Democracy over Governance

AMELIA CORREA
ROMAR CORREA*

Varieties of institutional economics are available to evaluate varieties of capitalism. These methodologies dig behind preferences and technology to arrive at the ground on which agents make choices. The individual is at the foundation of these edifices, neoclassical and otherwise. Consequently, the denouement of all these models is that the market knows best in the absence of effective counterfactuals. A natural corollary is that the task of the government is to set effective mechanisms in place in order to approach the best outcomes. In contrast, we propose a framework which contends with the modern economy as an aggregate that evolves in historical time. Problems like effective demand failures are endemic to capitalist economies. Therefore, systematic State intervention is essential to their functioning. In particular, political economy teaches us that intervention must be in the interest of wage earners. In contrast to the earlier model, the fabric of norms and conventions that facilitate the growth and development of economies must emerge from the consciousness and practices of the working class.

Keywords: New Developmentalism.
JEL Classification: B52; E02; E12.

OVERVIEW

Mainstream economics has been extended to mainstream political economy by developing elaborate concepts to contend with the malfunctioning of markets. Hitherto, market failures were dealt with by the theory of externalities and public goods. Now, notions like institutions, governance, property rights, and the like are

* Department of Economics, St. Andrew’s College, Mumbai 400 058, INDIA. E-mail: ameliacor@gmail.com; Department of Economics, University of Mumbai Mumbai 400 098, INDIA. E-mail: romarcorrea10@gmail.com.
applied to address/redress the aberrations of capitalism. However, by these own accounts, it not clear why institutional regimes change. Nor, as in the hands of Douglass North, why optimal arrangements are not to be seen (Fine, 2013). ‘Social Capital’ is innocent of class and conflict, silent on finance. ‘Good governance’ is the creep of incremental changes in these spheres and does not require substantive alterations to the mode of production (Hanlon, 2012; Hardt, 2012; Kelsall, 2012). It throws out the baby of the infrastructure of the State and domestic capital with the bathwater of corruption and rent seeking. The conception was developed so as to police neoliberalism and, perversely, deprive poor countries of the avenues to prosperity used by Europe and the US in the late nineteenth and the early twentieth centuries and the Asian tigers and the Latin American countries like Brazil and Mexico recently. ‘Good governance’ is unnecessary for transformative pro-poor growth. A more efficacious strategy would be to centralize rents and manage them over the long term. In tested cases, the plan involved patron-client relationships with a vertically-disciplined economic technocracy. The result was a secular effective industrial policy in an atmosphere of relative political stability.

We suggest that institutional economics (old and new) is ‘intervention from above’. The direction is Pareto-improvements and consists of policy packages that are not destabilizing. The laws and rules and regulations crafted in this light might not be inconsistent with the ‘view from below’. However, it is possible, as in the case of progressive taxation, that a democratic economic policy is in conflict with the incentives of a class of agents. In a representative agent world, the fundamental theorem that is held up is that the income tax is a disincentive to work. Warren Buffett differs, vociferously proclaiming that the propensity to earn billions by billionaires will not be impaired if some of those billions are taxed. Indeed, the theorem may not hold when the strong homogeneity and rationality assumptions supporting it are removed (Diamond & Saez, 2011). It is preferable to work out optimal tax formulae from a clutch of stylized facts. In that case, very high earnings should be subject to high and marginal tax rates. Capital income should be taxed. Secondly, when a tax represents collective action, the tradeoff between efficiency and increased production vanishes (Campos-Ortiz, Putterman, Ahn, Balafoutas, Baitsakhan and Suller, 2012). We work through some of the tensions posed between policy regimes reflecting the interests of people directly and those that are ultimately founded on ‘trickle down’.

Thus, one plank on which all brands of institutionalist thinking rests is the establishing and securing of property rights by governments. The terms in use are never defined (Milonakis & Meramveliotakis, 2013). The ownership of property is explained in terms of person-to-thing connections. However, the concept of property essentially involves relations between people. Therefore, the meaning of property will vary between societies and within any society over time. It would be more fruitful to conceptualise property relations as reflecting relations of production. Besides, history teaches us that property rights have been wrested in struggle (Kennedy, 2011; Pagano, 2012). For instance, the enclosures movement to raise sheep in support of the expanding British textile industry was an assault on the cultivation
of land for food. David Ricardo theorised that the accumulation of land rents could be an obstacle to growth. Indeed, it is often imperative to destroy entitlements in the interests of growth and development. There is nothing sacrosanct about a given allocation of property rights. Thus, there is no criterion under which the resources of those who own capital be aggregated for investment. The strengthening of intellectual property rights today has been compared to the enclosure movement before the industrial revolution. Then, the commons were turned into private property. The difference with the present context is that the subject of land was localized and involved a few people. Today, the privatization of intellectual property transforms the legal positions of individuals across the world. Decisions can be taken in one corner of the globe about production processes in another. While it is true that enclosures of land might prevent exploitation and avoid the ‘tragedy of the commons’, the growth of knowledge is stunted by enclosures. The rush to acquire property rights runs along with the reduction of public investment in knowledge creation and dissemination. The result is the attenuation of investment opportunities. Knowledge is not a pure public good. The possibility of exclusion from consumption is not absent. Disembodied knowledge can become embodied in capital and then intellectual monopoly capital. When knowledge is privatized, the size of firms matters. Due to increasing returns, complementarities with other units can be exploited. The greater the concentration of knowledge, the lower the unit costs of defending ownership rights on each unit of knowledge which competitors could discover or imitate. The accumulation of capital can, for instance, be accomplished through taxation and public expenditure or through a variety of State-sponsored entities ranging from chartered corporations to development banks. Different modes of the aggregation of capital entail different conceptions of the ownership of capital.

The idea of democracy in the title of the paper is classical or Weberian as contrasted with the liberal (Kárpáti, 2012; Polychroniou, 2013; Streeck, 2012; Werlin, 2012). The latter slides into markets for the delivery of services and has evolved into good governance. The modern expectations of diversity, individuality and choice in the context of commodities and services are subversive when it comes to the production of public goods. Collective goods are indivisible and must reflect the beneficiaries. The values are solidarity, distributive justice, and rights and duties. The former connection is with the Athenian conception of community and continuous discussion in public and for a political education in civil virtues and the sense of a shared fate. Citizens are enjoined to subject their preferences to scrutiny in public dialogue. Collective action implies high investment and transaction costs without any assurances that the joint outcomes satisfy all preferences. Participants in a democracy display a willingness to modify their choices in the light of general principles. Orderings evolve in the direction of aggregation and unification rather than diversity. An important illustration is wholehearted support to taxes in the hands of a lawfully-constituted government which would be put to uses as yet undecided upon. Political economy is about the creation and maintenance of social order. Its results cannot be disaggregated into a variety of different products and
services in customer markets. The role played by the State as well its accountability and responsibility is central. The criterion is a dignified life for its citizens. The State is neither a Leviathan nor a bumbling incompetent. Individual actions grow into social actions by being oriented towards others. When actions that are uniform in their orientation and have similar drivers evolve, regularities of actions emerge. What Weber called substantive rationality, distinct from formal rationality, relates to value-laden action and, thereby, to ultimate values. Through a process of theoretical rationalization, a methodical way of life emerges that connects practical and material interests with psychological impulses consistent with the interests. Consequently, as ideal interests change, value-relational action changes. The underlying ethic Weber called “practical ethics”. He also underscored the sequence from the sophistication of the State structures to the apparatus of the law of a society (Lapuente, 2012). It is not true that cross-country differences in the quality of institutions are explained by the legal origin of countries, common law or civil law traditions. Broadly, State trajectories can be classified as patrimonial and bureaucratic and they influence social institutions. The bureaucratic type constrains, the patrimonial enables.

Corporate social responsibility, another frequently-accessed entry in the lexicon of all shades of institutionalist economics, can be examined in this light (Boeding, 2012). The phenomenon is grounded in conflict between stakeholders. “Middle-range theories” must be used to capture the interplay between agents and institutions. The role of business in society is ill-posed. The context must be the role of the economy in society. Principal-agent theory, a popular tool in the armoury of formal institutionalists, underpins the shareholder value maximization model (Dobbins, Plows & Lloyd-Williams, 2012; Lazonick, 2012). The shareholder is the principal, the manager the agent. Other stakeholders like workers contribute without a guaranteed share of the returns. For instance, through government investment and subsidies, taxpayers provide finance to companies without assured payoffs. A consequence of the shareholder value maximization model is that business corporations in the US do not invest in new higher value-added job creation. Falling prey to Wall Street’s expectations of higher and higher quarterly earnings per share, large companies repurchase large tranches of their stock in order to manipulate their stock prices. Instead, billions of dollars could have been spent on innovation and job creation over the past three decades. The result has been what Guy Standing has called a growing “precariat”, a class of insecure people ‘making do and mending’. The logic is relentless. Shareholder value maximization means perpetual restructuring via redundancy, wage cuts and work intensification.

Macroculture guides the actions of citizens in the accomplishment of complex tasks (Kyriazis and Economou, 2012; Tsuda, 2012). A proper inductive political economy must move from extant practices to the human tele. The combination of induction and history gives dialectics (Bresser-Pereira, 2012a, 2012b). Novelty and surprise are always waiting around the corner as people go about the ordinary business of life. Instincts for survival and solidarity coexist and collide. The classical principles that apply are ‘isomomia’ which is equality before the law in safe-
guarding property rights and ‘izsezoria’ which is the freedom of speech before the assembly. To illustrate, in less than a decade, Cambodia’s garment sector has been transformed from a set of sweatshops where human rights violations were rampant into hundreds of factories adhering to labour laws (DiCaprio, 2011). In 2010, an ILO-affiliated monitoring mechanism found that 98% of the factories neither interfered with freedom of association nor were anti-union. The reason for this revolution is the establishment of dedicated spaces for the interaction between the State and society. The State wholeheartedly embraced its responsibility for social protection policies as a redistributive mechanism.

Put differently, the panoply of ideas around property rights, contract enforcement and antitrust positions are a part of the neoliberal orthodoxy (Bresser-Pereira, 2011, 2012c, 2012d). They detract from the critical role of the State in defining and implementing a developmental trajectory. Thus, equitable and steady growth characterized the period from the late forties to the beginning of the seventies. The elements of new developmentalism can be crafted from macroeconomic identities. Thus, the equation connecting wages and productivity must be respected. Profits fulfill a role in the capitalist dynamic and the progressive taxation referred to must be restricted to unearned incomes and/or incomes in the production and circulation of luxury commodities. The next section takes steps in moving from an individualist orientation towards a structural perspective on institutions. In the following section we trace out the contours of a democratic macroeconomic institutional milieu.

TOWARDS STRUCTURAL INSTITUTIONS

High on the agenda of mainstream institutional economics is the problem of coordination. Game theory, in many cases, is employed to explain how trust and cooperation emerge in the interaction of self-seeking agents. The technique is to iterate games over time. The trust that emerges is instrumental or strategic. The results might explain cooperation in the small. The agenda is less helpful in illuminating social cooperation in limited interactions. In order to regard institutions as the solutions of repeated games, recourse must be had to recursive states of the world and beliefs across players. How are such states generated and sustained? Public representations in the form of external cognitive signals perform an intermediating function. They assume forms such as norms, social rules and ideologies. For the purpose, a certain critical platform size is necessary (Aoki, 2012; Elsner & Schwardt, 2012). A threshold mass is necessary for expectations to mesh across all members of a society. Crossing this Rubicon, social trust emerges (Sturgis, Patulny, Allum & Buscha, 2012). Here, individuals hold expectations about the drives and incentives of a diffuse ‘other’. The trust is “horizontal” or “thin” and facilitates cooperation in the absence of fine-grained information about others. Vietnam is an illustration that directly pertains to our thesis (Dang, 2012). It is ranked at a low level in international ranking tables such as Polity IV and Governance Indicators. All the same, World Value Surveys show that the Vietnamese level of national social
trust exceeds other East Asian countries at the Vietnamese stage of development. Here trust has evolved over the demand of peasants to cope with the uncertainties associated with the vagaries of the weather. Variables like genetics and education are inferior as explanatory variables in comparison with the primary form of village democracy in Vietnam. At the same time, in this non-neoclassical context it is unlikely that decentralized decisions maximize social welfare. Centralized authorities must administer incentives (Nosenzo & Sefton, 2012; Valenti & Giovannoni, 2013). What the Club of Madrid calls a “virtuous cycle” is one in which governments engage in and invest in all members of society, thereby creating an environment that enables all economic agents to contribute their mite. In supporting the common weal in their turn, people will provide governments the popular support they need. Physical capital accumulation leads to social capital accumulation, which leads to physical capital accumulation. A “vicious cycle” is initiated, in contrast, when governments are uninterested in the common good. Some sections of society, as a result, will be either unwilling or unable to add to social capital. Consequently, governments will be relatively precarious. For instance, in many fractionalized polities, marginalized groups cannot own property. The atmosphere of hierarchical societies is ‘limited morality’. Trust comes from a ‘generalized morality’ and is fostered by participative democracy. Absent the overall context, it is not easy to demonstrate the salutary effects of policies of social inclusion. Neither the metrics nor the tests have been developed. At most, what is suggested is that the benefits of putting marginalized people to work, in general, exceed the value of their inputs. It should not be forgotten, however, that monitors will face stronger incentives than members of society to abuse their power. The script must include leaders from within the group as well continuous accountability by the central authorities to society.

Saint-Paul (2012) has characterized the “post-utilitarian society” as one that respects the fact that individual choices are less than rational. As a result, outcomes are less than optimal. The government, therefore, is expected to pursue a higher ideal than maximize the sum of the utilities of the citizens. He recommends “experts” who will measure the effects of alternative government policies on social welfare (see also Altman, 2012). Furthermore, Post Keynesians, following the master, insist that the future is unknown and is open to multiple interpretations. Decisions driven by these different meanings might not coalesce to a good equilibrium. The task of the government is to “manage expectations” and, thereby, “manage confidence” (Beckert, 2012). In order to do so, the authorities must not just motivate ‘right’ decisions based on correct expectations but must manipulate the institutional structure that generates the expectations. The mathematics to be employed is not individual optimization but matrix algebra (Kirdina, 2012). The matrices to be constructed have strong distributive elements in the sense of Polanyi and are predicated on a communitarian ideology. ‘We’ takes pride of place over ‘I’. Following Janos Kornai, there is a planning model underlying the systems approach. The Center regulates the flow of goods and services as well as rights over their use. Accordingly, private ownership is completely conditional on rules that might change over time. The sphere of work is not excluded under a public guarantee of lifelong employment.
Classical economists analyzed the effects of government borrowing and spending on the budget according to the doctrine of ‘sound finance’. Post Keynesians, on the other hand, are concerned with the impact of government spending on the economy according to the doctrine of ‘functional finance’ (Konzelmann, 2012). In democratic agendas to revitalize fiscal policy, community-proposed programmes have been recommended (Tcherneva, 2012). The contrast is with the familiar item, expenditure, in the government balance sheet. In that regard, the crowding in of private investment by government stimulus is necessary but not sufficient to generate employment. The potential salutary effects on private investment and consumption might add up to more growth. However, growth must be an offshoot of employment not the reverse. According to the scheme, fiscal policy would be matched to people, their needs and abilities, rather than their employment conforming to a macroeconomic variable. In this connection, the appeal for an educated workforce is irrelevant. The expectation places the onus on job creation on the millions of unemployed rather than the government. If the claim was well-founded, wages would rise rapidly by virtue of the forces of demand and supply (CEPR, 2012). If qualified workers are not available at prevailing wages, a potential employer must induce employed workers out of their existing habitats by offering higher wages. 

The critique of mainstream macroeconomics has been extended to its more fecund developments like endogenous growth theory as well as models recommending emphasis on health, education and the like. A constructive contribution from Latin America is *buen vivir*, an engagement with a relational understanding of the processes by means of which different societies transform themselves (Monni & Pallotino, 2013). The focus of attention is local development and the politics is a form of humanistic socialism. The time span for reflection is the web of sociocultural institutions preceding colonization with the attendant self-consciousness of the people. Besides, *buen vivir* recalls an ethos of sharing not excluding the harmony of human beings with nature. Social life is understood as an arena in which the needs of the individual are satisfied within the ‘living well’ of the community. The community, in turn, is conceived of in relational terms rather than as the conglomeration of individuals. The primacy of the community over the individual is promoted through an engagement with the State. Freedom is the key tenet of this brand of socialism and indissolubly involves participation. The movement is not naïve enough not to acknowledge the threat of the emergence of totalitarian regimes but proposes that the continuous self-organization of popular forces can be a built-in antidote.

Budget deficits do not define Keynesian economics anymore. In order to address the horrific gap between the rich and the poor everywhere in the world, public expenditures will have to be supported by effective taxation of the wealthy (Streeck, 2012). The alternative strategy is to borrow. In that case, repayments with interest will augments the earnings of the rentier class who will bequeath their wealth, thereby perpetuating the inequality of income and assets. We can continue
to challenge the work-leisure tradeoff in the case of taxation on its own grounds, microeconomics. Neuroeconomics professes to unearth biological bases for hitherto unobservable aspects of individual decision making. Social norms, it turns out, might be an alternative to the law in ensuring tax compliance (Alm, 2013; Dulleck, Fooken, Newton, Ristl, Schaffner and Torgler, 2012). Evading taxes comes with internal sanctions like guilt and remorse. Individualist treatments cannot explain the following conundrum: Why do so many people pay their taxes? Standard microeconomics would suggest much larger tax evasion than is witnessed. Behavioural economics is not an answer based, as it is, on choice-theoretic foundations. The voluntary provision of a public good cannot be accounted for by the familiar equilibrium of a Prisoners’ Dilemma. To recall, an individual’s optimal strategy depends upon the strategies she expects others to follow into an infinite future. Full voluntary contribution may be the dominant individual strategy. An individual pays her taxes because she values the goods provided by the government. Social norms that arise are process-oriented rather than outcome-oriented in the style of individual rationality.

The quality of institutional economics propounded above includes financial arrangements and rentier interests (Hudson, 2012). The ways in which a mode of production can be embedded in finance capital are multifarious. Rentier interests are absent in some. Soviet Russia, America, Japan, Britain and Germany shared a repertoire of technological blueprints in the 1970s and 1980s and yet had vastly different banking systems. The financial counterpart to our discussion is community banks. Robin Blackburn makes the case for public-utility banks. A public-utility financial system would be run with publicly-owned and publicly-accountable banks and social funds and would be insulated from commerce and speculation. The German manufacturing system has benefited from the country’s largely publicly-owned Landesbanken. In recent times, several of them were tempted by the returns promised by complex mortgage derivatives to their detriment. United States Savings & Loan Associations, Fannie Mae, many British privatized former mutuals, the Spanish Cajas, all worked well for decades on publicly-owned funds till they were privatized and demutualized. Another illustration is the impact of the Community Development Financial Institutions (CDFI) Fund on credit union activity (Cortés & Lerner, 2012). Established in 1994, the mission of the CDFI fund is to expand the capacity of financial institutions to provide credit, capital, and financial services to undeserved communities in America. It has turned out that the delinquent loans are a small proportion of additional loans generated and political influence plays no role in the grant of awards.

CONCLUSION

New Keynesian economics is new classical economics with frictions. A classical equilibrium with nice properties is still believed to exist but there are contracting and cognitive rigidities stymieing the movement towards the market-clearing
outcome. In like manner, we have appraised a variety of concepts that comprise brands of institutionalist thinking. The pre-analytical orientation is that the market works and that State intervention is welfare-reducing. The set of frictions impeding the movement towards a social equilibrium are subsumed under the battery of concepts referred to: governance, social capital, private property, and the like. Au contraire, we propose the germs of what Luiz Carlos Bresser-Pereira has termed a “modest” agenda in the social sciences. The macroeconomy can be captured in an input-output matrix evolving in historical time. There is no immanent rationality in market economies. The economy consists of classes, working and consuming in the shadow of the State as an employer of first resort.

REFERENCES

Alm, James, 2013, Expanding the Theory of Tax Compliance from individual to Group Motivations, Tulane Economics Working Paper No. 1309, Tulane University, February 2013
Blackburn Robin 2011, Crisis 2.0, New Left Review 72 November/December, 33-72
Bresser-Pereira, Luiz Carlos, 2011, Structuralist Macroeconomics and New Developmentalism, Escola de Economia de SPaulo, Textos para Discuss, Agosto de 2011
________, 2012a, Why Economics Should Be a Modest and Reasonable Science, Journal of Economic Issues, XLVI, 2, 291-301
________, 2012b, For a heterodox mainstream economics: an academic manifesto, Journal of Post Keynesian Economics, 36, 1, 3-20
________, 2012c, The new Developmentalism as a Weberian Ideal Type, Escola de Economia de SPaulo, Textos para Discuss319, Outubro de 2012
________, 2012d, Summing up Structuralist Developmental Macroeconomics and New Developmentalism, Challenge, 55,5,59-70
Centre for Economic and Policy Research (CEPR), 2012, So Hard to Get Good Help, Issue Brief, February 2012
Charron, Nicholas, Carl Dahlstrom and Victor Lapuente, 2012, No law without a state, Journal of Comparative Economics, 40,2,176-193
Dang, Anh Duc, 2012, Cooperation makes beliefs: weather variation and sources of social trust in
Vietnam, Australian National University Working Papers in Economics and Econometrics #596, November 2012


Fine, Ben, 2013, Economics-Unfit for Purpose: The Director’s Cut, Working Paper No. 176, SOAS


Kennedy David 2011, Some Caution about Property rights as a recipe for Economic Development, Accounting Economics and Law, 1,1 Article 3

Kelsall, Tim, 2012, Neo-Patrimonialism, Rent-Seeking and Development, New Political Economy 17, 5, 677-682


Kyriazid, Nicholas and Emmanouil Marios Lazaros Economou, 2012, Property rights and democratic values in Bronze Age and Archaic Greece, Department of Economics, University of Thessaly, September 6, 2012, MPRA Discussion Paper No.42399, posted November 1, 2012

Lazonick, William, 2012, Financialization and the U.S. corporation: what has been lost, and how it can be regained, July 17, 2012, MPRA Paper No. 42307 posted October 29, 2012

Milonakis, Dimitris and Giorgos Meramveliotakis, 2013, Homo Economicus and the Economics of Property Rights is History in Reverse Order, Review of Radical Political Economy, 45, 1, 5-23

Monni, Salvatore and Massimo Pallottino, 2013, Beyond Growth and Development: Buen Vivir as an alternative to current paradigms, Dipartimento di Economia Università degli studi Roma tre Working Paper No.172

Nosenzo, Daniele and Martin Sefton, 2012, Promoting Cooperation: The Distribution of Reward and Punishment Power, Centre for Decision Research and Experimental Economics (CEDEX), The University of Nottingham, Discussion Paper No. 2012-08, August 2012

Pagano Ugo 2012, The Crisis of Intellectual Monopoly Capital, Università Degli Studi di Siena Quaderno Del Dipartimento no.624 Febbraio 2012

Polychroniou, C.J. 2013, Toward a Post Keynesian Political Economy for the 21st century, Levy Economics Institute of Bard College, Policy Note 2013/2


Streeck, Wolfgang, 2012, Markets and Peoples, New Left Review 73 January/February
_____ 2012, Citizens as Customers? Expectations of diversity, individuality and choice, New Left Review 76 July/August
Werlin Herbert 2012, Governance or Democracy: Which Works? Challenge 55, 1, 86-113