

THREE DIMENSIONS OF MODERN SOCIAL GOVERNANCE: MARKETS, HIERARCHIES AND KINSHIPS

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ABSTRACT

The paper is based on the analysis of economic and social systems in the last 80 years that ended up both in the processes of transition, and globalisation. The paper is theoretic with an illustrative material on new features of social governance, including the comparison of transition economies with advanced EU countries.

Author challenges the dualistic view of social, political and economic governance, where markets and hierarchies (i.e. the state and governments as agents) dominate the theoretical fields. This is also a problem of new frontiers of economics. A classification method for analysing the “fundamental ways” in organising and governing human societies is developed and the authentic building blocks for a three-pronged policy-making are found in the objectives of individuals and their micro-organisations (kinships). The issue is how individuals are included into the macro-systems of markets and hierarchies.

No instruments of socio-political governance can dissociate themselves from the patterns of behaviour where justice, solidarity, altruism, reciprocity, consensus, cohesion local networks, human capital or ethics play important roles. The demise of communism, the hardships of transition and the differences in the performance of capitalism can be explained by their particular involvement of the third social pillar (the network of human micro-world) into the working of state hierarchies and economic markets.

Paper illustrates the particular developments of real societies by using the historical evidence on growth and institutional developments related to our third pillar of governance (cohesion, social inclusion, culture, redistributive coalitions or rent-seeking). We will concentrate on the countries of Europe and particularly the transition countries. The long-run economic developments depends not so much on the proportion how markets or hierarchies are used in the socio-economic governance (e.g. contrasting the present situation in Denmark with Ireland, or Germany with Sweden; or Estonia with Czechia) but how the individuals are included or excluded from the governance.

There can be observed several principles of a new organisation of social governance, as seen from the analysis of our amalgamated social systems:

- Interaction of markets, hierarchies and institutions of social culture.

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- Cohesion of organisations (enterprises, public administration, political parties) and individuals.
- Bridging the interdependencies between the future (normative visions) and the past (experience).

All these phenomena call for a wider “endogenisation” of theories explaining modern social order, for achieving further integration of social sciences and for a more varied portfolio of choices offered by political parties. The sharply rising weight of globalisation in both the markets and the supra-national hierarchies posits a threat of their dominance over the grass-roots of the society at the level of individuals.

This inclusive character of civil society and democratic checks and balances in the performance of markets (e.g. for achieving the equity of opportunities in the entrepreneurship or employment) is at least as important as their role in improving the performance of state hierarchies. This is a crucial challenge that all societies share in common in the globalised world. It is a quest for new extents of freedom and coexistence at the levels of kinships (e.g. families), enterprises, states or world communities.

1. Alternative Meanings of the “Third Principle”

The coming new age of globalisation and dismantling of the world conflict of Cold War brought some new vision to European politics and social governance that were associated with the “third way of new social democracy” (Giddens, 1998 and 2001) or the Lisbon strategy of the European Commission that dealt with practical politics and real economics. The idea is that two basic pillars of the socio-economic organisation and policy-making, i.e. the **markets** and the direct **commands**, need certain upgrading, specific to the new stage of development, because their traditional organisation fails at meeting new objectives. Such concepts appeared and disappeared many times in human history and always drifted between being an objective phenomenon and a speculation.

The subjective definition of the “third principle” (i.e. a mere political marketing trick) can be contrasted by a definition based on objective criteria. What matters here is the exogenous ontological nature of the third alternative. For example, it can be associated with emerging new **objective processes** changing the present social order and its existing bi-polar constituency of interests. It is not a mere aberration of existing politics. We may call it a political break-through at the level of such fundamentals as the wealth and the power.

The strength of the emerging third pillar, which would be at a par with markets and hierarchies, would be magnified if it came up with a non-orthodox alternative to existing **fundamental policy variables** upon which the present institutional superstructure was built. Such a superstructure would be subject to a typical institutional inertia, even though previous fundamentals have lost the reason for existence. Have we entered the ground of historical breaks and their institutional shakeouts? What kind of variables might these be? In this paper we are dealing with politics – i.e. with the ways of determining **social governance** related to **hierarchies of social organisation** and their **decision-making**. Politics of break-through is therefore addressing not only certain vested interests but also the basic principles of their functionality.

The development of capitalist market economies was accompanied by an emergence of theoretical reasoning claiming that the State (or any similar hierarchy) should be nearly

completely discarded. The ideology of *laissez-faire* was brought to an astonishing perfection in the models of general competitive equilibrium by Walras, Arrow and Debreu (see Weintraub, 1983). Nevertheless, as a response, the model of perfect markets was soon challenged by models of imperfect competition published in 1933 by Chamberlin and Robinson (see Hart, 1985). At the same time, the reality of Big Crash (1929-1934) and further empirical studies of industrial organisation confirmed that a convergence towards perfect competition was not a natural state of affairs and that oligopolistic markets or market imperfections pervaded. The role of the State was steadily increasing throughout 20th century, as could be measured by the share of taxes or government expenditure on GDP. In the 1980s, in some Scandinavian countries and in all countries of “real socialism”, the tax quota appropriated more than 50% of GDP.

The theory of second best was an attempt to reconcile the orthodox neoclassical economics with empirics (Lipsey and Lancaster, 1956). Absolutely perfect markets lead always to Pareto optimum and assure the unrivalled most efficient usage of resources. In contrast, distortions of the market cause deadweight losses and less efficient outcomes. The policies of *laissez faire* should then strive to bring the economy to a state of zero distortions. But is it ever possible? Such renowned economists as Samuelson, 1968, or even Friedman, 1981, p. 4, agreed that there are no pure market economies, even in the anarchist-litertarian ideals. All real economies are actually mixed economies where both elements of markets and command co-exist in various degrees.

Even though it is now a nearly complete consensus around the world that markets are a necessary institution for socio-economic governance, there are also many voices adding that their existence is not a sufficient condition. An intervention by a visible hand of a hierarchy can improve the efficiency of some economic subsystems, as was argued by Keynes, 1936, Coase, 1937, Schumpeter, 1947, Sen, 1992 or Stiglitz, 1994. According to the second best theorem, there is a continuum of market distortions (i.e. a mixture of market and command principles) where the system is always outside of the absolute optimum and challenged by infinite number of local optima, which cannot be ranked by a Pareto efficiency criterion because there is always someone who gets worse off.

Let us now turn our attention at the hierarchical commands (as the potential alternative to markets) and at their impacts on governance. Theory of second best can be also applied on these pure systems. We could argue that, hypothetically, the command system could perform best in a completely collectivised system where all participants are agents of someone superior. Their aim could be a capacity build-up: by a suppressed present consumption and high investments the system would lead to the highest long-run growth on a von Neumann optimal path. According to Friedman, 1981, in the ideal case that would be a hierarchy of agents only – the top one being the God. A sort of a new enlightened serfdom of *nul homme sans seigneur*.

But is it compatible with reality? Although the idea of central command (planning) could have been an appropriate technologically-dictated management of scarce resources during a war, an economy in peace would have to yield to the pressures from the civil sector, i.e. from the interests of individuals and their need for personal freedom, choice and initiative. Guided again by strong academic assumptions, we could draw Figure 1 showing a continuum of economies based on a different combination of commands and markets.

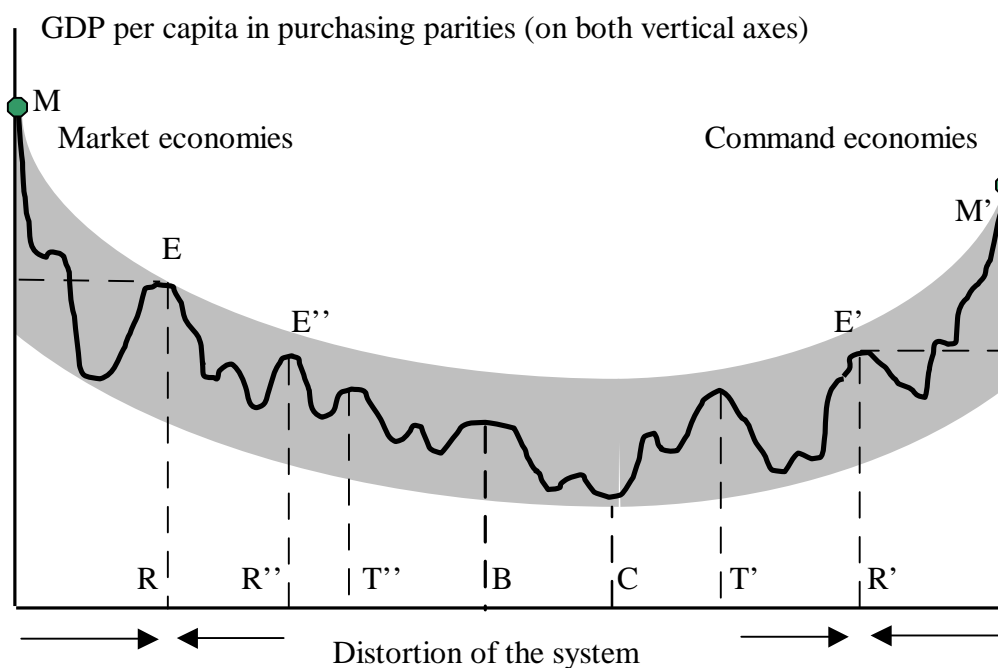


Figure 1: Trade-offs between markets and hierarchies

We interpret the shaded stripe as a smooth quadratic envelope for the fluctuating efficiency indicator. If the search for optimum is constrained by transaction costs, imperfect information and short-run expectations of decision-makers, then rationality becomes bounded and the quest for an optimum is terminated if the solution is “satisficing” (Simon, 1947). For example, although the global maxima² are in M and M’, points E and E’ may be compatible with local maxima, pointing to arrangements to which the real system might converge and where the eclectic combination of both markets and hierarchies is sustainable. Appeals for returning back to systemic purity in M or M’, called for by market or planning fundamentalists, would not be compatible with real politics. For example, a social experiment with abandoning all government regulation and transfers in any contemporary economy would end up in a state of intolerable uncertainty, risks of anarchy and a burden of social costs that would be vetoed by vested interests entrenched in politics. Also a call for an alleged “third way” propagating a heavily mixed economy in B would have little chance for success because such arrangement offers no guarantee for efficiency either.

Figure 1 can be also interpreted as a path for “transition from planning to markets”, i.e. from R’ to R, which must result in a fall of GDP until the build-up of market institutions is not prevailing over the legacy of direct command. There could be an uncertainty here, too, as the whole process can run out of steam and get stuck in inefficient local maxima T’ or T’’, a situation illustrated by the cases of Belarus or Czechia in 1996. If we compared the performance of these two basic social systems (as in Figure 1) we might find that the objectives they followed diverged so

² One should resign from comparing the utility differential between M and M’. The objective functions of these two incongruous systems are so different (e.g. maximal consumption versus maximal military build-up) that neither the resultant numeraire of the GDP per capita nor the “lists of achievements” offer a sound base for global ranking.

significantly that a simple comparison would not be impossible. The alleged GDPs per capita (necessarily adjusted to non-market purchasing parities), which served for their comparison, were products emerging from virtually different demands. While the market economies satisfied the subjective demand of individuals, the planned economies satisfied the (subjective) demand of top hierarchies. Granted this inconsistency, both systems could be assumed to be efficient in their functioning *sui generis*.³

Nevertheless, collective choice dilemmas in command economies, lack of accountability for losses, undercapitalization, incentive to wage overshooting and underemployment, problems with ownership transfers and inflexibility in restructuring made firms with closer worker-control still less competitive internationally than firms under the control of private investors (Dow, 2003). The Darwinian selection turned the odds against them in the long-run whenever they were faced by a direct market confrontation with an authentic private sector or even with an authoritarian command system. It is clear then that economies with firms under the dominance of labour operate in the field of opaque markets, unstable governance, risk of defaults, and reliance on State interventions. In Figure 1 we should locate them somewhere into the middle of the graph where the economic efficiency is low.

The assumed convergence between the market and the hierarchical systems, as conceived by Tinbergen, 1961, did not take place. The swing of the pendulum to neoliberal policies in the 1970s and 1980s had wide repercussions throughout all market economies and the reforms in all European planned economies failed. The wishful thinking in redefining our Figure 1 from convex into concave, where the minimum of the shaded envelope at C would elevate to become a maximum, did not materialize. The search for a sustainable “third road” failed throughout the period 1956-1989.

The transition between social systems is not without deep conflicts. Each natural system is embedded in certain **local equilibrium** and its institutions are resistant to changes. Society in transition has to overcome mounting internal conflicts, clashes over the economic and social governance, uncertainties with ownership and its productive collective actions become paralysed by rent-seeking strategies. The idea that a **modern society based on choices cannot be built exclusively on one-pillar system, because it has more than one social objective, is crucial for our argument.**

2. The Untenability of One-Pillar Social Systems

The majority of early reforms in transition economies were marked by the belief in unfettered markets (Ellerman, 2001) that would not only lead infallibly to high growth but also that these markets were self-contrived and self-enforcing entities. The actual developments in transition economies, in direct contrast to that, followed the path of unprecedented economic slump, stagnation and slow growth for many years. Out of nineteen countries undergoing transition in Europe, only three (Poland, Slovenia and perhaps Eastern Germany) were able to recover the output recorded in 1989 after 10 years of changes. We could gather that the build-up of the market environment was much slower than expected because otherwise we could not explain why

³ *The problem of the more recent hierarchical systems was that, once the hierarchy without Stalin /or Mao/ became less authoritative and the choices of individuals had to be granted certain autonomy, the criteria turned in favour of the market system and the planning system commenced to falter in both its aims and its means.*

the gains in efficiency were so small. For example, in Figure 1 we could depict that the actual transitions reached the critical level of depression in C during approximately 2 years after its start in point E'. But it took the most successful transition economies another 7 years to reach the state of high distortions approximately at E'', instead of ending in the ideal arrangement of M or in the more realistic point E, closing thus the end of transition in mere 5 years altogether, as many analysts presumed.

After 1996 the approach to transition, guided by a couple of simple macroeconomic imperatives of the Washington Consensus, was slowly fading away and an approach based on institutional economics (e.g. Stiglitz, 1995, Olson and Kahkonen, 2000) gained grounds. These two moves had far-reaching consequences not only for the policies of transition but also for the re-shaping of modern economics, social governance and the re-invention of public policies. As was pointed out by Olson, 2000, many modern markets are not self-enforcing and a large part of production and exchanges cannot be self-protected. It was somehow forgotten that the functioning markets were subject to long-lasting evolution and that markets could not be declared simply by a decree. Even though markets are everywhere, not all market economies are rich. Thriving advanced market economies require socially-contrived markets, production guarded by property rights and certain mechanism of governance. The role of State, governments and other institutions assisting markets in their functioning are crucial guarantees of economic prosperity.

The lists of problematic fields in transition countries show quite clearly that they all are associated with some **aspect** of public goods present in the following fields: information, environment, pollution, health of the population, medical care, hygiene, education, science, R&D, technical standards and norms, culture, arts, agriculture, forestry, landscape, housing, water resources, security of individuals, national defence, public security, regulation of monopolies, competition among firms, public utilities, energy networks, transport infrastructure, telecommunication, legislation, judiciary, care for children, youth, disabled and elderly, social security, stable currency, job security, property rights enforcement, public administration, public procurement, bureaucracy, fiscal system and political system.

In a wider sense, public goods of paramount importance are the markets and the human values, the latter being reflected in the system of ethics. Both markets and ethics act spontaneously as autonomous regulators of socio-economic order (Hayek, 1973). In the former we can mention markets for commodities, factors, institutions and political parties, which are just information networks of auctions that can be easily distorted by power. In the field of human values and ethics we can mention their links to the cognisance of justice, charity, benevolence, human dignity, social equality, solidarity and tolerance of cultural, racial or religious differences. Their negative form (as public "bads") is also crucial in shaping the terms of socio-economic co-existence: violence, malevolence, terrorism, etc. Their elimination can be neither left on markets alone.

At this moment we can conclude that the collapse of communist regimes and of their system of social governance based on hierarchies and non-democratic authorities was based primarily on a sudden outburst of public choice. It was because of these countries' inability to comply with some highly demanded "post-modernist" human values, such as the provision of consumer goods, leisure, innovation, private initiative and democracy. In a search for the common denominator, we may say that it was the systemic inability of the communist system to support individualism as a value, or if reverted, to receive a public approval of an idea that collective subordination to the authorities and posthumous reward are the true reasons for life.

The subordination of the whole economy to a hierarchic command would be objectively legitimate only in a system where:

- all goods are public goods (preferably with absolute externalities);
- the central authority (due to perfect information) is able to rank all alternatives;
- objective functions of individuals are not autonomous (i.e. there is no free individual choice).

All three conditions are not valid: there are both public and private goods, the authority is not omnipotent and individual choices (and initiatives) matter. Thus all modern economies are forced to split into a dual system – leaving the allocation of private goods to the competing bidding of simulated markets, while the provision of public goods would be administered by public governance. The problem left here is to agree on workable processes and instruments of governance, reconciling such amalgamated systems. Markets imply a myriad of conflicts among economic agents (Rajan, Zingales, 2000). Their organised pressures or the defence against them implies politics. Big players in this game (corporations, unions, governments, states) mean big politics. But there is a contradiction here: the objective reason for an active economic role of the government comes from the existence of **public goods** (Mueller, 2003) and not from the politics as the rent-seeking opportunistic actions of pressure groups. The contradiction is between the objective and subjective reasons for establishing the State, as well as from the productive and redistributive objectives of agents.

But if markets are not perfect, and if private goods are not exclusive objects forming the GDP, then markets are sub-optimal. It then follows that alternative institutions, more appropriate for the solution of the problem, should be activated. It is not an accident that economics in the last 40 years have been gradually shifting its attention from technicalities behind the optimal allocation of given private resources to inter-human relationships and their institutions, which may result in economic behaviour full of conflicts, locks-in and disequilibria.

Some of the most important advances in economics in the last 20 years were dealing with transaction costs, externalities, asymmetric information, moral hazard, free riding, rent-seeking, incomplete contracts, adverse selection, signalling, uncertainty, incomplete or missing markets, altruism, oligopolies, re-distributive coalitions, increasing returns to scale, public choice, law, ethics, endogenous growth, environment, inequity and human capital. All these challenge the markets as universal instruments of economic organisation and governance, and call for an additional pillar supporting these changes. **The governance over the public goods looks now wider than ever before – becoming the dominant economic problem in modern societies.**

Now in some countries merely 2% of employed workers are enough to provide for self-sufficiency in agriculture and 25% in manufacturing. The remaining more than 70% of employees work in services. The majority of them are “invisible”, like banking, insurance, communications, education, consultancy, health or entertainment. The aspects of non-excludability, parallel consumption, externalities and scale economies are present in too many of them.

The existence of public goods and the autonomy of politics outside of economics – these are main reasons why the market system could not become a single pillar dominating the social organisation and governance. Similarly, no system of command alone could take over such an exclusive role in modern societies based on performance. However, once we grant the public goods an important place in modern economies we also open the Pandora’s box with its mixed blessings. Crucial problems of public good is the problem of allocation of national resources:

how to measure the net benefits of public projects or the social costs of government regulations, how to organise the public governance without the risks of moral hazard, and how to avoid crowding-out and/or waste of resources. The stagnation of Japan or the fall of Enron are serious warnings.

3. The Structure and the Governance of Two-Pillar Systems

The structure of two-pillar social systems differs substantially between the command and the market economies because the position of their economic agents is substantially different. It is dependent on the way how the governance elite is recruited, how their objectives are set, which algorithm of the decision-making is used and what policy instruments are selected. The two-pillar socio-economic systems are therefore bi-polar, as depicted in Figure 2, where there is a tendency to dominance by one of the poles (pillars). We will use the symbols of Ernest Gellner, ***, for distinguishing between the systems dominated by “the plough” and the systems dominated by “the sword”. Alternatively we could do the same by choosing the representation by means of “wealth” (or “money”) on one hand and “authority” (or “coersion”) on the other hand. Thus we can also connect economics with politics and involve the driving forces in the (neo)liberal and the totalitarian models.

Each pure model has its specific mechanisms of organisation, governance, objectives, inducement mechanism and exchange, enlisted also in the figure. As we explained it above, the pure models cannot exist in reality and there is some degree of complementarity. Therefore we can also speak about a balanced (“Scandinavian”) model where there is a tendency to countervail the power between pillars. Actually the problem is in the balance between the sizes of private and public sectors, and how the pillars succeed (or fail) in keeping them autonomous without evoking mutual deadlocks.

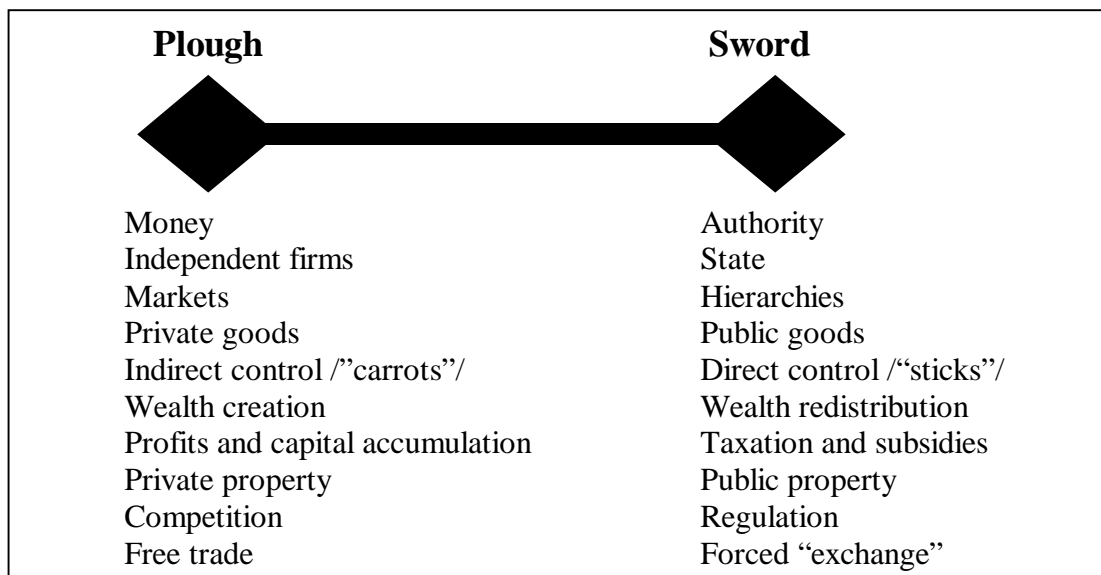


Figure 2: Traditional bi-polar orientation of social systems and their instruments of governance

It should be noted that the extreme (Hobbesian) interpretation of these two pillars is by taking them as competing substitutes of a zero-sum game and not complements. Granting more weight

to one of them means stripping the other of its influence, as was shown in Figure 1. That figure represents an extreme polarised concept of a two-pillar society where the envelope of performance between two poles is convex and narrow. It could be admitted that such model fitted best the period of emerging industrial capitalism and the militant stages of communist industrialization.

The biggest paradox of the developments in the last 15 years was that both traditional pillars of the society were losing its credibility. The central planning lost the last residuals of practical appeal after the collapse of the Soviet empire and the subsequent fundamental transition in China. However, though gradually, also the beliefs in pure neoliberal market models joined the losing side. There were the following real developments, which became a challenge to the functioning of both the neoliberal and the “mixed” economics:

- a) Expansion of the “weightless” service sector and declining share of material production;
- b) Increasing fuzziness between the “formal” and the “informal” (shadow) economies;
- c) Growing importance of increasing returns to scale and product differentiation;
- d) Cartels and monopolistic competition raising the market transaction costs for the outsiders;
- e) Globalisation of the world economy and the rise of multinational corporations;
- f) Chains of governance in the corporate sector becoming longer, leading up to a separation between ownership and control;
- g) New styles of management required by technological break-through and globalisation;
- h) Dramatic changes in the IT technologies;
- i) Increasing role of human capital as the main constraint of growth and the rise of the knowledge economy;
- j) Weakening of physical capital and natural resources as production factor constraints;
- k) Rising demand for public goods accompanied by sharply rising rates of taxation and bureaucracy;
- l) Environmental pollution, crime and terrorism (as “public bads”), countervailing the gains in material affluence;
- m) Importance of social networks and institutions, reflected in the theory of social capital;
- n) Rising awareness of the importance (and the scarcity) of ethics, trust and consensus in economic interactions;
- o) Market failures accompanied by government failures;
- p) Increasing unemployment, income inequality and social polarisation;
- q) Rise of hierarchies parallel to the national government: bureaucracy, police, army, mafia, business oligarchy, religious or environmental fundamentalism, international organisations);
- r) Individualization of the society;
- s) Declining trust in politics, governments and democracy in capitalist countries since late 1960s.

We could even generalise the problem of “post-modernism” over wider time-span. As the industrial revolution was approaching the stage of world-wide dominance in the second half of 19th century, the widening of gap between the liberal and the traditional authoritarian systems was reversed. Thus the objective processes leading to intermixing of both principles were also challenged by opposite tendencies: the births of command economies, ideological fundamentalism or the integration of markets and anti-monopoly regulation.

The odds of the dichotomy were unexpectedly stopped by the dismantling of communism in Europe and the rise of entrepreneurship in China in early 90s. As a result, the separate worlds of

“plough” and “sword” have lost suddenly on their polarity. Instead of a complete dominance by liberal markets, as some expected, the systems of money and authority became even more co-integrated at the world-wide scale. Not only that the intra-enterprise hierarchies grew in their size (Coase, 1937) and their influence on decision-making in the world progressed, they became more interlocked with the parallel hierarchies of the states. Thus the systemic disjunction between markets and governments became smaller and the interdependence between them grew in intensity. The explanatory power of bi-polar abstract systems, like those ones we depicted in Figure 1, became ever fuzzier to interpret after the collapse of communism and accelerated globalisation (Marcusen, 1995, Arndt, Kierzkowski, 2001).

In contrast to the big organised players in the economic and social fields, who were in the focus of the bi-polar systems, the role of individuals in influencing their own “governance” got somehow lost in-between. But can any explanatory systems, where the individuals as crucial agents are eclipsed (or completely superseded) by collective “proxy actors”, offer a satisfactory explanation of a contemporary social governance? It leads to a paradox as if the people (originally conceived as the sovereigns of the capitalist/democratic society) had no reason for existence and no autonomy without these two pillars. Even if we assumed that the obsession with consumption and fiscal redistribution on one hand, combined with growing uncertainties in employment and personal security on the other hand, the conclusion that such “modern” setup stripped the people of their autonomy and made them a toy in hands of “enterprises” and “governments” is hardly an acceptable paradigm for of any social systems.

Even though we may admit that the role of autonomous individuals has been challenged by the rising power of institutions in the last hundred years, two crucial questions remain: **What is the position of individuals in the given social setup? And how are they organised?** Or we can reverse the problem: What are the factors bringing (some) individuals to a state of impotence? Or what are the mechanisms by means of which the individuals enforce the authenticity of their unique existence and resist being dictated by the virtual world of organisations and markets?

In many aspects the marginalisation of individuals in the modern societies seems very deep. The approach to politics by representative democracy could threaten its pro-active orientation that would require visions, prevention of future defaults and offering the people more space for their own initiative. **Our argument is that the rule of “money” and the institutionalised power of “authority” are far from being exclusive elements of the modern governance.** Paradigms limited to explaining the development of the world merely at the level of (big) enterprises and/or the top officials of the State are failing in the test of reality. Individuals remain still the key players in the game of social governance.

4. The Missing Third Pillar for Stability

The conclusion of our previous findings was that the pillars of markets and hierarchies must act in parallel in order to explain the functioning of real economies. It was also stressed that the structure of markets and hierarchies in societies are not able to determine the level of GDP by means of a deterministic function. We had to use the concept of an envelope in order to extract the general features, what also revealed the degree of indeterminacy and the spread of efficiency outcomes. The use of a random term (in order to describe the extent of indeterminacy of the function) is only a spurious approximation. The correct approach is by adding a third pillar representing additional factors that actually act behind the seeming variations and “uncertainty”.

In Figure 1 the reality depicted by black line MM' is a very complicated relationship between economic performance and organization, full of reversals in slopes and discontinuities. Its explanatory power had to be wrapped into a shaded envelope in order to explain the smoothed-out trends. The width of the envelope thus suggests how important the third factor could be, not included in the original two-pillar world. In highly stabilized conservative societies it may be very thin, but in societies subjected to shocks of social reversals it may become the decisive explanatory factor for a suddenly improved or collapsed performance. The study of post-communist transition economies is a prime object of such studies.

The logical outcome in a quest for our missing third pillar of social governance is to concentrate on individuals as autonomous economic and social agents. It can be represented by citizens organized in families, households, clubs and other types of micro-communities, looking at the world from their down-to-earth position. Actually this is the archetype of any human interaction and its objective function is of paramount importance: the human survival as both a biological and a social entity.

It commences with the Darwinian aim for survival of the fittest and extends to the aim of the preservation of species. The social outcome of it is a co-operative behaviour at the grassroots of social organization based on the principles of trust, morals, solidarity, altruism, long-run individual stability, consensus building, satisficing barter and “reasonable” reciprocity. This system of exchanges and cooperation is based neither on the principles of money nor on the principles of authoritative hierarchies, although its interaction with both is evident. Economic literature that points to that interface can be found in Simon (1947), Sen (1987), Meade (1989), Buchanan (1994) and Rowls (2001), among many others. According to them, the nature of modern economics downgraded when its link to individuals was limited just to an abstract *homo economicus*. Also, the growing distance between the world of colluded markets and hierarchies on one hand and the solitary individuals on the other hand, resulted in further crowding-out of people from their role sovereign economic decision-making agents.

Once the number of social pillars is extended to three, so that markets and hierarchies are complemented with the civil sector as the third pillar, we arrive at a concept that is more compatible with reality. The third pillar represents individuals, their authentic relationships (“kinships”) and exchanges. Such three-pronged systems cover all three levels of organization and exchanges: micro (at the grassroots of families or citizens), mezzo (at enterprises) and macro (at the national level). It is also evident that the interests at these three levels can be disjunctive and autonomous, even though in principle it was individuals who agreed to have both markets and governments as their instruments caring for their well-being. Another parallel can be raised on the democratic ideals of French revolution: *liberté - égalité - fraternité*, which can be interpreted to involve liberal markets, equality of people in hierarchies and brotherhood of individuals. But once there would exist three parallel objectives among the social agents, there must be three policy instruments (pillars) for their management. This is the logic of Mundel’s assignment rule (Mundel, 1962).

Table 1: Classification of political systems based on three pillars

Markets	Hierarchies	Kinships	Characteristics of the political system
1	0	1	Liberal
0	1	1	Syndicalist
0	0	1	Trotskyist /anarchistic/
1	1	1	Balanced , based on three social objectives
1	0	0	Business fundamentalism
0	1	0	Etatist /communist/
0	0	0	Nihilistic
1	1	0	Elitist /oligarchic/

The three-pillar socio-economic system based on markets, hierarchies and kinships allows altogether eight (2^3) vectors of fundamental alternative policy strategies, of which four are involved in the support of the individual/civil society (see Table 1). Remaining four political strategies take the existence of autonomous interests of individuals for irrelevant. The “old third way” then gets on an equal footing with the policies addressing markets or governments. We will call it a **three-pronged principle of social governance**. Now we arrived at a nominal criterion for testing whether some declared policies can be labelled as politics based on three pillars. For example, we can test a list of features designed for British Labour Party, as proposed by Giddens, 1998, and compare it with politics of “old social democracy”, as is indicated in Table 2.

Table 2: Classification of the “Old” and the “New” politics (according to Giddens, 1998)

Old politics	New politics
Welfare state	Welfare society
Collectivism	Individualism
“Objectivist” consumption pattern	Personal choice
Critique of capitalism and markets	Synergy with capitalism and markets
Dominance of the State	Dominance of the Civil society
Keynesian support of aggregate demand	Support of the supply side
Distrust to markets	Markets matter
Bi-polarisation of the world	Bi-polarisation is less important
Low awareness of the environment	Environment matters
Fetish of forced income equality	Equality of chances and individual performance
Mass material production	Employment in services
Big business are crucial	Small and medium-sized businesses matter
Elitist state and public administration	Transparent state and public administration
NGOs as partisan interventions	NGOs are crucial for democracy
National economies	Cosmopolitan economy
Physical capital as the main factor	Human capital as the main factor
Material consumption	Quality of life and human development
Gvt. protection and discretionary intervention	Discipline and encouragement by incentives
Authority, traditionalism	Democracy, libertarianism
Traditional family	Female emancipation
“High” politics	Politics for life
Exclusion by formal hierarchies	Inclusion outside of hierarchies
Science and technology elitism	Science and technology openness to public
A-priory rights of State for re-distribution	No rights without duties (responsibilities)
Rising taxes and public administration	Reform of the state and public administration
Negative public social services	Positive public social services
Centralisation	Decentralisation, devolution, subsidiarity
Bureaucracy and corruption	Efficient service to the public
One-time big elections	Permanent direct democracy

Provision of public goods by the State	Mediated public procurement tenders
Closed national state	Cosmopolitan state and nation
Economics of selfish interests	Economics of communitarian coexistence
Formal business entrepreneurship	Informal social entrepreneurship
Traditional hierarchical family	Flexible family ties based on equality
Economic certainties and re-distribution	Promotion of wealth creation
Physical asset investment	Social asset investment
Business ethics are secondary	Business ethics are primary
Formal (positive) law and regulation	Natural law guided by moral norms
Class society	Development of the middle class
Exogenously given inequality	Justice and equality are endogenous
Dependence on external provisions	Self-support, grass-root initiative, soc. capital
Sharing of means via the State	Sharing and prevention of risks via the State
Inflexible and generous pension fund	Flexible, parametric pension funds

The “old politics” of industrial capitalism (both conservative and socialist) that developed in the late 19th century were based on an explicit acceptance of a two-pillar system of social organization, which was dominated by the co-existence of markets and hierarchies. The role of an individual dissociated from the command of markets or hierarchies was passive. Features that were not a direct functional part of these two pure systems (e.g. morals, solidarity, informal relationships or individual sovereignty) were taken as **exogenous residuals** that were considered constant in time and consensually recognized. As capitalism approached the limits of the welfare state, there was a gradual tendency to transfer these “exogenous residuals” into policy variables. This is clearly visible by comparing column 2 in Table 2 with column 1. The role of an individual was changing from passive to active.

At this moment we can raise again the most basic question of human motivation: “what are the drivers of human behaviour”. As the satisfaction of human needs kept diverging with the maturity of capitalism from markets towards the State provisions⁴, the role of individual activism (responsibility and freedom) was declining. According to the classifications of Maslow, 1971, and Aldorfer, 1972, the satisfaction of physiobiological needs (intake of energy, water and oxygen; procreation), relatedness (security, affiliation, recognition by others, cooperation and exchange) and competences of self-actualisation (abstract problem-solving, emotional capacities and working skills) got constrained by the traps of bureaucracy. The two channels of provisions (oligopolistic markets and paternalistic State) became too dissociated from the free will of more-and-more individuals. The paramount human need of self-fulfilment has been calling more urgently for a new corrective channel. Such channel can be found in re-installing the individual as a direct and active agent of decision-making and public governance.

We can therefore extend the philosophy of Figure 2 by adding a third fundamental pillar. Table 3 provides a review of principles that characterise the differences in functioning of our three pillars of social governance. We can see that each of the pillars is based on a set of specific principles (objectives and instruments), which allow them to perform specific tasks that an alternative pillar does not cover at all or it is covered only partially. The “logics” or the form of rationalisation of individual pillars are sufficiently different for granting them status of an existential autonomy. Therefore the question of substitution, complementarity, specialisation and exclusivity in the

⁴ This drift can be observed by rising share of the State budget on the GDP in advanced countries – from less than 10% in 19th century to over 50% in 1980s.

functioning of pillars is a crucial problem challenging all alternative structural compositions of social governance.

Since the ways how the society may influence the governance of pillars are rather limited and subject to institutional inertia of embeddedness, the evolution of social systems is not only slow but also highly autocorrelated. Features of path dependency and embeddedness may therefore interfere with attempts of applying rationality to such designs of human engineering. Politics is a common field for the social governance of pillars. Table 3 shows how complicated its objectives are and how many vested interests act against finding a social consensus.

Table 3: Characteristics of social governance in post-industrial societies

	Pillar I.	Pillar II.	Pillar III.
Agents:	Firms, businesses	State, government	Individuals, citizens
Channels of interaction:	Markets	Hierarchies	Informal kinships
Origin of gains (social objectives):	Wealth creation, profits	Wealth redistribution, rents	Externalities of justice, equity, solidarity; altruism
Objective of agents:	Profits, money, wealth	Power rents of discretion	Felicity – secure, pleasant and enduring life
Instruments of power:	Money, capital, contracts	Coercive administrative institutions	Human and social capital, civil society network
Media inducing social adjustment :	Prices of goods and factors	Regulation, decrees, legal code	Culture, moral code, natural law, social cohesion
Media of governance (of the pillar):	Competition, economic policy	Political democracy, constitution	Consensus, ethics, meta-culture
Sources of growth:	Capital accumulation	Taxation capture	Education, social wisdom, cooperation, loyalty, trust
Relationship to property:	Private property	Public property	Property sharing, voluntary inter-dependence
Nature of exchanges:	Free trade	Non-equivalent, (enforced) transfers	Satisficing barter, (“reasonable” reciprocity)

Capitalism of free markets was based on an institutional and ideological support of pillar I, while communist “real socialism” did the same with pillar II. Traditional social democracy relied on the combination of both. That is the old origin of the “third way”, going back to 1880, which we think is confusing and incorrect. The key players in traditional political games in industrially advanced countries during 19th and 20th centuries were organised in businesses and in governments. Their real power came from the wealth creation and taxation. The bureaucratic hierarchy of the State is represented at its summit by the Government that exercises its monopoly of coercive power down to businesses and individuals by means of police, army, legislation and judiciary.

In the ideal case, industrial capitalism could have existed nearly exclusively on the principles of the market alone. However, some exceptions were required since predation was (is and will be) a human feature as natural as production. Markets cannot function without enforcement of property rights and a defence against external invasion. That would require the existence of the Minimal State – thus the introduction of a parallel second pillar to our table was inevitable. So we can see that the State is defined as an unavoidable complement and not as a competing substitute to markets even in the archetype of the neoliberal capitalist system based on free trade. The same logic must be applied if the previous two objectives call now (at the globalised post-industrial world) for a support of the **authentic role of individuals, morals, solidarity and justice**.

The call for political power associated with the third pillar (described in the fourth column of Table 3) has been on a gradual rise in recent 50 years, as the post-industrial economic development was gaining ground and civil society strengthened. Nevertheless, it should be said that it is still not dominant at the present state of economic development. The dominant playground of “people” in modern post-industrial societies remains in their role as input factors (i.e. as labour challenged by unemployment) and consumers of both the private goods and the public goods (i.e. the recipients of public transfers). But if the value of human and social capital of “labour” is growing (as is growing their marginal productivity), so is rising their political role in the economic sector. Its increasing role in the government sector is also recognized.

The weakness of individuals is that they are atomised and their defence against businesses or governments is generally by passive resistance. As is argued by Thurow, 1999, the wealth in the past was associated with the ownership of land, natural resources, plants and equipment. The new trends in creating wealth are associated ever more clearly with the control of knowledge, and with the social organisation and education that encourage creativity and curiosity. At the same time the process of acquiring knowledge in the free open world is ever more biased to personal initiative than to the activities of governments or businesses.

The role of the third pillar in politics was coming to prominence as the nature of industrial capitalism was gradually changing with the rise of service industries, economies to scale, product differentiation and imperfect markets. The demand for the provision of public goods, or for commodities having some aspect of public goods, grew much faster than the demand for private goods. At the same time there were growing supplies of products with negative externalities, like pollution, congestion or crime. On one hand, the markets were crowded out by the interventions of the State. But on the other hand, there rose a tendency to involve civil society more intensively in the social decision-making. That was also instrumental in building the theory of public choice, as an application of economics to the analysis of “non-market” decision-making. Actually the new ideas are to introduce markets, competition and/or auctioning mechanisms into fields dominated by hierarchies, traditions and morals. Thus the decisions in big corporations, governments, bureaucracies and NGOs are supposed to be more exposed to transparency and market-like procedures. The seminal contributions by such economists like Buchanan, Olson and Stiglitz opened with such arguments a new avenue in economic thought of development and economic organization, what was also reflected by new approaches to politics.

The preferences for former market and etatist fundamentalism changed slowly in favour of the present "European approach" to politics, economic policies and social organization. That system is marked by the idea of “partnership economy” based on social contracts (Meade, 1989), regulation of factor and some commodity markets, heavy public spending and the stress on solidarity and justice (Rowls, 2001). The most idiosyncratic European policies are the policies of cohesion and the Lisbon agenda (Murray, 2004). They are both extending the traditional fiscal macroeconomics into their involvement with enterprise co-financing and the inclusion of civic sector into socio-economic development.

Although the parties, which gained most from applying the principles described in this chapter to their policies were the "new" Social Democrats (Giddens, 1998) or the Greens, the three-dimensional approach to politics, where the dialogue between Market, State and Citizens is balanced, will doubtless influence also the policies on the liberal side.

5. The Integration of Citizens and Civil Society into the Socio-political System

By placing individuals on the same footing with amalgamated social players, such as enterprises and the state, we can re-design the tripod foundations of any industrial societies as it is shown in Figure 4 (modified scheme of Pestoff, 1992, and Abrahamson, 1995).

In this figure we see how the three exclusive sources of social organisation, governance and wealth divide among themselves the arena of human consensus, politics and policies. The division of fields is delineated by institutions, the most apparent of which are formal, i.e. legally enforced rules and classifications, like those ones distinguishing between profit versus non-profit organisations, between public versus private sectors and between formal and informal rules of acting. However, the criteria given by formal institutions should be double-checked for its consistency by informal institutions because they need not overlap. It is actually the real behaviour and not the official label that matters.

In the middle of the social organisation there is left a large niche for the "**public domain**" as the cross-boundary for social interaction, which is subject to **formal rules**. Some authors call it the "**civic sector**" (Abrahamson, 1995) because its agents are organised individuals (often forming civic legal bodies) bargaining about objectives (i.e. their inner revealed preferences) that need a support of other social agents (i.e. other individuals, governments or enterprises). Here we touch the **central idea of this paper – the hypothesis that the area of "public domain" is the *nervus rerum* (engine) of social governance.**

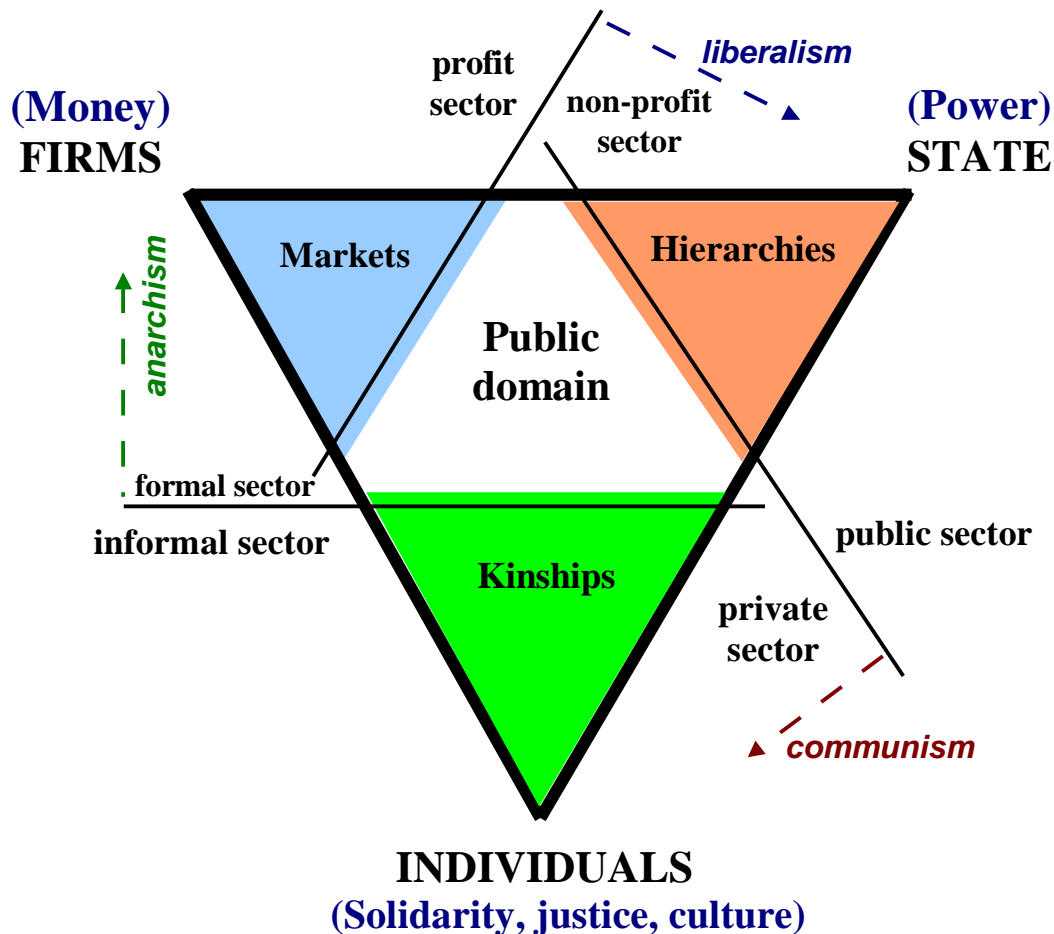


Figure 3: The triangle of socio-political pillars and the forces changing the scope of their dominance

It would be incorrect to infer that the public domain /civic sector/ should be an extended platform of individuals using formal civil initiatives for following their objectives pertaining exclusively to the field of kinships. Our inner niche is the platform for enforcement of interests coming from any of the three pillars. These can be non-profit and non-state civil organisations, churches, trade unions, professional chambers, but most markedly political parties and media.

The crucial point here is that the instruments with which the three groups of social players coordinate their activities (i.e. markets, hierarchies and kinships) are omnipresent in the whole social system. Although they have its specific home domain, where their functional principles originate (as depicted by a corner) and where their influence is most visible, their functional principle is universal and can be used in other domains. For example, markets can be used in allocating resources for enterprises, but also in competitions for tasks of public administration, political party competitions, guiding NGO decisions, allocating leisure or finding a partner. Hierarchies are used in most varied fields of public administration, but also in running enterprises and families. Social cohesion, culture and its standards are important not only in maintaining individual social contacts, but also in running businesses and hierarchies (trust, loyalty, justice, etc.).

The imposition of new roles to civic sector, together with assigning more substantial role to its exchanges with the “informal community” of individuals, are the special objects of interest of our

description of new features in the political economy of social governance. While we can agree with Habermas, 1987, that the “system world” of money and bureaucracies in the industrial societies has colonised not only the public domain but also the life of individuals, we can also witness how the cause of individuals, families and voluntary organisations of collective (shared) interest rebounds. For this we must rely on the role of culture (including ethics) in the functioning of societies. In its anthropological sense, culture is conceived as the reflection (abstraction) of all capabilities and habits acquired by man as a member of society. In its function it is assigned intrinsically and exclusively to individuals. It is actually a definition of *homo sapiens* as a social and not only a biological entity. The culture assigns man two paramount social properties:

- a) The maxim about the right of an individual to be the own master of his/her creative entity, without being responsible to any higher power. This is the crucial principle of liberal approaches to society (Williams, 1996).
- b) The objective that by developing culture the life will become more secure, rich and enduring.

Both properties thus can serve as criteria for human social activities, their structures of institutions (such as ethics or laws) and the choice among alternatives of interaction. They also serve to distinguish between authentic human activities and the loss of sovereignty due to external manipulation or domination. In that sense, **the objective function of individuals is superior to the objective functions of enterprises or hierarchies.**

Dividing lines between sectors in the triangle of Figure 3 represent the domains of institutional arrangements particular to given society. In the terminology of Hayek, 1973, they reflect the status of *taxis*. The dividing lines can be shifted in response to how much the society is willing to accept the ideas of liberal economies, totalitarian organisation or anarchism. Also the division between sectors should not be treated in a strict discrete (binary 0 or 1) logic. Depending on the state of social formal versus informal organisations, the borders should be treated like a shadow (fuzzy) interface, not defined by a legal status but by the actual behaviour.

The inclusion of individuals and their informal and formal organisations into the mix of agents of social governance widens substantially the processes of coordination. We have three basic **instruments** at our disposal (markets, hierarchies and culture) that can be exercised by three basic types of **agents** (firms, governments and individuals) in order to follow their three specific **objectives** (profits, power and felicity). It is not difficult to understand that none of them has among its objectives a concern for a globally balanced social optimum. This could be ascribed only to God. The global social optimum is an outcome of interactive processes (“*tâtonnement*”)⁵ in the whole system – their negotiations, concessions and re-adjustments based on free exchange of information. We have also identified the core of the social system (the public domain) that included also the civic sector and where the alternative forces driving the society are conciliated. The only part that is missing in Figure 3 are external linkages to similar structures of other nations and external shocks coming from the nature.

It is only the interaction of all our players and their instruments that brings the society into a movement that is called “development”. Naturally, the development can be evaluated by

⁵ *Tâtonnement is an iterative process of global coordination among agents in large social systems applied by Walras to finding a general economic equilibrium. It requires perfect competition among agents for bidding prices under perfect information.*

historians by adjectives such as: balanced, harmonious, progressive, peaceful or constructive, including (more often) their antonyms. In any given moment we can only see a result of the equilibrium or disequilibrium of powers. There are no a-priory given “social” objectives. All is subject to an interplay of social powers.

A social coordination and governance subject to a wide combination of different objectives and instruments implies automatically a **choice** and a **specialisation**. The principles of comparative advantage in the usage of instruments, based on differences in local endowments and productivity, come again to prominence. Each instrument has its own domain of efficiency, even though its usage is potentially universal. Social optimum can be achieved only if all instruments are in balance in their marginal positive effects and any potential improvement is not compensated by a decrease in felicity by any other individual. Generally it is a black box ⁶ whose unique property is that it is hardly predictable ex-ante or empirically verifiable ex-post. Nevertheless, its message is not void: its existence helps in creating social equilibria that otherwise, if judged logically by means of comparative statics of isolated criteria, would imply that social reality evolves only within the range of seemingly suboptimal levels. If the mechanism of consolidating public and private choices gets stalled, the myriad of potential trade-offs for any social development will expose the social governance to a risk of indeterminacy.

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⁶ *Black box is a processing mechanism whose inputs and outputs are known, but its functions remain hidden. The most famous regulatory black box is the “invisible hand” of economic systems. It is obvious that societies are challenged by a similar problem of general equilibrium in many other activities than producing commodities for market sales. Any human act of choice that requires time is subject to scarcities and externalities. Its allocation requires a process of communication and negotiation similar to auctioning.*

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