Mature Capitalism: Reflexions on the Organized Market Economy

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It becomes increasingly difficult to explain how a capitalist economy works by relying exclusively on standard macro-economic theory derived from “Free-Market” assumptions1. Three reasons may be put forward here.

1) The economic reality has widely changed since World War II under the powerful influence of the revolution in electronics and in other key technologies and under the globalization trend which crosses over a growing number of economic issues and solutions. This upsets our creed in equilibrium theory: although the concept of equilibrium is needed in order to understand what we call disequilibrium, market equilibria should not keep a monopolistic role in economic explanation. Growth theories have offered tentative explanations of the new trends in postwar economics. They remain linked to the market transactions approach and to the economic aggregates which are its by-products. This does not give a thorough appreciation of the role played by organizations and their contribution to the “Wealth of Nations.”

2) An overwhelming proportion of students in economics do not care a lot about abstract macro-economic models where the complexity lies for them in the mathematical tools, whereas the complexity of reality has been moved out by the assumptions of the models. Their job expectations turn their curiosity and attention on many other aspects of business life in which pure market and transaction rationality has to compete with many other features of human behavior.

3) When Ricardo, Walras and Alfred Marshall published their works, political economy was in those times still the leader in social sciences. When, at the end of this century economists express their views on how the economic component of social life works, they cannot ignore the main findings and quests of sociology, psychology, political sciences and management sciences.

Having had personally to start from scratch entirely new syllabuses in a brand new university of management sciences in France twenty years ago, my own frame of mind, as a young economist brought up at that time in macro-economics and neo-classical economics, was bound to big changes. I gradually came to the conviction that something should be done in order to modify our standard conception of macro-economic issues and to revise the theory of decision on which we are founding most of economic theories. My central point is that industrialized countries at least are not uniquely and fully pure market economies, but that they are a kind of hybrid. They form a mix of markets and organizations. It seems fruitful to elaborate some theoretical deductions from this starting point. This observation which looks almost commonplace has not percolated enough the dominant thoughts of the economists’ community. Either they remain strictly Keynesian or, as “supply side” advocates, they keep reasoning as if economic agents where interrelated by a unique medium of coordination: the markets.

Oliver Williamson has made a very good point in 1975 by stressing some major differences beween markets and hierarchies. But his analysis stresses more the opposition between market and organization than their complementarity; it does not single out all the main differences between markets and organizations; and finally it stands firmly on the field of micro-economics. He has opened with R. Coase a wide field of investigation with many gaps to be filled. Market coordination works through the exchange of property rights; organized coordination deals with doing things; they both create utility but through different ways. Exchange on property rights and a common agreement on making up things involve differences in time horizons, disparities in time-lags, variety in types of decision. An organization cannot be purely assimilated to a pure hierarchy. Organization offers a specific frame for long lasting activities. Their deep interaction with markets makes it impossible to elaborate on macro-economics as if adjustments were entirely implemented by markets transactions. Our own
perception is that we have to look differently at macro-economic issues, if we assume from the start that economic individuals, both as households and members of the labor force are invited to choose every day and/or at some specific day, between addressing to the market and accepting the membership of an organization as an employee, as a trade unionist, as an affiliate or as a subscriber. This very fact has rarely been paid attention. K. Boulding wrote once (Economic Analysis, Harper and Brothers, New York 1965) that 90% of economics is made of exchange and market transactions. This assumption expressed by a great and inventive economist has to be discussed and challenged.

Let us look first at the standard supply and demand curves by which we are teaching our freshmen the processes through which a price is making its way to one equilibrium position, E.

Economists explain why in area 1, prices are coming up due to excess demand; they explain why in area 2, prices are declining due to an over supply. Furthermore they have built a surplus theory in order to show that in area 3 a lot of suppliers are paid above their supply price at the market equilibrium price and a lot of clients are supplied at a lower price than the price they expected and were ready to pay. So, every point left to the point E, within the area SED, delineates the sea of economic serenity, This area concentrates all the market participants who are quite satisfied by the market mechanisms. It contrasts with the sea of deception and desolation at the right of point E, area S'ED'. Indeed, what can we say about area 4? An area where the faintly expressed demands are not met by adequate supply: pure market theory stops at that point. If we consider a sequence of n periods, the crowds of economic individuals who leave the market dissatisfied increase gradually a population of non-competitive suppliers on one side and of would-be clients whose income is much too low to afford any expenditure at the equilibrium price on the other side. The market is an efficient way for helping sellers and buyers to meet each other: but it does not assure that everybody will at once, nor after one search period, find his counterpart. Market equilibrium is reached thanks to a subset of well organized agents who are able to reach a low supply price and/or to withstand a high (but hidden) price. These high performers on both sides may be many and point E will be situated far to the right of the diagram. But they may as well be very few: the market size will be very small and point E will be located quite near to the vertical axis. In that case, assuming strong needs for the relevant goods, something else has to be done in order to lower the supply prices and to raise both the psychological demand price and the purchasing power.

So, our first assumption is, that besides the economics of transactions cost hypothesis, explained by R. Coase and O. Williamson (The Nature of the Firm 1937), another argument explains why economic agents may choose to coordinate their activities through another medium than market transactions. This argument is the following: grouping of individuals within an organization raises their average productivity, diminishes the average cost and the supply price of production, increases the average individual income, the purchasing power and the solvency of demand. This is done in such a way that they can shift to the left area of the market: the point E jogs its way eastwards on the diagram, through time owing to the differential productivity of organizations over pure individual market transactions. A. Smith made a core observation with his needles factory by pointing out the specific advantage of a non-market division of labor besides the market division of labor. But Ricardo and the neo-classical theoreticians neglected organizations (except the market which in itself may be considered as "the" organization) in expressing their views on economic Society. More recently the concepts of "organization's slack" coined by Cyert and March (A Behavioral Theory of the Firm, 1963) and of inefficiency-X (H. Leibenstein) have rightly pointed out some discrepancies between the "optimal" use of resources and their actual use within organizations, at least those which are more or less protected against harsh competition. But these concepts should not be confusing the main discovery inspired by Adam Smith, i.e. the organizational division of labor begets at additional productivity by allowing decisions to
be incomparably more and better differentiated than in a pure market economy crowded with individual sellers and buyers. So we have, according to our first assumption, a powerful argument to consider that our market economies are pregnant with organizations just as heavy-traffic streets of New York are edged with lots of buildings and skyscrapers.

To our mind the main difference between the market and an organization does not lie so much in the fact that an organization shelters hierarchies, and that a purely competitive market is not a hierarchy. The main difference is that a pure market relationship has no past, no future and gives no room for strategic decisions; it expresses a pure freedom of choice of partners and a multilateral way of coordinating present and immediate activities. Whereas an organization offers some guarantee of stability, of protection and is necessarily associated with duration, with the flow of time and some long term expectations. This leads to the root of the problem: between the market logic where the partners are focusing on short run variables, mainly the quantities and the prices, and the logic of organizations, there is a sharp difference, a gap. A gap which is not filled by the theory of market imperfections nor by the concept of monopoly power.

On the one hand, the market decider has to choose what quantities, at which price to buy and sell, when and where. On the other hand the organization decision maker has to decide who does what, to whom he has to report in due time, etc... The attitude towards risk, commercial performances, profit-motivation are quite different in a powerless purely competitive market economy and in an economy where specialization is funnelled through organizations. Our so-called market economies are hybrids crowded with schizophrenic individuals, now dealing with markets, now dealing with organizations. And this explains why the economic rationality of "homo economicus" is quite irrelevant in dealing with adult capitalism strategies. The organizations are indeed the homeland of widely differentiated types of decisions where pure rationality of transactions plays second fiddle. The structure of the decision network, the role played by words, symbols, imagination, the yearning for security and building up the future, the conflicts of interests make the decision process within companies much more complex and less predictable than in pure transaction theory.

Our second assumption stresses the fact that industrial economies are largely shaped and influenced by a specific kind of organizations: the business companies. Whereas in the pure market framework, we pretend to believe in the perfect symmetry in the crowd of suppliers and the crowd of demanders, the concept of organized market economy we propose singles out the following features:

- a) It insists on the specificity of each type of organization: business corporations, households, and public administrations have their own timelife and their own ways of exit.
- b) It stresses the absolute necessity of supply to be organized in order to reach higher levels of productivity. Sophisticated innovation can hardly spring up from individual initiative and conquer quickly wide new markets.
- c) It points out the fact that a business company is as well a political unit as an economic unit to the extent that its leaders have to elaborate compromises and to muddle through the decision processes.

Item a) reminds the role of risks which hang over the fate of any business company, even the behemoths. Item b) stresses the impossibility for any human being to copy alone through market operations with the difficulties of engineering and selling any manufactured goods whatever its degree of sophistication might be. Item c) illustrates the countless trade-offs in which any decision-maker is involved between economic constraints, specified goals and other contingencies within the firm. We contend that, on a purely methodological ground, economics has also to deal with those contingencies of a specific kind which are bounding pure economic rationality. The macro-econometric models which remain rather reliable as far as their Keynesian side is considered (forecasting overall consumers demands) are hampered by several drawbacks on the supply side for one main reason: they make wrong estimates about production and growth rates because their designers keep reluctant about business strategies, decision processes related to investment, production, innovation and global competition. As a consequence of this assumption, we suggest that the standard theory of production which relies on a pure market definition of production factors - capital, labor and natural resources which can seemingly be easily bought on markets - should be amended in order to take into account the organisational
perspective: this means that a business company needs skills, experience, a good image in order to attract capital and new staff; therefore it needs time in order to build its inland resources, it needs space command in order to operate on the adequate scale and scope. Skills, time and space are the organisational equivalent of the market-driven definition of production factors. The clear-cut market-wide definition of production factors is thus challenged by the key resources on which the business strategy has to rely and concentrate. Of course, they are somewhat more fuzzy concepts than the production factors concepts. But accuracy in explaining economic reality should not be confused with precision (A. Kamarck, *Economics and the Real World*, University of Pennsylvania Press, 1983).

Our third and last assumption regarding the micro-economic foundations of macro-economics addresses the fact that since World War II, our economics are quite dominated by a sweeping and deep industrial revolution. New technologies are emerging every day in the market; new products are invading our lives. Innovation has become the rule, technological steadiness the exception. This is largely due to the fact that R and D is mainly flowing out from organized laboratories and not only springing out from grass-root capitalism. The process through which new techniques are chosen, introduced, improved, discarded after a while is quite inconsistent with the core theory of economic optimum in a purely competitive market economy. Business decision makers have to cope with:

- Information asymmetries and uncertainly.
- Costly knowledge acquisition through experience, patents acquisition and tough competition.
- Unequal skills and technology mastering.

Instead of considering all competitors as equally able to accede at once to the best technique of the present time, they stretch on a long road where the leaders are building for themselves costly new experiences, where the laggards still hope not to be out-sold by outsiders, and where everybody is trying to do its best to improve its own performances by comparisons with its own past and with its nearest competitors. The Marathon races open to all classes of long distance runners display perhaps the best image one can find of the kind of contexts of decisions involved in economic competition. Unlike world-class champions, these racers do not permanently seek shelter under a hypothetical first best solution. Economic agents, more or less dissatisfied with their present fate struggle more or less efficiently in order to stay running and if possible to improve their situation. Of course, we agree with both the bounded rationality theory of Herbert Simon and the contextual decision theory of March. But our point is that we have to draw some conclusions on the working of macro-economics from the set of assumptions we have just drawn out and put together and which can be summarized as such:

1) Economic society should be contemplated as a mix of markets and organizations and not as a pure market transaction economy.

2) Among the whole set of organizations dealing with economic issues the business corporations are a specific, dominant subset: they are the hosts of a complex network of highly differentiated decisions in which market spot transactions are largely put between brackets. This means that if a pure market economy could totally be represented like an open-air economy where transactions and prices concentrate all the information needed and available, an organized market economy is full of shady squares which require new tools of analysis.

3) The overarching importance of technological progress restrains the operational power and the relevancy of Pareto-optimality and excludes the possibility that economic agents could remain satisfied, even in the short-run. The concept of relative improvement is better and more relevant and appropriate to reality.

Now, how do these assumptions fit with our understanding macroeconomic problems?

Let us concentrate on a few key issues. Those which we have selected in the forthcoming book are:

- Macro-economic adjustment.
- The quest for monetary stability.
- The international economic relations.
- The role of the State.

1. The macro-economic adjustment concept tries to catch a part of the message contained in the general market equilibrium approach. According to this legacy, economic expansion remains positive with an average long run growth rate ranging between 4% and 2% and cannot deviate very far from its median path. But, economic adjustments discard almost all the perequisites of pure market equilibrium, i.e.:

- The market as a unique medium of cooperation.
The pure and perfect competition axioms.
The focusing of decision theory on prices, quantities and profit maximisation.
The idea that one single principle could be considered as the keystone of the whole economic system.

Indeed in the neo-classical systems the keystone is given by the supposedly individual rational behavior. In the Marxian thought the keystone is given by the idea that class struggle is the engine of economic history. In the Keynesian theory, the keystone lies in the principle of effective demand. Within each model, the central principle acts as the hub around which detailed theories and specific observations are built. As mutually exclusive paradigms they show, if needed, that in fact the economic activity is probably too complex to be considered as the field of action of one central principle of motion.

In our opinion, macro-economics should be otherwise explained by taking into account the fact that prices and decisions have to be replaced in their social and historical contexts. The economic quantities are subject to inertias, rigidities which give to the business cycle a somewhat chaotic pace. The economic path of expansion is hemmed in a series of strategies and reactions where prices and quantities play an intermittent role and not always a dominant one. And each country shows a specific cocktail of economic adjustment paths, whereas economic theory seems to put on it a veil of uniformity.

The vision of an enlarged overall adjustment of economic aggregates enlightens the ambiguity of many core economic concepts which are in the tool-kit of equilibrium theory. All the following seemingly familiar concepts play a major role, i.e. production, consumption, saving, investment, interest rates, prices, information, contracts, etc.... But each points out complex realities so that the same words may designate different phenomena which are at work within the process of adjustment.

Production, for instance, which flows upstream of supply, is much more determined by organised programs which flexibility depends less on price observation than on data processing, marketing strategies and technological progress. Production which is less and less the reproduction of known outputs with familiar inputs does not mainly respond to relative prices but to competitive strategies designed in the long run. Relative factor prices are more determined than they play a determinant role in resources allocation.

Consumption expenditures of households are not only constrained by the after-tax real income available for consumption nor only by the prices, but also by the bulk of subscriptions which are almost necessarily taken out by the household once and for all to organizations like telephone and insurance companies, gas and electricity utilities, automobiles and durable goods repairing companies, private schools, etc... Our point here is that the field of consumer theory where the freedom of choice is expressed just by an instant compromise between tastes, budget and prices, is strongly narrowed by choices taken once and for all years ago and to which a rigid timetable of payments is linked. And so much the more if the household has to repay debts previously contracted.

The famous equation linking overall savings and investment should be revisited by considering the major role of transformation of the raw savings supply into a span of highly differentiated financial products. The cost of banking and financial organizations is thus mainly reflected by the spread of interests. But, curiously, this spread and its possible variation does not interfere very much in the theory of the equilibrium interest rates nor in the standard macro-econometric models.

Prices play many roles except the major one of clearing continuously the markets: they display some information, but not all. They contribute to the benefit and income sharing. They can be very confusing when the clients do not know what kind of services are available or out of supply within the product they buy, and so forth.

Information itself is badly needed besides prices inasmuch organizations contribute to make markets somewhat inefficient and impenetrable to sight. Now information needed by economic agents flows unequally from three main sources: the market information which may be slow to come out: the insider information diffused by specialized agencies such as newspapers, mass media, expertise, oracles and guessimates stated by consulting groups, scientific and statistical offices. All these flows of information suffer from their own biases, and the receiver has to make his own interpretation. No information is in itself totally reliable. Risks of error, of misinterpretation vitiate thus the free adjustment of wills.

The contracts which are freely negotiated by partners are much more complicated than the
hypothetical contracts of pure market theory: as Oliver Williamson (The Economic Institutions of Capitalism, 1985) has recently shown, contracts can be so highly sophisticated that the organization component may often overwhelm the free market relationship.

Furthermore, macro-economic adjustments keep going in part because other match-makers than free market agreements play their role. "The common knowledge" or collective understanding, the role of experts and mass media exert great influence on expectations and this does not, unfortunately, ease the way to reach a set of mutually satisfactory positions within our societies. One may add that the computing techniques used for instance in automatic trade orders are also an example of the way by which an economy crowded with organisations disturbs the equilibration process a long while before the right but transitory answer can be found.

2. The regulation process in an organised market economy may be studied from the central point of monetary stability and the kind of policy-mix which is used to curb inflationist trends. We discuss here the substance, the content of three traditional weapons: the anti-trust policy, the fixed income adjustment policy, the monetary policy. Our conclusion is that we need them all because the organisational component of our economies blunts the competitive edge of each of them. Anti-trust regulation deals for instance with companies which aim at different goals, more or less consistent with the minimum spot prices. They squabble about relevant markets and object the necessity of staying competitive when suspected of abuse of dominance or secretive collusion. Wages and farmers income policies are getting complicated owing to the balance of power of trade unions and employees associations, the unstable relationship between inequalities of income and efficiency. They have to cope with the dilemma between the freedom of wage negotiation on the field, the intrusion of professional links which run across the whole country and peg wage increases to each other. Finally, monetary policy raises the problem of what is an independent central bank and why its independence is required for stuggling efficiently against inflation. Industrialised countries do widely differ on these issues which are deeply revealing on how a national community chooses its own organization network and is distinctive set of decision procedures.

3. Since World War II international trade on goods and services has grown more than proportionally to the aggregate world production. It represents today nearly 20% of the world output. And financial flows reach a high multiple of trade flows. This is not so much the outcome of free competition between individuals located in different nations as described in a Richardian world than the result of an expensive production network involving both competition and cooperation within multi-plant companies, clusters of clients, suppliers and sub-contractors. As a major result of economies of scale, of scope, of experience, organizations expand largely beyond national borders. If was live in a borderless world, it is also a world where neighbouring nations feel the need to expand their links of solidarity through some kind of economical, political and social integration. Production factors are much more mobile internationally than was assumed by mainstream theory. But cooperative solidarity within European Union, ASEAN, EFTA countries, North American free trade area, may be considered not so much as second best solutions in an imperfect world than the expression that a collective will to master some new problems generated by international economic interdependence. Problems which cannot be solved by relying on pure market mechanisms and which require a mix of multilateral negotiations, organized common strategies and market solutions.

4. Finally the economic theory of State has to be revisited. Traditionally, pure economic theory stresses a vision of the State which makes it a "deus ex machina" located well above society, and look like a homogeneous big economic agent which expresses from outside society a purified and dignified collective will supposedly be inspired by common interest. In France especially, the central State has been, from ancient emperors and kings after Charlemagne around the 9th and 10th centuries up to the 1980's, a kind of secretive, transcendent institution which was widely felt as holding the monopoly of defining what is the common interest, the common weal.

In our view, one should, as implementation and evaluation of public policy decisions show growingly, consider that the State is both above and within society, a referee and a player. This entails a few major consequences. For example, we cannot just oppose the State decisions to market oriented decisions for a number of reasons. On one side, the State regulates property
rights and market operations. The State is playing market games, for instance, through public orders or as suppliers of public services, or as owners of public companies. On the other side, the organizational component of the private sector makes it necessary to compare public and private organizations strategies and not only public organizations and private markets. Even in those industrialized countries whose political authorities assert openly their commitment to free trade, free competition, deregulation, public authorities play an influential role. And they meet a very reactive set of private and public organizations which are diligently lobbying in order to improve their own relative position in the production and resource allocation system. Thus, in conflicting situations especially, the very process and criteria of public choice make their outcome very unpredictable to the economic partners of the public administration. To that extent pure market uncertainties may be somewhat simpler to anticipate than the content of public strategies. And this in turn makes it quite difficult to give a firm ground to the rational expectation hypothesis.

The contrast set up by dirigists between the short-sighted markets and the far-sighted public decisions of the State is an irrelevant myth; this is because at least some industrial organizations could not survive without being involved into the implementation of far-reaching initiatives and because short term and electoral contingencies bear on political decisions. Finally the era has ended during which the State could regulate competition between the private actors without being themselves submitted to international competition. In an arena of capital mobility and mobility of skills like the European Union, the public administrations of the twelve member countries come under scrutiny. The quality of public services and the tax load of the public sector are becoming a major issue both as a key resource or as a potential weakness in the Western European countries.

So, these are the reasons why economists should modify their premises, their assumptions about society and their conception of economy. Standard economic theory does not pay a thorough attention to the specificities of adult and modern capitalism. Our hint is that we should build a new paradigm based on the genuine mixity of organizations and markets and a research agenda on this ground.

By way of conclusion we can put forward the following ideas:

1. The pure market transaction approach emphasizes only one aspect of economics: the clearing of markets through equilibrium prices. These prices gather all the proposals which can come up to a settlement. But they exclude a subset of actors who might enhance their purchasing power and productivity through an alternative approach offered by the organisations. The proposal according to which quantities supplied grow up with the equilibrium price does not give full and fair account of the influence exerted by organizations on the supply curves.

2. The organization approach brings into the economic picture:
   - Long term and medium term goals in the decision process.
   - The quest for greater stability.
   - A wide differentiation within the set of economic decisions.
   - A less predictable rationality than the "homo economicus" type of absolute rationality.

3. Supplies and demands are heavily influenced by organization programs and technologies and do not just meet smoothly through price adjustments.

4. Macro-economic adjustments become more chaotic but invisibly controlled by social mechanisms and historical features of the country. The chaos is limited by redundant actions within each country.

5. Concepts and words which express economic realities conceal many different meanings, as for example prices, competition, State intervention and so forth.

6. As in a military and warfare escalation, where initiatives are answered by retorts of different kind, economic activity intertwines organizations and markets in a chaotic way. Each organisation is in a way a device to advert market instability, to protect its members against external risks, but at the same time, it contributes to keep alive the general level of instability. It suggests some devices, like insurance, State regulation, forecasting and planning methods; the public sector is required to intervene and to offer new kinds of organizations constrain unpredictably the environment of market decisions. Thus, the cost of freedom may be to sacrifice long term views and vice versa the dedication of organizations to long time achievements necessarily entail a trade-off in terms of freedom of action. And each country makes its own trade-offs between market flexibility and long term organization programs.

In that perspective, the economist’s research
agenda should be focused on the following issues:
- The criteria required for designing efficient non-market organizations and the right market-organization mix for specific countries.
- The equilibration process between organizations who trade together occasionally: they come to an agreement but strive for different goals and do not necessarily fit their decisions within the same time horizon, nor are they equally burdened with sunk costs.
- The range of scenarios which derive from market asymmetries when partners appeal to threat and resort to countervailing weapons.

The pure market transaction paradigm dodges these issues by asserting that complete competition offers the unique optimal solution and by formalising the behavior of trading partners in oversimplified terms.

In short, the efficiency of market economies which is highly celebrated since the collapse of the Berlin Wall is largely due to underground factors where well thoughtout but unveiled strategies play together with pure market reflexes.

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Note
1. This article refers to a forthcoming book in print at Presses Universitaires de France.