALITY	**HIGH INEQUALITY**
HETEROGENEITY/DIVERSITY	▪ corporatist democracy? ▪ paralyzed corporatism? ▪ beneficial political competition? ▪ special interest paralysis?	▪ authoritarian plundering elite? ▪ insider/outsider developmental regime?
HOMOGENEITY	▪ developmentalist dictatorship? ▪ Scandinavian democracy? ▪ hierarchical, Asian-style obligational system	▪ plundering elite? ▪ developmental elite?

Political economists point out that there are political opportunity structures in between these structural features of the society and the type of regime which is established. But then we are simply back to the issue raised by Aghion and the school of comparative economics, i.e. how underlying configurations of social forces give rise to institutions, i.e. political opportunity structures and economic governance regimes.

To get around this risk of infinite regress in the analysis, then, the question must be reframed, in three ways. One is to lower the level of aggregation or abstraction, and to analyze bonding and bridging in relationship to specific domains of economic problem-solving. The relevant institutions are not just constitutions, legal regimes, and political-electoral systems, nor even just formal institutions that regulate labor and capital markets,

[15] This also echoes Lipset's (1963) notion of cross-cutting diversified alliances as generating a kind of

but also include a wide range of quotidian ways that groups create voice and how they relate to each other, much in the same way that was suggested for the democracy question in section 3.1.[16] Another is to see bonding and bridging as interactive, mutually transformative processes, rather than determined by fixed functional parameters, at one extreme, or totally malleable according to Coasian bargains, at the other extreme. A third is to hold that bonding and bridging have causes which are, at least partially, independent of formal institutional architecture and political opportunity structures, that they drive the different economic performances of institutions and governance regimes and they also affect the "choice" of such regimes.

4. HOW SOCIETY AND COMMUNITY FRAME INCENTIVES

As we have seen, markets and development pathways require both bonding and bridging. In markets, transactions costs and moral hazards may be reduced by communities and by societal rules and practices. Spillovers which are at the heart of achieving the increasing returns which are central to the growth process can only be achieved in the presence of certain kinds of bonds between people, but rigid bonds or too much social hierarchy may also inhibit them from coming about. Developmental pathways require bridging between people, without which the coalitions that make it possible to deal with problems and governance are impossible, but bridging is ultimately strongly shaped by the underlying patterns of bonding or communities.

moderation, generalized bridging.

[16] Along the lines of this focus on "small" and not just big institutions, we can cite economic historians like O'Rourke and Williamson who claim that the "Industrial Revolution" was not a revolution, but a long drawn-out process of rising productivity through many small improvements, and good incremental problem-solving. Technological breakthroughs helped, but in order to have their full effect, they required wide, long, and deep ongoing institutional complements.

Communitarian and societal forces interact, necessarily, in shaping the complex institutional contexts that actors face. What do they do when they interact? They shape the basic ways that individuals can participate in the economy, creating incentives for them to do some things and not do others. This is why considering society and community in interaction allows us to analyze the formation of incentives under institutional conditions which are *not* "well controlled." Society and community are in a sort of delicate interaction with each other, generating a wide variety of strengths and weaknesses in the development process, and doing so differently across space and time.

What are these incentives? The first column of Figure 3 lists three main institutional areas in which certain first-order conditions for economic growth must be satisfied: those that assure microeconomic efficiency; those that define social policy underpinnings of such efficiency; and those that encourage effective problem-solving (see also Rodrik, 2003).[17]

To take the first such feature, any set of forces which systematically reduces transactions costs and moral hazards creates a microeconomic environment that comes across to individual actors as the possibility to have confidence in the economic process and to better estimate future rewards. This environment is reflected in discount rates, risk perceptions[18] and the estimation of long-term wealth accumulation prospects, leading to higher expectations and effort levels. These in turn have many beneficial effects on long-term economic performance by encouraging actors to participate in the routines that are favorable to the economy, which are shown in column three. They include encouraging innovative (Schumpeterian) entrepreneurship (Casson, 1995; Kirzner, 1973; Schumpeter, 1991); improving the coordination of inter-firm transactions, both lowering costs and raising the

[17] There is of course a fourth area, macroeconomics, but that is beyond the scope of the present paper.
[18] We are reminded here of the fundamental distinction between risk and uncertainty, introduced by Frank Knight (1921). When confidence is weak or absent, the problem is that risks can no longer be estimated and

willingness of firms to try to construct them, hence improving the growth-inducing effects of the economy-wide division of labor (Young, 1929; Stigler, 1951); and raising investment levels through the abovementioned effects on discount rates and risk perceptions.

Confidence is directly related to the central mechanism of contemporary growth theory, which is the accumulation and application of knowledge (Lucas, 1988). As noted earlier, knowledge is different from many other factors of production, in that it can have increasing returns because it can be re-used at no additional cost and can be applied in many different ways and recombined into different uses; these features permit it to avoid diminishing returns. Communities facilitate the selective affinities underlying knowledge spillovers and snowball effects in its application. At the same time, if knowledge stays too much inside such communities – when communities mistrust each other -- then development will have a limited and uneven spread; so, there need to be ways of bridging between communities, in other words ways of providing more knowledgeable communities with confidence that their knowledge will be well used by members of other communities. Mutual confidence through both bonding and bridging is essential, then, to creating knowledge-based growth. In addition, confidence encourages governments to be less myopic in their policies, and myopic governmental policies have been shown to be harmful to growth (Persson and Tabellini, 2002).

The second feature is an effective social policy environment, as reflected in distributional arrangements -- not to be confused with the absence of distributional conflict. When there are social forces that generate acceptable distributional arrangements, such arrangements will encourage necessary sacrifices to be made when economies undergo the inevitable shocks and setbacks of any development process (Rodrik, 1999). Thus, it also has

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hence minimized, and actors must face true uncertainty, with strongly negative effects on many of the foundations of long-term growth.

a positive incentive effect. Aghion (1998) has argued that excessive inequality is just as bad as excessive income levelling, because too much inequality simply leads to withdrawal of effort by potentially productive actors; formally, it amounts to a capital market imperfection.[19] In the context of knowledge matching and spillover effects, appropriate distributional arrangements encourage participation and discourage withdrawal of effort – whether between or within groups. One way in which they do this is by providing incentives for those who are not the greatest beneficiaries of new technologies to support (or at least not block) innovations, generally most strongly pushed by those who stand to benefit the most from them (Mokyr, 1990). There is a balance to be achieved between individual and group incentives in order to minimize moral hazards but maximize complementarity effects. Alesina and Rodrik (1994) and Persson and Tabellini (2002) argue theoretically that less inequality has a positive relationship to growth, which is consistent with the empirical evidence which shows that the Highly Performing Asian Economies (HPAEs) have all been characterized by limited inequality, in contrast to the poorly-performing Latin American economies. Moderation in inequality improves overall investments in skill creation, raises the incentives to participate fully in the formal economy and to become an entrepreneur (hence, participation rates and levels), and improves the willingness to pay taxes and to invest. Effective distributional arrangements are central to achieving the spillovers we identified in section 2.2 as essential to long-term growth.

Veblen and other precursors of evolutionary thinking in economics gave us the basic notion that an economy's institutions would allow it (if successful) to self-select in an ongoing way into the things it could do well, and hence to develop (Hodgson, 2002). Behind

[19] These have an indirect link to Sen's (1999) notion that extreme inequality expresses the lack of, but also impedes the construction of, the social bonds which are crucial to development, because it discourages provision

this is the notion that no institutional arrangements resolve all problems for good. Ongoing adjustment of the rules governing investment, entrepreneurship and the regulation of labor markets, which are necessary as an economy undergoes structural change in the course of development (what are good institutional forms at one stage are no longer appropriate at others) and as external circumstances change (Bremer and Kasarda, 2002). Problem-solving coalitions and processes are necessary.

These three broad features and their associated economic behaviors characterize a wide variety of successful long-term economic development experiences. By contrast, cases of stagnation or long-term developmental regress manifest failure to achieve these features and to enjoy the microeconomic and aggregate effects described in Figure 3.

of certain necessary social goods and deprives the poorest of the preconditions (basic resources) which would enable them to contribute to their own, and society's, development.

Figure 3:

THE FOUNDATIONS OF DEVELOPMENT

INCENTIVES NECESSARY TO LONG-TERM DEVELOPMENT	PRINCIPAL MICRO-ECONOMIC EFFECTS OF EACH INCENTIVE	OPERATIONAL INSTITUTIONS: BEHAVIOR, ROUTINES, REGULARITIES
MICROECONOMIC: Generate confidence ?	▪ Reduces transactions costs (coordination) ▪ Reduces moral hazards (incentives) ▪ Raises expectations and efforts: discount rate (incentives) ?	▪ Encourages Schumpeterian entrepreneurship ▪ Improves coordination of firm-firm transactions ▪ Raises investment levels ?
SOCIAL POLICY: Effective and acceptable distributional arrangements ??	▪ precedent encourages ongoing 'sacrifices' in face of shocks (incentives) ▪ Overcomes disincentive to participate and make effort: limits to exploitative rent-seeking(incentives) ▪ Overcomes disincentive to invest and create employment : limits to revanchist rent-seeking ▪ Improves willingness to pay taxes (incentives) ??	▪ Raises investments in skills ▪ Raises work and entrepreneurial participation rates ▪ Raises public investment levels, some of which lower business costs ??
PROBLEM-SOLVING: Adjustments of incentives and coordination, prevent sclerosis	▪ Participation of groups enhanced (incentives, coordination) ▪ minimize rent-seeking from corporatism (incentives, coordination)	▪ Better adjustment of rules governing entrepreneurship and labor markets. ▪ Intelligent ideas more likely to receive support as public policy ▪ Coalitions can form, avoiding chaotic instability

Figure 4 now shows how each of these types of incentive is shaped and given concrete institutional form by society-community interactions (horizontal), and in turn on their mutual interactions (vertical). The crux of our argument is shown in the fourth and fifth columns.

Generalized confidence emerges when the pervasive information problems, attendant moral hazards, and market failures of all modern economies are attenuated, especially in their most creative and innovative activities and sectors. Communities are low-cost ways of resolving these problems, by creating trust, reputation effects and shared conventions. No

fully "societal" system – whether markets or administered, centralized bureaucracies -- has ever succeeded in doing everything that communities can do in this regard. But communities can be prejudicial to economic development if they lead to rent-seeking; hence, they must be in a delicate and dynamic relationship with the forces that promote transparency, entry and exit, and limit rent-seeking, helping to complete markets where communities might stifle them. Generalized confidence, in other words, requires both society and community.

The same is true of the achievement of effective and acceptable distributional tradeoffs. These can neither be administered by a societal overseer, nor will they come about from the spontaneous interaction of different communities with each other (and certainly will not come about from the spontaneous interaction of individual agents). Communities are based on loyalty, and they can give voice to agents whose claims would otherwise go unheard by markets.[20] Moreover, group membership has the virtue of diffusing a sense of "being in the same boat," and those who are in the boat can contribute to a mutual sense that fairness has been achieved (as well as injustice and anger). In the former case, the acceptability of any distributional tradeoff is enhanced. Finally, communities -- even in the most modern of economies -- often have concrete effects on distributional matters. Families in some economies carry out income redistribution and smoothing, mobilize savings at low interest rates, and share work. But society is necessary as well, if undesirable forms of cronyism or enduring hierarchy are to be avoided. Competition and political interaction between groups counteract corporatism and distributional hold-ups; generalized standards of efficiency and fairness can constrain certain group demands and privileges; and inter-group mobility (the possibility of exit) can have disciplining effects on what groups do to obtain their piece of the pie.

[20] In the formal sense, scale lowers transactions costs and raises the payoffs to addressing preferences shared on a large scale.

Ongoing conflict resolution is, in many ways, the overall dynamic outcome of these other features of development. Resolving such conflicts involves, at the very least, adjustment of rules governing the vital center of the development process: entrepreneurship, labor markets, and investment. Effective problem-solving and institutional adaptation come about when it is difficult for groups to practice excessive corporatism and rent-seeking and when problem-solving bridges are built between the relevant groups. On the one hand, the community-based social bonds referred to above provide groups a certain degree of security, allowing them to be "at the table" so that their voices can be heard, whether formally or in a more diffused manner. Societal forces described create limits to group power, parameters for their actions, so that the position of groups is not so secure that other coalitions are impossible. Participation of many different groups prevents them from practicing negative forms of exit (resignation or winner-take-all) from the problem-solving process. This helps avoid the twin dangers of “bad” stability in the form of interest-based but non-developmentalist (rent-seeking) coalitions, on one hand, or extreme instability, on the other (Alesina, Ozler, Roubini and Swagel, 1996). Hence, there is less danger that intelligent ideas will be blocked out, because the principal interest groups have less ability and incentive to bind themselves to rigid, exclusively self-serving positions. This makes institutional learning more probable (Haggard, 1990) and even may allow ongoing revision of the most basic institutional infrastructure, such as legal principles, the system of political power-sharing, and other factors that influence political opportunity structures and hence the possibility for competing ideas to be heard (Aghion et al, 2002; Evans, 1995).

Figure 4:

SOCIETY-COMMUNITY INTERACTIONS AND INCENTIVES

INCENTIVES NECESSARY TO LONG-TERM DEVELOPMENT	PRINCIPAL MICRO-ECONOMIC EFFECTS OF EACH INCENTIVE	OPERATIONAL INSTITUTIONS: BEHAVIOR, ROUTINES, REGULARITIES	ROLE OF COMMUNITARIAN "BONDING" IN BRINGING ABOUT EACH INCENTIVE	ROLE OF SOCIETAL "BRIDGING" IN BRINGING ABOUT EACH INCENTIVE
MICROECONOMIC: confidence ?	▪ Reduces transactions costs ▪ Reduces moral hazards ▪ Raises expectations and efforts ?	▪ Encourages Schumpeterian entrepreneur ▪ Improves coordination of firm-firm transactions ▪ Raises investment levels ? ?	▪ Reputation effects, shared conventions, identities: (depends on process of group formation): ▪ overcome certain information problems in low-cost way (but can encourage rent-seeking) ?	▪ Overarching rules promote transparency and limit rent-seeking, help to complete markets ?
SOCIAL POLICY: Effective and acceptable distributional tradeoffs ??	▪ precedent encourages ongoing 'sacrifices' in face of shocks (Rodrik) ▪ Overcomes disincentive to participate and make effort (Aghion) ??	▪ Raises investments in skills ▪ Raises work and entrepreneurial participation rates ▪ Improves willingness to pay taxes (investment) ?? ?	▪ Voice and loyalty ▪ Being in the same boat enhances acceptability ▪ Membership may involve real forms of intra-group redistribution ?	▪ Counteracts corporatism and distributional hold-ups ▪ Standards of fairness and efficiency constrain group demands ▪ Inter-group mobility (exit), disciplines groups ?
PROBLEM-SOLVING: successful ongoing conflict resolution	▪ Participation of groups is enhanced ▪ minimize rent-seeking from corporatism	▪ Better adjustment of rules governing entrepreneurship and labor markets. ▪ Intelligent ideas more likely to receive support as public policy ▪ Coalitions can form, avoiding chaotic instability ?	▪ Secure groups encourage coalition formation: voice that gets heard (but risk of P-A problems) ?	▪ Limits to group power encourage compromise ▪ Exit options, defection, make other coalitions possible, hence dynamically limit P-A problems ?

Legend:
? ? : cumulative and/or one-way causal effect
? ? : **two-way interactions and feedbacks**

What exactly is this relationship between bonding and bridging, however? Notice that in each area, the ideal-type outcomes described above are based on a sort of bargain, where a favorable balance of society and community allows the positive effects of each to emerge, while each also acts as a check and balance on the potentially negative effects of the other, taken alone. Thus, together society and community permit actors to reduce transactions costs, limit moral hazards, and reduce rent-seeking, while also reducing the exercise of absolute power by any group and hence promoting competition and innovation. All are critical to the definition of the expectations of agents and hence how they identify and project their interests into the collective sphere.[21] A favorable balance comes about when the right mix of forms of participation exists.

Thus, society and community shape each other, but paradoxically they do so because of their independence from one another; each consists of different kinds of social practices and interactions, constituted at different spatial-temporal scales. Hence, for the purposes of a theory of the institutional bases of economic development, Putnam's categories, rather than being added together into a single index of social capital, may be better maintained separate, as their effects are offsetting or corrective. This is also why the tendency for the social sciences to become partisans of either society or community as the source of development is very likely wrong and why we argue here for a reformulation of the problem of the social foundations of the institutions that promote economic development.

This approach should help explain degrees of success in long-term economic development. Roughly speaking, we expect that bonding without bridging or bridging

[21] Although the principal-agent problem and impossibility theorem show us that even within a group, such tensions can exist. However, there is a major difference in degree of tension and hence in the intensity of relationships within groups and between groups. If this were not the case, bridges between groups would be

without bonding lead to the less desirable outcomes described in the NW and SE cases in Figure 5. Some kind of interaction between the two is most favorable to creating the incentives to long-term economic development.

Figure 5: THE MANY POSSIBILITIES [22]

SOCIETY \ **COMMUNITY**	**LOW**	**HIGH**
HIGH	▪ Insufficient public goods; ▪ Lower confidence, higher transactions costs ▪ Long-term,unacceptable distributional tradeoffs; ▪ Costly conflict resolution, confrontational society	▪ Facilitates confidence ▪ Facilitates sustainable distributional trade offs ▪ Facilitatesconflict resolution; ▪ Strong society modernizes community; ▪ Strong community reduces costs assoc. with anonymity;
LOW	▪ Chaos ▪ Law of the Jungle	▪ Prevalence of “primitive” forms of community; ▪ Hierarchical relations between groups ▪ Rent-seeking groups ▪ Low-trust, lack of confidence; ▪ Unacceptable distributional effects due to rents and hierarchy; ▪ Permanent conflicts

transformed into bonds within groups as different groups of principals merged and decided to have unified agents working for them.

[22] This figure was suggested to me by Andres Rodriguez-Pose. See also Rodriguez-Pose, 1999.

5. CONCLUSION: SOCIAL FORCES, POLITICS AND ECONOMICS

The notion that there are complex contexts for action such as those resulting from interaction of society and communities meets with significant resistance from most economic theory, which generally prefers to consider only societal forces -- transparent and anonymous market-style relations between economic agents. These forces, by sustaining the whip of competition, effectively negate or render transitory and insignificant the possible roles for complex contexts. Even much contemporary institutional economics considers institutional forms to arise as consequence of set of market imperfections or information imperfections; thus, rational action generates institutional forms within the economy. As such its primary mission is not to analyze institutional contexts as *shapers of* the economy (Glaeser and Schliefer, 2001). Comparative economics goes beyond this, in its "recognition that the pure competitive model is not a useful way to think about capitalist economies, and that political and economic institutions crucially shape performance" (Schliefer, 2002:12). In contrast to institutional economics, which stresses the universal and common institutional foundations of modern economies, comparative economics emphasizes institutional diversity.[23] It shares with public choice theory an interest in political processes, but unlike the latter, admits that a wide variety of political and social factors will affect the choice of institutions and their efficiency. Comparative economics asks why certain institutional forms come about under different exogenous conditions, concluding that the latter set up particular bargaining or choice situations. Subsequent development can be seen as path dependent. Thus, for example, the existence of different communities (regional, ethnic, or feudal) affect the

construction of institutional forms of property rights and the rule of law, which emerge because of the particular bargaining games between such groups. These institutions then have long-term effects on economic development because of the ways they affect individual incentives and collective problem-solving.

Nonetheless, comparative economics does not tell us clearly whether diversity merely reflects efficient solutions to different starting points, or whether there are many different equally efficient institutions for a given purpose. Moreover, comparative economics mostly focuses on "big" institutions, especially property rights and the rule of law. Most of its work is not on gradual improvements in institutions, small institutional practices, or institutions below the national level, the practical quotidian substance of democratic practice and its relationship to the development process. Thus, a double diversity is at work, not merely having to do with starting points, but also with different ways to resolve the collective action situations generated by starting points.

A number of these dilemmas of institutional analysis can be confronted by focusing on the interaction of society and community in defining the landscape of incentives in the economy. A richer and more realistic palette of influences on action (notably those of community) can thus be taken into account than can be accommodated in most comparative economics, institutional economics, and public choice theory. This is because society and community interactions define the complex contexts alluded to above, with different starting points, but also with different possible efficient institutional forms for development. Society and community can interact in many efficient ways (not necessarily pareto efficient), such that the concrete institutional forms of confidence, distributional arrangements, and coalitional behavior which lead to development are many and sundry and they lead to

[23] Institutionalist economics, in this sense, refers principally to transaction-cost economics, which are centrally interested in whether the conditions for Coasian bargains exist and if they do not, how to secure them, and when

complex evolutionary selection dynamics of economies into what they do best. But economies also fail: a workable balance between society and community – and thus the creation of solid incentives to development -- is often not achieved, and this framework can be used to illuminate such failure.

Moreover, if the argument made in previous sections is correct, then there is no simple mapping of associational patterns or institutional forms onto success and failure, but rather the question of how institutions substantively resolve society-community relations. Along these lines, Rodrik (2003) and Engermann and Sokoloff (2003) show that there are many different ways to satisfy neoclassical development tenets; good institutions deliver first-order development conditions effectively but not necessarily in identical ways. The task of our theory is thus not to search for consistent institutional forms – a putative isomorphism of institutions to development – but rather to find context-sensitive "razor's edge" interactions between bonding and bridging that achieve the substantive outcomes identified in economic theory and evidence.

The central proposition of this paper requires much more analytical precision and theoretical elaboration than we are able to give it here. While it is likely never to be as analytically parsimonious as certain other theories of the institutional foundations of development, it does respond to the need to reintroduce a realistic view of social forces into the theory of comparative economics, i.e. to relax the overly-restrictive assumptions which are commonly used in political economy and institutional economics to theorize economic development. It is nonetheless still relatively parsimonious because it locates sources of variety in the interaction of two basic forms of social organization, community and society.

Current debates over development theory and policy, however, show just how far away we are from any such sense of the problem. Market fundamentalists and institutionalists

they do, what kinds of optimal institutional arrangements exist for a given problem.

debate each other with little common language, with the former claiming the high ground of incentives but losing sight of how they are really constructed, while the latter tend to emphasize control and authority over the development process and needlessly concede incentives and micro-efficiency to the context-less analyses of market fundamentalists.

The task proposed is complicated by the fact that the starting points for each society are different, and that the ending points, in terms of the precise articulations between society and community which are achievable and which correspond to the desires of each society, also show considerable variation. This in no way calls for complete relativism; it does help place the lessons from certain valuable parsimonious economic theories into a more grounded and realistic sociological framework.

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