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# COMMUNITY AND ECONOMICS

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## ABSTRACT

Community has a problematic relationship to economics. In general, contemporary political economics holds that groups have strongly negative effects on economic efficiency and growth, because groups bind individuals into situations where they can no longer realize their preferences, exit freely, and find effective representation for their interests. Communities are, at best, necessary evils when there are egregious market failures. There are other strands of economic research, however, that can be drawn on to provide micro-foundations for the welfare-enhancing properties of communities. With these in hand, we can draw a more complete picture of the potential welfare effects of communities, both positive and negative. Geographical processes -- increasing factor mobility and global market integration -- strongly affect the shape and functioning of communities and hence alter the balance of their positive and negative economic welfare effects.

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### 0. SHOULD COMMUNITY HAVE A BAD NAME?

“Community” has a generally bad name in economics and allied social sciences. Since Mancur Olson, we associate groups – everything ranging from informal, traditional communities to organized groups – with a range of growth-limiting vices, including rent-seeking and blocking of change (Olson, 1965). A second negative view of groups comes from several sources, including public choice theory, the economics of information, and contract theory. It provides a picture of the ways that collective life frustrates preference attainment: it is impossible to aggregate voices perfectly; leadership inevitably runs into principal-agent problems; and groups create insider-outsider dynamics, which in turn impede the factor mobility held to be the key to long-term economic growth.

The corollary of this negative, “blocking” view of communities, is that much of economics and political economy is favorable to “institutions.” This generally refers to broad rules of the game which, when appropriate, provide the order and stability in which markets can function. This facilitates the ongoing adjustments to the economy that make development possible. And, most importantly, institutions limit the damage that groups, or the “players of the game” can do, through such things as property rights, the rule of law, constraints on the executive, individual rights, and limits on monopoly power. Good institutions protect markets and individuals from the ravages of community, though there is immense debate about precisely which such rules/institutions do this optimally.<sup>3</sup>

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<sup>3</sup> This question is dealt with in more detail in section 6.2 of this paper.

In contrast, community has a rather good name in other quarters. The social capital literature argues that bonds between people, based on such things as trust, and underpinning social networks or associational life, have positive effects on social and economic development. Communities are held to encourage participation, generate forms of reciprocity that bind individuals to the wider society, and generally promote compromise and dampen conflict. Associational “Putnam communities” are hence considered to be different from the interest-based, rent-seeking “Olson communities” (Putnam, 2000; Olson, 1965; Knack, 2003). Overall, the mainstream economist’s “blocking” view of community stands in stark opposition to this theory of communities with effects of “empowering and efficient exchange.”

A third view of community, developed in economic sociology, is more agnostic in outlook than either of the above. Actor-networks are, simply, unavoidable in many economic processes (Granovetter, 1983, 1985).<sup>4</sup> The effects may be negative or positive, but in any case market exchange is under-pinned by non-market group mechanisms. Some actor-networks are welded together through trust, interpersonal relationships, and reputations, all of which can substantially lower transaction costs and hence improve the efficiency of economic coordination, but some reinforce special interests and privileged access to resources.

One particular type of actor-network that has been the object of intense interest recently are “communities of practice” (henceforth, COPS), where the action shared in

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<sup>4</sup> In addition, any examination of the question of community has to try to distance itself from its highly-charged political meanings. In the Anglo-Saxon political world, community conjures up images of “natural” social bonds, the mobilization of underprivileged groups, and the healing of the wounds of a highly fragmented society through the involvement of community-based organizations and other NGOs in the political process. International organizations have come to embrace these “communities” for the work they supposedly do in implementing development programs. In other regions, such as social democratic Europe, “community” tends to be viewed with suspicion, as a form of particularism, weakening the pursuit of the common social good.

the network is some type of shared practice. One probable reason that there is so much interest in COPS is that they correspond to so many important forms of modern organization that are not of the traditional community type. Many familiar organizations, such as firms, non-governmental organizations, and professional associations, are COPS. COPS are typically defined around the competences necessary for belonging to them, which allow members to engage in the routines of the community. One of the main concerns of analyses of COPS is how competences and routines affect dynamic processes, or performance, of the organizations (such as firms) or systems (such as industries) to which they are relevant. One particular concern has to do with whether routines allow members or groups to improve their competences, such as through learning. Not all COPS engage in, or facilitate, direct market exchange. Some of them may indeed do so, as when a professional actor-network establishes de facto standards for professional performance, and hence becomes an essential element of screening and signaling performance in labor or product markets. But some of them are well upstream of market processes, or are simply engaged in non-market activities, as in Putnam-type voluntary associations. COPS are thus actor-network communities, but with some distinctive properties.

The “blocking” view of the effects of communities on the economy has been most precisely formulated in relationship to the core concerns of economic theory, but the empowerment/exchange view has amassed a considerable literature in recent years.<sup>5</sup> A first task in considering community and economics is, then, to determine whether these two perspectives substantially cover the basic effects of community membership on the

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<sup>5</sup> For an extensive review of both these literatures, see Farole, T; Rodriguez-Pose, A; and Storper, M, 2007a.

processes of preference determination and choice that are central to economics. Our response is that they do not, in four major ways that are detailed in sections 1-4 below: (1) communities are often essential foundations of efficient exchange, and not just as “second-best” to markets; (2) communities can help individual economic agents discover their preferences; (3) communities can provide agency and voice in realizing preferences; and (4) communities can help certain types of efficient choice to emerge from a variety of preferences. Once we define these processes, we can then – in concert with the blockage and empowerment views of the effects of community, generate a more complete “balance sheet” of the micro-economics of community and hence of the welfare effects of group life (section 5).

Finally, we will consider the geographical aspects of community and economics. Traditionally, communities are identified with territories and, in a somewhat caricatured way, they are counter-posed to a world of perfectly mobile factors. The story is much more complex than this today. Indeed, certain types of actor-networks and COPS appear to be constructed more around links between practitioners, than links between geographically-proximate agents. What are the differences between an economy structured (for better or for worse) by a society of territorially-bound and differentiated groups versus one whose groups have no distinctive territorial roots? How does such a prospect relate to the core concerns of economic policies that promote factor mobility as their central objective (section 6)?

In this paper, we are interested principally in establishing the micro-foundations of communities or group life in the economy, and then aggregating up from there to broader possible effects of community on economic organization and performance.

There is no question that groups and communities “precede” individuals in time and over space; establishing micro-foundations is not the same as claiming that communities are instantaneously “generated” by individual choices, as some caricatured views would hold. But the reverse does not hold either, i.e. that individuals have no deliberative rationality and therefore are mere carriers of group routines and constraints imposed on them. Indeed, it is precisely the relationship between individual life and group life that gives rise to the most interesting insights into why communities exist and what they do.

## **1. INTERACTION: INTERPERSONAL RELATIONS AND IMPERSONAL EXCHANGE**

In the 11<sup>th</sup> century, the Maghribi traders around the Mediterranean faced a problem. These descendants of Jews who had fled the Baghdad region in the 10<sup>th</sup> century had a close knit community, but they needed distant agents for their commercial transactions, agents whom they could not monitor directly. Avner Greif (1993) shows that this community functioned according to the Merchants’ Law, such that any agent who cheated would not be rehired by any member of the community for a long time, and the options available to such an agent were substantially reduced by such potential exclusion.

From the vantage point of economics, anything that minimizes transaction costs per unit output is going to raise potential output. Such costs can be associated with information-gathering, as well as evaluation and determination of the reliability of information and possible moral hazards. Group membership can assist in all these

dimensions of transacting, through reputation effects, signaling, and gatekeeping/filtering of participants. The production possibility frontier from a given stock of factors is raised if, all other things equal, there are increased possibilities for impersonal exchange and hence a deeper division of labor. Along these lines, Fukuyama (1996) argues that economies with greater generalized trust will more easily build large firms, extending the circle of exchange beyond what it could achieve through direct managerial control. But economically-important trust can also operate at the level of communities such as the Maghribi traders. A more recent example is the way in which the world high-technology economy emanating from Silicon Valley has been extended to China, India, Taiwan and Israel through the ethnic communities that Saxenian (2006) calls the “new argonauts” -- extensions of impersonal exchange that would not be able to take place without underlying communities. The bases of exchange in many areas of the economy are initially developed by communities of practice, and as they are formalized, they then permit greater impersonal exchange to develop.

This issue is usually handled in economic analysis via comparative statics. Thus, Greif asks whether the Merchants’ Law was a second-best solution in a world where stable, spatially-extended institutions that could guarantee exchange were effectively absent.<sup>6</sup> But in real sequences of economic development, it seems often that larger-scale institutions are ultimately forged from experiences that begin as community-based exchanges. Technological and organizational innovation almost invariably require this to be the case, because of their high levels of uncertainty. These activities then sometimes ultimately standardize their community-based exchange processes in the language of, and

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<sup>6</sup> There is a general debate about this question of whether such forms can be optimal or just second-best (Bowles and Gintis, 2002, 2003).

through the judicial power of, formal rules. But their origins in community-based processes should not be forgotten, because they facilitate the dynamics of economic development. To represent the process in the sole terms of comparative statics is to miss the way that exchange actually develops over time and space.

## **2. DISCOVERY: KNOWING WHAT WE WANT**

Does belonging to groups help or hinder an individual in achieving her preferences? There are several parts to this question: knowing what we want (the formulation of preferences), acting on what we want, and aggregate choice of what we want (making choices). Here we will take up the first of these. Looking into patterns of group membership and their effects on preference discovery would help us to take on a central question of welfare economics, i.e. the extent to which self-centered goals enhance welfare as opposed to goals defined by other influences, including social ties.

Until recently, economics eschewed the question of knowing what we want, preferring to assign it to subjectivity, the domain of psychology. Social choice theory claims that we cannot know the preferences of others and hence we cannot expect, in any meaningful way, to align our actions to achieve common goals (Robbins, 1938; Arrow, 1951, 1963). Public choice theory holds that merely being interested in what others want (except strategically) is likely to involve us in stifling our preferences, because it requires deference to others and to the – necessarily limited – goals we perceive as being jointly achievable.



There is wide agreement that social context and preferences are intimately related. Sociology stresses the role of socialization, and group experience is demonstrably very important in socialization, but says little about how socialization relates to the wide diversity of choices made by individuals in the same social groups (Bénabou and Tirole, 2005; Alesina and George-Marios, 2005; Alesina and Fuchs-Schündeln, 2005).

Behavioral economics emphasizes *situations*, the idea that individual decisions are based on very local influences, rather than long-run well being. Local stimuli trigger emotions and these emotions influence decisions (Romer, 2000). Ross and Nisbet (1991) argue that the central lesson of a large body of psychological research is the importance of situational factors in decision-making.<sup>7</sup> Prospect theory tells us that people put enormous weight on reference points that are local, arbitrary and ephemeral (Kahneman and Tversky, 1979). Mental accounting theory suggests that people make decisions and ignore events and consequences outside of a narrow, local domain (Thaler, 1994). Hyperbolic discounters place extreme weight on the present and cue-theory shows the large role of ephemeral situational forces. If these are the realities of decision-making, then the supply of situations is central to preference definition and choice.

Membership in communities, groups or networks can be thought of as an important component of the supply of situations in which individuals find themselves. One obvious aspect of this is whether groups define situations that help their members to know what they want, and in a non-coercive way. If this is so, group membership can be said really to clarify things for their individual members, and not merely to inculcate

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<sup>7</sup> I owe this review of situationalism to Glaeser, 2003.

group values in them, or to steer them toward short-term welfare-distorting values and preferences.<sup>8</sup>

For example, it might be simply that the supply of situations is a parameter for individual maximizing behavior. If my neighbors are all members of a racist community, then my payoffs to being racist will rise. If, on the other hand, there is an anti-racism group in the area, my payoffs to being not racist are altered. It could well be that joining the anti-racism group changes my perceptions of race by giving me information I would otherwise not have. A more subtle distinction, however, is that *interaction* within and between groups doesn't just provide me more information, it also provides me with *experiences* and *examples* that intersect with my own view of my self, and hence exercise an impact on how I define my preferences (Young and Durlauf, 2001). This process of *discovery* is not considered in standard approaches to situations.

Another aspect of the supply of situations is their relationship to identity and, through this, the way we define our welfare goals (Akerlof and Kranton, 2000). Sen (1985) distinguishes between self-centered welfare (involves no sympathy or antipathy toward others); self-welfare goals (maximizing may or may not involve attaching importance to the welfare of others); and self-goal choices (not restrained by the recognition of other people's pursuit of their goals). The first thing to note is that these three requirements – generally imposed jointly in economic models of choice – are in reality independent of one another. For example, one can violate self-centered welfare (someone else's misfortune affects our welfare), but this doesn't tell us whether or not their self-welfare goal will contain this criterion or not. There are obviously differences

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<sup>8</sup> There is some literature on the degree of endogeneity of preferences and the role of situations: Alesina and Fuchs-Schundlen, 2005; Alesina and LaFerrara 2005; Alesina and George-Marios, 2005; Bénabou and Tirole, 2005; Bowles, 1998; Corneo and Gruner, 2002.

in subjectivity, as well as differences in situations, generating widely-varying propensities for self-welfare goals take into account the reality of others' lives.

In both the case where self-welfare goals conform to the standard definition – they do not take into account the welfare of others – and where they do take into account the welfare of others -- an external reality may still be an instrument to understanding and defining these goals. We are speaking here not of membership as a simple sympathy device – sensitizing us to others' welfare and integrating it into our own welfare goals – but rather as an instrument of learning and understanding ourselves, and hence of defining our preferences, whether those preferences turn out to be strictly selfish or more generous. Sen argues that “we all have many identities that are....depending on the context, crucial to our view of ourselves, and thus to the way we view our welfare, goals or behavioral obligations.” (2002: 215). Dworkin (2000:227) contends that a liberal community, one which allows individuals the autonomy to engage in self-discovery and, as we are suggesting here, helps them to do so, is not a “superperson, (which) embodies all the features and dimensions of a human life.” Community is an important source of resources for self-discovery, in this view, not a crushing, all-encompassing machine of total socialization. When it works in the way described here, it is precisely because community is partial, we can be members of many communities, and there are at least some possibilities of exit.

Note that this has nothing to do with using the social world as a device for defining one's preferences as those that are more achievable (more “efficient” preferences); we return to this below. It simply holds that groups may help us know what we want, irrespective of whether we are likely to get it or not and that in addition

we may want things that have to do with the welfare of others or with our joint welfare.<sup>9</sup> What we lack, however, are good theories about precisely when group membership obscures such self-welfare goals and when it clarifies them.

The notion that under some circumstances membership in groups helps actors to know what they want implies that larger-scale patterns of institutional development will differ according to the tissue of group life, because there will be different opportunities for “principals” to learn what they want. Innovation, for example, can be “pulled” by the demand of consumers for design, performance and quality, which they only learn and sustain through communities (information acquisition, communication, identity), and then sustained economically through network externalities. Innovation can also be “pushed” through producers’ communities of practice (norms, capacities, routines, gate-keeping). In this vein, one can think of fashion and design producers (at all levels), or of technical communities such as the engineers that graduate from France’s *Ecole des Mines* or *Ecole Polytechnique*, who give a strong imprint to the conception of infrastructure and the techniques used in building it in France, a strong innovation export of the French civil engineering industry. These preferences do not emerge spontaneously or individually. The core of the matter here is whether the standards for competences that are set up and used as gate-keepers to such producer communities of practice really help in the work of discovery or whether they limit it. There is a circular interaction with the routines of producer communities, which require individuals to have competences and also, in some cases, are sources of imparting those skills to individuals or at least to screening for which individuals are good at them or not. There is not going to be an easy answer to this thorny question. It is difficult to imagine even the most revolutionary artist being able to

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<sup>9</sup> For example, certain things are only achievable as network externalities in production or consumption.

carry out her revolution without the underlying skills that are learned through collective routines. But the conservative tendencies of many gate-keeping groups are also well known.

### 3. GETTING WHAT WE WANT: AGENCY AND VOICE

Any eventual contribution to economic efficiency in helping individuals to discover their preferences must be weighed against the costs of group membership in making choices. These are not just limited to the well-explored case of principal-agent dynamics, where there is a problem of aggregation of heterogeneous preferences. Even in the ideal case where no such agency problem exists, there are costs in defining the end collectively, and this would be true even where some kind of collective action or decision is needed for any individual to get what she wants. The most favorable combination would be big gains from community (collective action) as a means to reaching our ends, combined with small losses (costs) from group life in coordinating with others to define those ends, and small compromises on individual preferences.<sup>10</sup>

The canonical case from economics, where group membership stifles action by imposing big transaction costs on the realization of goals, or by stifling the pursuit of preferences through principal-agent dynamics, certainly covers an important set of real world cases, especially at high levels of social aggregation (big groups, big institutions). But as we move down in scale, toward membership in smaller groups, there is less

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<sup>10</sup> This case is rarely considered in public choice theory, because the latter assumes that any group with big payoffs to membership will then conflict with other groups' desires and possibly extract rents from its position. But – as we shall argue in the following section – if these cases approach “social choice,” then there is little risk of these losses outweighing the gains.

probability that they describe real welfare losses, and more that there are real gains. A key issue is how any economy affects the supply of such situations, notably through the way it structures the transaction costs of group membership. Different such supplies could generate huge variations, from one economy to another, in the aggregation of preferences and hence in their satisfaction. What types of preferences are these?

First, some outputs are indivisible and lumpy. They cannot be produced without aggregation of supply. Public goods like public transport fall into this category, as do virtually all consumption goods with strong network externalities. They can be detected through proxies (public opinion polls) or through organizations (lobbies). But the organizations only emerge in some cases, so an agent is needed.

Second, some preferences are obscure, even to those who hold them, until they get clarified through group membership and agency – as in discovery, discussed above. Groups translate them into understandable preferences and give them voice. Vague desires become realities through group process and access to others with similar desires and agents who assist them. Demands for public services or certain kinds of culturally-specific goods don't emerge spontaneously from private preferences; nor do certain work methods, ethics, or standards of quality.

Third, some preferences are shameful or stigmatized when they remain strictly private. Many minority rights or tastes fall into this category. In the 1960s, when Black Power emerged as a cultural theme in America, it was shameful to affirm one's blackness in looks or behavior. Until recently, a taste for pornography was shameful, as were many lifestyles considered "atypical." They are only initially voiced if they are transformed from fragmented individual desires to aggregates, and often it is the agents who see that

this is occurring, who first break the taboo. They will possibly then emerge into the mainstream and at some later stage no longer need group mediation (the market for culturally-specific goods and services can become mainstreamed in this way).

Fourth, some preferences are geographically or socially fragmented, so that their holders don't communicate. They become too marginal, within the boundaries of any effective market area, to be satisfied. On their own, they will probably not happen because the transaction costs will be too high. But if they correspond to "strong bonds," then such groups may sufficiently reduce such transaction costs or rank them high enough to bridge time and space, thereby overcoming aggregation costs and giving existence to these preferences.

One additional aspect of aggregation in these cases refers back to our analysis of discovery. Such preferences are likely to be discovered in smaller groups where preferences are strong and homogeneous, and risks are lower. But such preferences may be widely distributed in the society. So, there's a double aggregation problem, of getting from small-group discovery and aggregation to the larger scale. This has happened many times, when minority movements start out small and local and become big coalitions and ultimately become big social identity categories. But the process of getting there is uneven and not guaranteed.

The supply of group or community membership opportunities that facilitate aggregation should depend on transaction costs in relation to the incentives and payoffs to supply and demand. Incentives correspond to the payoffs for group/community "entrepreneurs" or leaders to supply membership opportunities, as well as for individuals to belong to them. This is also the response of mainstream economics to behavioral

economics: even if people make situational choices, in the aggregate situations are supplied according to rules that conform to rational culmination outcomes.<sup>11</sup> But this point has never been subject to any empirical proof, and common sense holds that in every situation but a perfectly competitive market, the supply of situations is likely not to lead to culmination outcomes.

Historical institutionalists such as North (2005) go beyond this, allowing an independent role to cognitive frames and belief systems (see also Greif, 1994). Political scientists draw our attention to agents that construct, and not merely reflect, interests (Jabko, 2006). Moreover, there appear to be significant lags between changes in payoffs, specific types of belonging, and the beliefs and frames that lead people to bond with other people into groups. And if this is so, then beliefs and membership – i.e. social interaction -- could change the payoff matrix. I may believe something that leads me to be a member, and this ultimately enables me either to discover preferences or to realize preferences I couldn't have gotten without being a member, or even that are different from what I expected to get by becoming a member. Certainly, religious groups, high-tech entrepreneurs, and certain communities of practice fit this mold. The average non-expert cook does not become part of a culinary tradition expecting a payoff. However, when she joins, the collective payoffs may change as a result of increased network externalities, which in turn create feedbacks that change her individual payoffs, in ways she can not well estimate in advance. This is true of many sets of skills, as they first appear as new innovative inputs to the economy, before their ultimate effects – in terms

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<sup>11</sup> As noted, behavioral economics shows that, in certain kinds of situations, people will make choices that bear little resemblance to standard rationality (that which achieves “culmination outcomes”) (Glaeser, 2003:8, after Della Vigna and Malmendier, 2002). But it says little about how such situations are supplied. Group life supplies some situations. What are they, in relationship to choice?



of productivity and further qualitative dynamics and the possibility of satisfying preferences -- can be estimated and codified. Interaction affects learning, and learning transforms agents.

A final point that can be made about how membership facilitates preference expression has to do with the intrinsic value of being able to have a voice. Sen (2002: 159) argues for the fundamental relevance of the choice act itself. Behavioral economics has found that people are acutely sensitive to whether they have choice, and will often opt to make choices that affirm their rights to make choice as opposed to those that maximize their pecuniary interests. The possibility of choice responds to other criteria, such as “fairness” or “honor” or “responsibility.” This is another layer to the definition of preferences. If choice means total independence from social constraint, then groups have no role in it; but if it means being able to express things that cannot be achieved individually, then group membership will have this intrinsic value for individuals.

To summarize, we could benefit from knowing more about the supply structure for membership that allows certain kinds of preferences to be expressed by reaching a minimum necessary aggregation threshold. If this is the case, then there should be a powerful incentive effect for the individuals whose preferences are made feasible in this way; however, we remain far away from being able to measure such an incentive effect. Associated with this, we would also need to know whether there are times when the “right” agents are present, and others where the supply is distorted toward the “wrong” agents, in terms of welfare. If non-distorting aggregation is weighted toward small groups or networks, are they likely to be parochial, and if so, do they “turn around” and

limit large-scale aggregation choices elsewhere by “taking up the social choice space?”

These are, to say the least, difficult but fascinating questions for research.

#### **4. THE EMERGENCE OF CHOICE**

In many cases, no special coordination among actors is needed to ensure that the right large-scale aggregate choices are made (emergence of supply). Individuals choose and in a world where markets are large, a diversity of outputs can be produced. Moreover, we can change our minds and be reasonably certain that most demands will find a supply, such that when individuals make mistakes they can reverse them. The overall configuration of outputs will be roughly “right” in spite of the fact that individual choices don’t need any special collective wisdom embodied in them. This is the standard case for markets and individuals.

Surowiecki (2004) argues that good, large-scale choices come about when certain conditions are satisfied, including diversity, independence, decentralization, and aggregation. He draws this from the economist’s notion of the “the wisdom of crowds.” The core of this wisdom, in standard models, is that even when many actors are situationally irrational or not fully informed (in the ways discussed in the previous section), their preferences will be randomly distributed. The remaining actors – as long as the four conditions hold – will therefore make appropriate aggregate choices. But there are two major objections to this view of things. First, as we pointed out in discussing discovery of preferences, mere independence is unlikely to resolve all problems of situational behavior. The entire faith of the wisdom of crowds theory has to

rest on diversity, decentralization and aggregation. But it follows that we know little about diversity and decentralization once we admit that discovery can be improved by group life. This will especially be the case of goods and services where sovereignty, low sunk costs, and perfect reversibility are not present.

If the “wisdom” of un-linked individuals may be limited, is a “crowd” structure the best way to link them? The standard usage of crowds seems to refer uniquely to the sovereign individual chooser, because then, so it goes, there will not be intractable principal-agent problems, impossibility dynamics, group think, social pressure, and impacted information. But in collective choice processes, sovereign individuals will be less effective than something that is in-between small groups – such as families – or groups with “strong” internal ties (such as ethnic minority diasporas), and large (internally anonymous) markets. In our terms, these are loosely-structured communities, of which one version is the COPS.

The reason they may help in choice processes is what Granovetter (1973) calls “the strength of weak ties.” First, they have certain attributes which mimic the search features of markets and thus help in identifying good outcomes. These are: internal cognitive diversity in search and reasoning behavior; and independence and decentralization in expressing preferences and opinions on the part of members. In some cases, the information feedbacks on these search processes are better in groups than in open markets or crowds. “Strong ties,” by contrast, would not satisfy the need for diversity and independence. Second, membership may help in securing good decisions, in those circumstances where markets might tend to fail. One of the strong points of highly decentralized, market-based decision-making is that it allows for trial and error.

The mechanisms of trial are initiative, mimicry and imitation. Information cascades provide for sequential imitation. But they also are fraught with many problems, notably hysteresis, herding, and overshooting. In many markets, this isn't a long term problem, because the failures that result are resolved ex post, although when they are macro-economic or financial they can have hugely undesirable outcomes and become more difficult to absorb than we would like. That is why, for example, government regulatory authorities try to get financial markets to be more simultaneously – rather than sequentially – reactive, through immediacy and transparency.

There are two situations in which group membership can be helpful in avoiding the ex post “fix it” solution, with its huge costs. One is that it can speed up the feedbacks, and hence enable corrections that weed out emerging bad information cascades to be set into place before the system goes down the wrong path. Trust, norms and conventions, meta-information, and generally anything that facilitates more rapid and transparent exchange of information – these are consequences of weak ties. In cases where technological change involves high sunk costs or high costs of reversibility, then such feedbacks can raise the probability of good choices. Another situation where membership helps is that sometimes bad choices are actually not very observable until it's too late and their consequences are hopelessly magnified. We don't have enough access to the consequences of the choices because the costs of obtaining them, or access to observing them, are too high. In this case, ties to the others who have made them, and the possibility hence of observing the consequences, makes the feedback work better. Many private electoral choices fall into this category.

Note that both these features can be combined in diversified expert communities, as for example in the health care field. Allowing these communities of practice to carry out aggregation fulfills both these conditions, but ideally the communities should be weakly tied, so that diversity of opinion and competition of ideas is assured internally to the process of aggregation. Of course, nothing guarantees that these feedbacks are always going to lower the rate of bad choices. It might be that everyone involved in even these relatively large circles of feedback stands to gain from choices that aren't so great, and so they perpetuate them because they will be big gainers, even if the overall consequences will be bad. So, the old questions of parochialism and rent-earning are present. Still, the larger the circles, the higher the probability that they will be porous, hence open to those who can see their wider consequences. This is certainly the tension in the financial derivatives industry, where large, loosely-tied networks can hide certain bad decisions and information cascades, but where sometimes they are large enough for light to be shone on them by regulatory authorities before it's too late. Dispensing with networks altogether, however, is a utopia that won't work, so we are stuck with the problem of creating crowds whose "wisdom" minimizes hysteresis and rent-seeking.

Even in situations where reversibility is not a problem, but extreme complexity is, communities help in guiding the complex system. Electoral behavior is an obvious case: we vote on some issues that don't affect our lives directly, but do affect those of other people. We hold non-private values and we hold strong preferences for certain non-private consequences (Sen, 2002). There is a lot of quibbling in social theory over whether, for example, I can care strongly about whether women have right to abortion,

even though I will very likely never have a private interest in access to abortion.<sup>12</sup> We might think that the right choice was made if we didn't have ties to people who had been directly affected and could tell us that we voted for the wrong thing.

All in all, weak ties would seem to square the circle of ensuring diversity of inputs, independence, avoidance of group think on the input side, but allow better choice by facilitating aggregation.<sup>13</sup>

Membership – weak or strong – might also help in achieving the “wisdom of crowds” in some conventional ways as well. For example, if many people can make choices that are in some way bad for themselves or for the society, but if the costs of making those choices are low, then chances are they will continue to make them. Thus, referring to an earlier example, it's easier to be racist if one has little contact with members of other groups, where there is low likelihood of having to act on one's views, and little ability to obtain first-hand information that could influence those views.

Interacting with others may not cause us to stop hating them; but interacting in relatively intensive and structured ways can make it more costly to us to act on our preferences.

Another example: we can allow others to choose poor quality goods, thereby leaving a smaller market for high quality goods, with the further indirect effect that those goods become an elitist and more expensive output to have for ourselves (because it reduces

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<sup>12</sup> Dworkin (2000) and other philosophers take up the possibility that our “comprehensive consequentialist preferences” could be illiberal, i.e. wanting to deny someone else rights and freedoms, or to impose a morally homogenous vision on a heterogeneous world. In any case, Dworkin also points out that none of the positive benefits of community as a form of coordination require moral homogeneity within the group; it simply requires that the weak ties be useful in allowing us to make choices we want over certain kinds of private and comprehensive outcomes. The questions of whether that involves illiberal behavior on the part of the group, or illiberal outcomes, are important, but beyond the scope of this paper.

<sup>13</sup> This might not be limited to cases where we don't feel the impacts directly. We could unwittingly make choices that have an indirect, but unpleasant impact on us, but not be able to connect the dot of our choice to this outcome. This is certainly the case with such things as traffic. Only by comparing experiences with others might we be able to draw the lines between the dots.

economies of scale and network externalities), and if the low quality goods of others don't impinge on our environment. But group ties that raise community norms of quality could reverse these dynamics, making high quality goods cheaper for all.

Finally, all these choice processes depend on the relationship between the organization of suppliers and consumers. In some markets, the producers have greater incentives to be organized than the buyers; one can think of political markets in this regard, so that the political parties and lobbies are more organized than the citizens. In government and services markets, unorganized consumers are at a disadvantage in influencing the choice menu and the overall evolution of choice. Where producers are organized as communities of practice that promote learning and skill acquisition and efficiency-enhancing standards of quality, then the choice set for consumers will be altered in a potentially welfare-enhancing direction. By contrast, if group structure, for whatever reason, creates situations that are prone to distorting decisions through short-term and short-sighted imitative reasoning, hyperbolic discounting and so on, and if the penalties to such group think are relatively low, or if they have endogenous effects that raise payoffs over time by drawing in others, then groups may indeed be capable of reducing welfare.

## **5. THE WELFARE EFFECTS OF COMMUNITY**

The potential benefits of group life to economic actors are generally underestimated, especially in the four areas discussed above, which together we can call “coordination and preferences.” These are underestimated both by the mainstream

“blockage” school of thought, and the alternative “empowerment/exchange” view. A simple way to summarize this case is as follows:

$$\begin{aligned} & \textbf{WELFARE OUTCOMES OF COMMUNITY} = \\ & \Sigma \{ \textbf{INTERACTION/PREFERENCES.CHOICES} \} + \\ & \{ \textbf{EMPOWERMENT/EXCHANGE} \} - \{ \textbf{BLOCKAGE} \} \end{aligned}$$

where:

**INTERACTION/PREFERENCES/CHOICES** = increased impersonal exchange/productivity + discovery/incentive + increased agency/incentive + emergent choice/productivity

**EMPOWERMENT/EXCHANGE** = social capital + trust + lower transaction costs + better verification of qualities of partners + low cost sanctions

**BLOCKAGE** = higher transaction costs, coordination difficulties + principal-agent costs + parochialism + rent-extraction

This is a very wide palette of possible effects. We are a long way from having methods that would allow us to go upward from actors to groups for particular cases, not to mention for the overall “group structure” of a whole economy. But achieving the latter would immeasurably brighten the light that economic sociology sheds on economic development, while achieving the former would allow us to think more accurately about the potential effects of policies that support certain types of communities, such as the



contemporary attraction to communities of practice in innovation policies. A few points can be made about such an assessment.

*Club goods and the problem of bundling.* Groups are by nature providers of club goods and services and this is true whether the group is interest-based (Olson groups); associational (Putnam groups); or actor-network, including COPS. In order to get the benefits of being in the club, members must accept the interactions that underpin them.<sup>14</sup> All such interactions may have intended goals and impose costs, that we accept, to reach them; but they may also have unintended costs and consequences for members. In other words, one of the main reasons that people may engage in group “blocking” behavior is not because they want to do so, but because it is the price to pay for what they perceive to be the benefits of group membership. I did not join the COPS of university professors in order to block change; but such COPS may in fact block a lot of change. This is just as true of non-interest based groups (non-Olson) groups as of lobbies and other sorts of rent-seekers. Moreover, the consequences of such bundling may make these consequences unclear to the chooser or so difficult to calculate that decisions about group membership and about the rules of group membership for others will be clouded in obscurity.

COPS are a particularly complex case of bundling of effects. Actor-networks provide connections to individuals (hence empower them), but they also exclude those who are not members of the network and who may have “competences” to join. The door is then open to the construction of institutionalized power by central actors in the network. If the network occupies a strategic position in some economic process (for example, making large-scale choices of infrastructures with huge sunk costs) then its role

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<sup>14</sup> This can include involuntary communities, such as those imposed by exclusion or discrimination: once “forced” into the club, if we want what it can provide us (even as an undesired second-best), we must accept its interactions (Young and Durlauf, 2001).

in making choices may fall short of the optimal weak ties process alluded to earlier. Such actor networks may come to display serious principal-agent problems and Olson-type characteristics. The same may be said of the routines of a community of practice.

*Positive as well as negative externalities.* But things may also work in the other direction. There may very well be positive externalities of group membership, i.e. that accrue to people who are not members of the group. Putnam claims that strong associational life leads to better politics and even to better economic growth, and backs the claim up with some rudimentary statistical correlations; but he does not formalize the reasoning behind this intuition.

Think about the standard elements of the Romer (1991) growth model: rivalry and excludability are the key determinants of whether some factor of production (in his case, knowledge, in our case group life) can generate a growth-enhancing increasing return. In the case of knowledge, this takes the form of an economy-wide knowledge externality, because knowledge is ultimately non-rivalrous and, in the long-term, not excludable.

Interaction is excludable, as in the case of the Maghribi traders. But it is non-rival, in that its basic pattern does not get “used up.” The conventions or norms that lead to it don’t wear down through use. The impersonal exchange to which it gives rise may be an increasing function of the initial limited interaction, however, in that people learn about exchange and they may in turn be in a position to widen their exchanges, if not with the initial group, then with others, spreading out into other domains. All depends on how the tendency to rent-suck and keep a narrow circle intersects with the desire and opportunity to learn and possibly expand one’s earnings in other spheres.

Discovery is intrinsically non-rival. It may be excludable if it requires a high level of community-based understanding and context to make or understand the discovery. But, here again, we know little about the extent to which discoveries that can only be made within communities can be shared with non-members and in turn help the latter to define their own preferences in ways they would otherwise not be able to do.

Voice is a club service, with some non-rival characteristics. It can become a rival service if my voice cannot be used by you in any way because you lack legitimacy or scale by virtue of my existence. It can be excludable or not, depending on membership structure. This makes it complicated from a welfare standpoint; we tend to think of it as a combat of different interests, each seeking to crowd out the other, but this isn't at all clear, as Sen's research on social choice has illustrated analytically.

The emergence of choice through weak ties is a rival and excludable service, once the choices are made, and especially if they involve large sunk costs or irreversibilities, as in the infrastructure example used above. But if the choices are made in the way we have claimed above, with the enhancing effects of group participation, then the non-rivalrous and excludable character is only apparent, not real. What kind of group structure would be necessary to navigate the shoals between COPS that have strongly positive effects in guiding large-scale choice and those that do the opposite?

*The supply of situations.* The impulse to create groups is strong across all societies and yet the actual empirical contours of group life – type and level – are quite different from one place and time to another. There are many possible reasons for these differences, including everything from different preference structures to different costs of coordination (scale and diversity). Some of the difference is likely to come simply from

the incentives, costs and payoffs to group membership. And this in turn will be shaped by the over-arching rules within which groups are established and interact: in a word, higher-level societal “institutions.”

We have argued elsewhere at length that research on institutions suffers from a split between those are interested in societal-level rules, and those who concentrate on communities or groups (Storper, 2005; Rodriguez-Pose and Storper, 2006). All economies are shaped by both, and indeed, it is their interactions that determine the economic effects of each. For example, if the empowerment theories of groups are correct, then communities may lower transaction costs and make economic exchange wider and more efficient; but the extent to which they do this and avoid rent-seeking in so doing, depends on the broader rules of market interaction to which they are subject. Likewise, an economy with few intermediate group levels may suffer excessive bureaucratic costs, and problems of confidence and preference revelation and voice, even if its rules are strong. Rent-seeking groups will be free to go all the way when there are inexistent or weak possibilities for entry of competing groups; and they will be strongly tempered when institutions ensure the possibility of competition, exit by group members, and mobility to other groups. Institutions, in the sense of rules of engagement, thus shape the supply the situations, which in turn shapes at least some of the balance between negative and positive effects of communities. No examination of whether, for example, reinforcement of COPS in the knowledge economy would enhance economic welfare or not, can be complete without weighing how the broader rules context affects all the dimensions of group life examined above.

Institutions influence the supply of opportunities for agents to form groups as well. One is reminded of the antagonism to communities of practice (*corporations*) during the French revolution, and the institutional (constitutional and political) project to destroy their influence. The hostility to these COPS was engendered by their perceived Olson qualities. The fact that such a powerful project only partially succeeded (Rosenvall, 2004) is testimony to the power of the impulse to form such communities. But the institutions unleashed on the *corporations* profoundly altered the quantity and morphology of such COPS in modern France, as well as their internal functioning, their relationship to the economy, and the economic benefits and costs they generate. A key question in understanding different levels of innovation in today's world is: why are there are different levels and types of innovation COPS? Any answer must involve a consideration of the institutional rules that affect the opportunities for such groups to function. Taiwanese engineer associations in Silicon Valley are supported by access to venture capital, itself initially a COPS which probably responded to both financial incentives and associational incentives. But it's difficult to imagine an association of Taiwanese engineers in France, even if venture capital levels were to increase in that country. That's because the institutional forces that affect the supply of opportunities to form groups often have sources that are not apparent to the naked eye and far away from "innovation institutions" in the narrow sense.

In any case, a balanced analysis of communities requires that we consider how society (institutions) and community (groups) interact. It cannot content itself with analyzing the internal workings of communities or even the interactions between communities.

## 6. ARE COMMUNITIES STILL USEFUL TO THE ECONOMY? THE ECONOMIC GEOGRAPHY OF COMMUNITIES

Nothing is more characteristic of economic policy thinking today than the notion that factor mobility is essential to growth and development, and that this requirement is intensifying with the acceleration of technological change and global market integration. “Factor mobility” applies to technologies, sectors, firms, and – of course – places, and each of these may involve labor, capital, natural resource and knowledge inputs. The benefits of mobility are both static (specialization) and dynamic (pushing or moving toward the technological frontier). Even from this standard perspective, however, it is admitted that the costs of mobility are borne unequally by different strata of the labor force (Yellen, 1977).

In contrast to this perspective, there is a less coherent, but persistent, set of doubts about factor mobility, many of which come from the “empowerment and exchange” theories of community, noted above. To the extent that communities are built around long-term processes of creating norms, conventions, reputation effects, and mutual commitment, then factor mobility can be a problem for these forms of social life. Suburbanization – a form of daily factor mobility – is cited by Putnam (2000) as a principal cause of declining associational life in the USA. This is a long-term worry in the sociological literature, from Durkheim’s “anomie” to the recent communitarians and social capital theorists. Loss of community, for them, can generate loss of meaning and identity, and for individuals it can generate a loss of social networks, leading to anxiety,

depression, and disengagement from the non-market exchanges that generate a large part of the services essential to the functioning of society, politics, and economy (Sennett, 1999; Sandel, 1996; Putnam, 2000). It can also lead to loss of the networks that determine economic position through access to exchange (Granovetter, 1973).<sup>15</sup>

Critical views of factor mobility sometimes take extreme forms, clothing themselves in nostalgic and romantic views of group life, and often themselves misrepresent communities as unchanging, stable environments. Moreover, at least some group life reconstructs itself in the face of mobility – from nation-states to COPS to neighborhood associations, and so it is wrong to associate communities uniquely with tradition; but we do not have tools for evaluating whether loss of community has transitory effects on individuals, and whether the gains from change outweigh the losses for such individuals. Thus, when naïve and caricatured visions of community are put aside, there is certainly room for a debate about the benefits and costs of factor mobility in relationship to the spatial and temporal bases of community life. Whole cultures have been effectively destroyed by mobility, and though this process is as old as human civilization, it is very probably accelerating and taking new forms (Lear, 2007).

In addition, in direct contrast to the Olson view that groups block change, an extensive case-study literature on local economic development (Becattini, 1990; Farrell and Knight, 2003; Florida, 1995; Cooke and Morgan, 1998) demonstrates that under some circumstances, community life creates capacities to redeploy economic resources very successfully. Unfortunately, these claims have had little direct confrontation with

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<sup>15</sup> There are viewpoints from other disciplines, such as neuroscience and evolutionary biology that can make other claims about the benefits and even the necessity of group life to human survival, to human identity and to human happiness, but they are beyond the scope of this paper.

the standard view, because of the different methods used, generally involving little or no formalization and even less testing with large-scale comparative evidence.<sup>16</sup>

Still, this is a potent question, because so much policy today is motivated by the desire to increase such mobility in the face of the twin pressures of globalization and technological change, as for example in the Lisbon Agenda of the European Union (EU, 2004).

### 6.1. Communities and global integration

The starting point for thinking about this is to realize that most groups are territorialized. There are some groups that are not exclusively anchored to a particular territory (city, neighborhood, country, region, continent), including such COPS as international networks of professionals. But even in the latter case, there are often “local COPS in global COPS networks,” an intricate multi-scalar geometry of relations. In any given territory, a complex matrix of groups shapes the local economic environment. The consequence is that such group life, combined with formal institutions, influences the outputs and productivity levels of each economy, through the particular mix of coordination/preference, empowerment/exchange and blockage effects it generates.

In addition to promoting labor mobility, another dimension of the European Commission’s official position on European integration is that it should reconcile exchange with diversity: a “Europe of regions” (EU, 2004). This specifically refers to the promotion of durable *collective* differences between the European economies,

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<sup>16</sup> For a review of some of the evidence, see Farole, Rodriguez Pose and Storper (2007a). For statistical testing of some of these issues, see Farole, Rodriguez-Pose and Storper (2007b).



preserving their specificities, based on the assumption that this will benefit Europe as a whole. Economic theory is more skeptical. On the one hand, generating fluid factor mobility presupposes a certain institutional harmony and leveling between places; on the other, given different factor endowments, each region should discover the efficiency-based specialization that expresses its comparative advantage. Diversity based on standard comparative advantage generates a territorial mosaic of specializations that allow economies to function efficiently; most importantly, they change over time in concert with the new possibilities for combining inputs into outputs.

European policymakers are Janus-faced when dealing with this subject, some emphasizing the diversity that comes from comparative advantage, while others refer to collective or institutionalized diversity. They rarely tell the public that the two sources of diversity are radically different and that their policies pull in two different directions. American federalists and public choice theorists like to think that they square the circle by emphasizing certain forms of harmonization and free trade, while allowing different territories to make their own, locally-appropriate institutional choices in many areas, but as we shall see, this is not entirely valid.

There are potentially positive effects of institutionalized diversity; the coordination/preferences and empowerment effects lie at the heart of the economic development of a territory or nation that is favorably endowed with them. But the net effect will always depend on the blockage effects that are present as well, in the form of organized interest groups, political coalitions, state structures, and rent-seeking through development policies.

Is the collective diversity of something akin to a “Europe of regions” likely to enhance welfare and development? Assume that the differential distribution of communities leads to an array of territorially-specific specializations in output, in addition to those generated by comparative advantage. These specializations reflect the effects of interaction/choice, blockage, and empowerment/exchange *within* different territories on what and how they produce. There is an analogy here to the production of culturally-specific goods and services by different places.

In a multi-regional world economy, it is difficult to say whether this is greater variety than would be obtained under the condition of institutional/community homogeneity and free trade; this is because the “diversity between” places it generates might be at the price of “diversity within.” Collective life could enforce more homogeneity within, even as it preserves diversity between places. A fair guess is that the diversity is different in the two cases, where the diversity generated by differences in institutions/communities between territories is slower to change than strictly efficiency-based diversity. Output and consumption inside territories probably changes faster when it is the result of comparative advantage, because institutions – including communities – are slower to change than markets. Data on economic convergence for Europe suggest that it has institutionalized/community diversity, because significant growth rate differentials between regions are persistent, with unaligned economic cycles. In the USA, by contrast, the states are simply at different points in the same economic cycle, suggesting that their pattern of specialization and diversity is more tipped toward comparative advantage.

Each type of diversity – comparative advantage, or institutionally-generated – has its price. Indeed, something like a Europe of Regions or a world of culturally/institutionally differentiated territories trading with each other will generate winners and losers from the different types of diversity they generate. The literature on cultural diversity and globalization has developed analytical models of this type of question (Rauch and Trindade, 2005; Janeba, 2004; Cowen, 2004). Thus, if the world is very diverse under autarky, and trade leads to the breakdown of collective structures and more imitation of the dominant goods/services pattern – which happens when costless trade and communication exist – then trade might be inferior to autarky by reducing diversity. A reduction in diversity could also come about if there are economies of scale in production and Hotelling (duopoly) behavior induces producers to cater to the “middle of the market,” rather than its edges. At a high level, this can lead to “cultural destruction.” Moreover, consumers of imported “cultural” goods tend to gain, while consumers of exported goods will lose. If the latter are greater than the former, there is potential overall welfare loss. The process of imitation occurs under certain market conditions, notably when there are network externalities in consumption, and possibly (though less so), when there is convergence toward the extremes or toward the dominant taste, and all this is aided by low communications and trade costs. In a more dynamic perspective, if tastes are partly endogenous to learning and imitation (discovery, agency), what starts out as a re-alignment of production and consumption patterns can result in re-alignment of the situations in which people learn and discover for the next round of production and consumption.

If what we have said about community is valid, then two points follow. First, insofar as differences in output and consumption result not from institutional “barriers” but from interaction, discovery, voice, choice and empowerment/exchange, then the value of a world of different regions rises because the output and consumption diversity it contains reflects “real” preferences, not second-best (“we are old fashioned because we don’t know any better or can’t have anything better”); and correspondingly, if integration reduces this diversity, it is likely that the post-integration equilibrium will reduce both intra- and inter-territorial welfare.

For homogeneous goods, integration probably increases welfare, whereas for strongly heterogeneous or specialized goods based on community values, and especially those with consumption externalities, the effects of integration could be more mixed (McElreath, Boyd and Richardson, 2003; Rauch and Trindade, 2005). Theory and policy have a real interest in understanding these dynamics and in getting the right post-integration equilibrium. Though the “Europe of Regions” is mostly just a politically-correct moniker, there is a serious issue behind it when it comes to diversity of production and consumption, just as there is at a world scale in the negotiation of trade rules.

## **6.2. Institutions, diversity and innovation**

Douglass North argues that European success in development “was the dynamic consequences of the competition among fragmented political bodies that resulted in an especially creative environment” (North, 2006: 138). More recent literature on the size

of nations emphasizes the internal gains from appropriately sized units, which achieve the right tradeoffs between minimizing heterogeneity of preferences and reducing coordination costs and getting the benefits of scale (Alesina and Spolaore, 2006). Taken together, they suggest that development is facilitated by internal coherence at some scale, but diversity and exchange among units: let many ideas emerge and then competition and exchange will select and refine them.

This is different from the view that we could extrapolate from standard theory, since it suggests collective diversity “between,” and not just individual factor mobility and diversity “within,” as key to development. One of the biggest puzzles of historical development is why the fragmented European states managed to develop so much virtuous, competitive exchange in the late Medieval and early Renaissance periods, instead of allowing their internal collective structures to block it, as they had for centuries previously.

A world of diverse communities appears to maximize its potential contributions to development only when there are well-enforced societal rules of exchange and openness, effectively placing groups in fair (i.e. non violent) competition with one another, while not destroying the virtuous aspects of their diversity. Historically, this has occurred in the presence of certain kinds of state structures and political regimes, on the one hand, and outward-looking “bridging agents,” on the other. A good example is what Saxenian (2006) terms the “new Argonauts,” the mobile agents from local high-tech communities that bind Silicon Valley to Israel, Taiwan and China. Without strong community structures, the wider processes of impersonal exchange and specialization that spread development geographically would be weaker, and so would innovation within the world

high tech economy as a whole. Oddly enough, the most “globalized” of systems, the international high technology production and innovation system, is really a composite of intricate, territorially-rooted, community structures. But without institutions – trade rules, intellectual property rights, inter-group competition, enforceable legal rights generally, international organizational practices and “translating” agents -- none of this would be possible, because there would be no way to get from interpersonal exchange to impersonal exchange, with its intricate divisions of labor and specialization.

Communities of practice appear at all geographical scales in this process. They may take the form of relatively localized actor-networks, as well as constituting the structure of the agents that enable different territorial nodes to relate to each other to form the global innovation economy. Sometimes these COPS overlap with other forms of community, as in ethnic networks or interest-based professional categories who engage in persistent rent-seeking and lobbying. Certain individuals may belong to both local COPS and global COPS, and indeed they may even belong to more than one local COPS, as in Saxenian’s cases of Taiwanese and Indian engineers.

Given that blockage tendencies exist in all communities, the rules of engagement, and not just the internal functioning of communities, are essential to economic outcomes. Moreover, if history is any guide, pluralism is important to limiting the rent-seeking blockage effects of communities and maximizing their innovative potential. The open question for research is the scale at which such pluralism must operate: “within” or “between” territories, and at what scale of territory, as well as how less territorialized networks can be subjected to the beneficial effects of pluralism and competition. These

types of distributed actor-networks, if big and powerful enough, may have “lock in” and Hotelling effects that tend to limit such competition and increase welfare losses.

### **6.3 Scale and diversity: is community an illusion?**

In one sense, these questions of diversity within and diversity between are just side-effects of the scale of the units of observation. For example, as we reduce the scale of territorial units that we analyze, there are strong chances that they will become institutionally more internally cohesive and homogeneous and hence that economic diversity and institutional competition is obtained through exchange with other places. As scale gets bigger, then there will be more internal diversity. Research on community – as on institutions in general – is extremely sensitive to the territorial scale of units of observation and great prudence therefore must be used in going forward.

At the same time, the irregular scale of units of observation is unavoidably real. Such things as legal boundaries, custom, and culture, express the functioning of real communities reflecting the varying territorial scales of real, accumulated practices and social bonds. So it would be naïve for the researcher to claim that if we had homogeneous units of observation, the issue would disappear. For example, the Europe of Regions is a set of fairly small units, with rather high levels of collective organization “within” and a lot of exchange between. The USA, in spite of its federalist system of government, is socially and economically more a case of big regions with a lot of factor mobility, so that the diversity of production methods and consumption styles is found more “within,”

reproduced from place to place, than from a diversity between places, with a certain homogeneity at the large scale.

This means that if policy hopes to enhance development, it must account for starting points. In the Europe of Regions, it involves insuring that the process of exchange, or bridging, between regions is strong and dynamic, and that regions do not become closed off, stagnant, rent-seeking community structures. In a system such as the USA, exchange and mobility are strong, but sometimes this comes at the price of the strength of community structures *in situ*, weakening their internal coherence (or “bonding”). In Europe, widening of bridges between coherent communities might be needed in order to get scale and exchange; in the USA, a deepening of bonds within them in order to get more efficient coordination.<sup>17</sup> Neither public choice theory nor social capital theory allows policymakers to appreciate this difference.

As noted above, there appear to be some communities that have a very strong global structure. They are not entirely “deterritorialised,” of course; even in the case of high technology networks, there are strong local nodes: Silicon Valley, Taipei, Bangalore, Ireland, Israel. But an interesting question presents itself: with their further globalization, could there emerge world monopolies in certain types of community functions? Could these networks enforce parochialism and rent-seeking and limit competition and innovation? One could argue that a certain global plutocracy already does some of this, especially with the weakening national identities of the top world elite. In any case, understanding the ways that such widely-dispersed networks contribute to

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<sup>17</sup> For more detailed analyses of the question of bonding and bridging in relationship to economic development, see: Storper, 2005; Rodriguez-Pose and Storper, 2006.



the economic process along the lines suggested in this paper, is likely to be a key question for institutionalist economics and economic sociology in the decades to come.

Merely asking these kinds of questions suggests how far the more policy-oriented branches of institutionalist economics are from being able to help us with knowing what, if anything, to do about groups and communities. In practical terms, many economies have needed a strong dose of rent-destroying openness, so that up until now, the existing tool kit has been useful. But in many areas of the world, we are asking more and more questions about how to keep the “good” side of community while throwing out the “bad” – from the Europe of Regions to the problem of “exit” in the USA, to the “need for social underpinnings of development” in emerging countries. A reintegration of the question of community into economics thus deserves its place on this agenda.

## 7. CONCLUSION

Community has a bad name in economics because it is partly deserved. But there are vast other aspects of community that complicate the picture. Economics has tended to be neglectful about posing questions about these other aspects as empirical phenomena, while the contributions of sociologists, economic historians, and students of local and regional economic development have awakened us to them. But paradoxically, economic reasoning is a good way to think about the nature of these aspects in a coherent theoretical framework that integrates both negative and positive contributions of group life to the economic process, and that is what we have endeavored to do in this paper. In addition to attempting a more complete picture of the welfare effects of community, we have noted that in any real situation of economic development, several other aspects of

context are likely to be critical to how communities contribute to economics: the broader societal institutions that define the supply of situations for forming communities; their rules of engagement with markets, especially through competition and exit; and the geographical arrangements of communities, which determine the relationship between coordination effected within communities and competition between ideas and agents between communities. Research on these topics admittedly faces formidable methodological obstacles, but the agenda offers very exciting possibilities for the study of groups to contribute broad insights into the relationship between economy and society.

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