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CONTEMPORARY CAPITALISM

The Embeddedness of Institutions

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BENEFICIAL CONSTRAINTS: ON THE ECONOMIC LIMITS OF RATIONAL VOLUNTARISM

Wolfgang Streeck

Economists have succeeded in persuading most people that the performance of an economy improves as social constraints on self-interested rational action are removed. In this essay I wish to argue that, to the contrary, socially institutionalized constraints on the rational voluntarism of interest-maximizing behavior may be economically beneficial, and that systematic recognition of this must have far-reaching implications for both economic theory and the conduct of economic policy.

Note that I am referring not to social but to economic benefits of social constraints, and to constraint rather than choice. In other words, I am not discussing whether or not societies may or should impose constraints on economic behavior *for moral reasons;* even most economists agree that people should not be allowed to sell and buy babies, regardless of whether this was the free will and perceived rational interest of all parties involved.[1] And I am arguing for the economic benevolence not of individual freedom, but of *limitations on individual volition and the pursuit of self-interest.* To support high economic performance, I am claiming, a society requires a capacity to prevent advantage-maximizing rational individuals from doing things that they would prefer to do, or to force them to do things that they would prefer not to do.

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The suggestion that *social institutions* constraining the rational voluntarist pursuit of economic advantage, and thereby interfering with the spread and operation of *markets*, may be economically beneficial directly contests the leading premises of mainstream economics with its *laissez-faire* conceptual heritage, and strikes right into the heart of darkness of liberal individualism. For standard economics, rules and institutions are legitimate in principle only if they are confined, like contract or competition law, to ensuring the continued viability of rational voluntarism. By comparison, the notion of beneficial constraint implies that the performance of an economy may be improved by the surrounding society retaining and exercising a right for itself to interfere with the choice and pursuit of individual preferences, i.e., to *govern* "its" economy. Note that this goes further than three other qualifications of rational voluntarism that are more easily acceptable within the economic paradigm:

1. That good economic policy cannot consist *exclusively* in the removal of constraints on rational actors, and that it in addition must include subsidies and services from public institutions ("industrial policy"). While supportive governmental intervention of this kind may indeed be meritorious, such policies typically no more than cater to the existing preferences of market actors, for example by offering them an attractive infrastructure or other "incentives" in exchange for (still "voluntary") investment. I maintain, by contrast, that sometimes economic performance may be improved not by servicing, but by constraining actors' preferences, employing governance to bar them from doing what they would want to do, and making them do what they would not want to do on their own.
2. That societies may have the right to intervene authoritatively in markets and correct their outcomes in pursuit of objectives other than economic efficiency, like equity, at the expense of efficiency. While there may or may not be trade-offs of this kind, I argue that efficiency is to an important extent conditional on the effective enforcement of social constraints, and that rational voluntarism *alone* generates fewer resources than might otherwise be available for political intervention to reallocate to the pursuit of social values or collective political preferences. In other words, the notion of beneficial constraint implies that there is no such thing as a self-sufficiently "rational," efficient economy apart from and outside society, into which the later may or may not decide to intervene; and that how "rational" an economy is depends on the social institutions within which it is enclosed.

3. That constraint may be required and legitimate for the correction of "market failure," to enable rational individuals to contribute to collective goods which they in principle want but are unable to generate, caught as they are in prisoners' dilemmas and similar rationality traps. While this is an important and underestimated productive function of constraints on rational voluntarism, social constraint may also contribute to performance by *transforming* the preferences of actors – i.e., instead of enabling them to act on their *given* preferences, teaching them that what they *really* want is something else. More generally, the idea of productive constraint is premised on the principle that rational choice alone is less than fully instructive for the selection of preferences and courses of action, including economic action; that choices between preferences, as Hirschman (1992) has shown, are choices between alternative social identities; and that by socializing their members through constraint, societies implicitly select between alternative models and standards of economic performance which may be more less sustainable in competition with others.

Summing up so far, I am proposing to apply a *Durkheimian perspective* to economic action.[2] Specifically, the point I am setting out to make is that a society, when it leaves market-rational economic actors the freedom to act as they see fit, fails to utilize optimally its productive potential, and ends up performing less well economically than it might. The general principles this invokes are that an economy can perform well only to the extent that it is embedded in a well-integrated society, and that a society exists only to the extent that it is capable of imposing normative constraints, or social obligations, on the pursuit of individual interest.[3] Without such constraints, social order gives way to anomy, ultimately depriving self-interested rational actors of essential conditions for the pursuit of self-interest, in part by allowing them to consume those conditions through their own activities.

An argument like this sits uncomfortably not only with liberal *laissez-faire,* but also with left libertarianism. This is because of its emphasis on the limits of individual rationality, including self-interested, voluntary long-term "prudence," and the need derived from this for governance of social and economic behavior by social – i.e., not themselves rationally or contractually constituted – institutions that limit options, foreclose choice, and override actors' "free will" against their resistance.[4] While I am not saying that *all* social constraints on economic rationality and rational voluntarism are economically beneficial, I do claim that some are, and in a fundamentally important way. It is at this point that I expect other critics of the neoclassical worldview to part company with me. But since I believe that the single most important issue in political economy is indeed the extent to which theory and policy must allow for *rational voluntarism being beneficially corrected by social constraint,* this is very welcome.[5]

BENEFICIAL CONSTRAINTS: SELECTED EXAMPLES

Economically beneficial constraints are of many kinds, and I do not pretend to have a conceptual schema to cover them all. For the time being, I can do no more than offer a number of *examples* – most of which I have come upon in my own research on industrial relations and industrial change in a number of Western countries[6] – as a point of departure for an exploration of some of the theoretical and practical implications of my general point: that social constraints on rational economic action may be economically beneficial.

ECONOMIC PRESSURES AND THE COUNTERPRODUCTIVE TEMPTATIONS OF SHORT-TERMISM

Employers, if given a choice and everything else being equal, usually prefer low over high wages; want to have easy access to external labor markets for hiring and firing workers, rather than being constrained by rules of employment protection; and wish to make decisions unilaterally, without having to inform their workers or to consult and share decision-making powers with them. At the same time, employers often realize that paying workers above the "going rate," keeping them in long-term employment, and giving them opportunities for participation may improve workers' performance and that of the firm as a whole. However, the voluntary supply by employers of "efficiency wages," employment security, and workforce participation is limited by opposing pressures on managements for cost cutting, "flexibility," and insistence on "managerial prerogative" allowing rapid response to fast-changing business conditions. In particular, short-term economic contingencies typically create temptations for employers to defect from long-term beneficial arrangements, if only temporarily until a present crisis has been resolved.

Employer defections, however temporary, toward what might be called the market and hierarchy minimum of the employment relationship (Streeck, 1992: 1 ff) may be highly counterproductive. Wage cutting can have devastating consequences for worker morale precisely in firms that have previously availed themselves of worker "involvement" through generous wage regimes. Firing workers who had informally been promised secure employment is likely to limit severely the beneficial results of the same promise being held out to the remaining workforce. And a participation regime that has once been circumvented by an employer in an emergency may never regain its credibility, making workers permanently hold back on participation effort. A single instance of defection may thus annihilate all of an employer's previous investment in the "X-efficiency" (Leibenstein, 1987) derived from high wages, secure employment, and worker participation. In fact, the mere *possibility* of defection, as is by definition inherent in *any* voluntary arrangement, is likely to reduce the behavioral effects on workers of even the best designed X-efficiency-oriented labor regime.

Vice versa, employers that do not have the freedom unilaterally to opt out of high wages, long-term employment, and participation may enjoy the benefits these produce more predictably and indeed in greater supply. Workers who can be certain that their participation rights will continue to exist when the returns on sacrifices they are asked to make will be available for distribution, or conversely when losses have to be allocated in harder times, are likely to be more willing to adopt a long-term perspective and extend "credit" to their employers, than workers who cannot be sure how long participation will last. Similarly, workers whose employment security is not just dependent on their employers' good will – that is, is based on employment protection rules or, as in Japan, on a common culture strong and instructive enough to act as a break on managerial unilateralism – are likely to identify more closely with the firm as a community of fate and find it in their interest to contribute to its prosperity. And workers whose wages are not determined by narrow metering of actual performance will feel less pressed to assume a narrow, calculative attitude towards their work. Employers, that is, that are *constrained* to adopt a productivity-enhancing labor policy – that are forced to operate on a *high general wage floor* under a binding wage agreement negotiated for an entire economy or industry; under strict *rules of employment protection;* and under constitutional or quasiconstitutional status rights for workers to *industrial democracy and codetermination* – may in fact find it *in their economic interest* to be so constrained, as this protects them from temptations to seek temporary relief through long-term costly defections, which increases their labor policy's credibility, which in turn improves its effectiveness.

THE ECONOMIC LIMITS OF SELF-INTERESTED PRUDENCE AND VOLUNTARY BENEVOLENCE

While trust can vastly improve the performance of both markets and hierarchies, it cannot be requested and extended *solely* because of its beneficial economic consequences. Trust is the belief that another party will continue to adhere to rules of reciprocity or "fairness" even in circumstances in which it might be advantageous to defect. Such belief will be weak at best where another's not breaking one's trust is perceived as being based only on self-interest. In fact, "You can trust me because it is in my best interest to be fair with you," will very likely be understood as simply announcing that, should the party's trustworthy behavior cease to be profitable, it will cease to be forthcoming. The resulting *lack of trust* is mitigated, but by no means overcome, if the party in question has made itself known as a *prudent trader* interested in long-term relations and capable of taking into account the value of other traders' "goodwill"; the possibility of a change in its payoff matrix causing it to break the trust remains in principle unabated.

Social constraints on rational behavior can reinforce trust, and thus facilitate the rational pursuit of economic objectives, by reassuring potentially suspicious parties of continued adherence to reciprocity regardless of changes in circumstances. Credible information that the other side has noneconomic *in addition to* economic reasons not to defect accelerates and consolidates the growth of trustful relations. Such reasons may consist of culturally supported moral commitments that preclude or inhibit opportunistic behavior. Or they may consist of impersonal rules, especially formal law, that provide for sufficiently strong sanctions to make opportunistic withdrawal from reciprocal obligations highly unlikely or factually impossible. Both cultural values, enshrined in traditions and enforced through informal group relations, and formal laws promulgated and enforced by the public power, are social constraints in Durkheim's sense that, by containing self-interested rational action within socially determined limits, make it more effective.

In modern Western societies – where one believes in another's goodwill only at one's own risk, where social disapproval for a "sucker's" lack of sophistication tends to be almost as strong as for the betrayer's opportunism, and where "healthy skepticism" regarding the behavioral significance of another's professed moral orientations is almost in itself a social norm – formally institutionalized constraints may have become the most important defense against erosion of trust. This seems to hold in particular where trust is to emerge in relations between actors of unequal power, such as between employers and workers. Typically, employers invoking their own normative commitments as a reason why workers should trust them are suspected of paternalism, while workers who refuse to be suspicious are suspect of being less than wise. To the extent that Western businesses cannot therefore be normatively integrated enterprise communities on the Japanese model, pluralist industrial relations with secure rights for workers to collective bargaining and, even better, codetermination – that is, with strongly institutionalized constraints on employer unilateralism[7] – may be the most suitable mechanism for generating economically beneficial trust.

THE SUBOPTIMALITY OF EXCESSIVE CHOICE AND THE PRODUCTIVITY OF CONSTRAINING OBLIGATIONS

Political conversion of productivity-enhancing labor practices from managerial techniques into rights for workers, and thus into constraints on management, may force managements to invent other techniques enabling firms to continue to operate successfully under changed external conditions. By foreclosing certain strategic options for employers, imposition on the economy of a safely institutionalized floor of obligatory social standards may start a process of *learning* among managements that may lead to successful restructuring, amounting to nothing less than a *redefintion of firms' identities.* Employers who find themselves permanently prevented by rigid high labor standards from being competitive low-wage mass producers may discover that what they *really* want to be is producers of quality-competitive, customized products, oriented towards markets in which the expensive social system of production that they have to live with may not just be competitive, but may in fact be a source of competitive advantage.

Constraints, in other words, can open up as yet unknown *opportunities* by making learning unavoidable. Firms that are barred from responding to competitive pressures by paying lower wages, employing more unskilled workers, cutting training programs, and terminating participation schemes may come to realize that, for example, higher investment in research and development may enable them to move on to competitive arenas where worker involvement and skills are an asset instead of a liability, and where what they are socially mandated to do and to be may provide the basis for a successful economic strategy. Comparison of industrial restructuring in countries like Germany, the United States, and Britain has assembled ample evidence that a high mandatory wage level and strong employment protection may create incentives for firms to train and retrain workers; that a training regime that results in "excess skills" may lead to changes in work organization towards broader job definitions and decentralized competence; that such changes can be solidified by union-imposed obligations for employers to "humanize" working conditions, changing the way in which new technology is deployed on the shop floor; that legally enshrined codetermination rights of workers may force managements to seek out strategies of adjustment that are capable of mobilizing worker consent – and that together a set of constraints of this kind may virtuously move the production profile of a company, industry, or economy towards more demanding markets that can sustain both high wages and high profits (Streeck, 1992: Chapter 6).

If improved economic performance requires a restructuring of identity, it will not normally be sought for economic reasons and voluntarily. This is because rational choice cannot in principle adjudicate between alternative identities, but makes sense only under established second-order preferences (Hirschman, 1992). Changes in the latter, in the kind of actor one wants to be, are accomplished through socialization and resocialization, i.e., through collective normative pressure rather than individual interest maximization. While actors can be expected to know and choose what is good for them in their present identity, they cannot be expected to know or to investigate what would be good for them if they were someone else, or whether it would be in their interest to become someone else.[8] To stimulate strategic creativity beyond present interests and structures, having fewer options and less choice may be better for rational actors than having more, if foreclosed options are short-term remedies under unreformed second-order preferences.[9] Constraining, choice-limiting social obligations, like a high floor of general labor standards, may be economically beneficial because they may protect rational actors from spending time and resources on exploring suboptimal options, and force them to concentrate their efforts on making successful use of potentially more productive alternatives.

Without social constraints, rather than embarking on an uncertain search for new structures and strategies, actors are likely to look for ways of defending present ones. Social constraints that foreclose this are typically not welcomed, even though they may eventually open up new and more profitable economic opportunities. German codetermination, for example, whose economically beneficial influence on management has come to be widely acknowledged, had to be introduced and expanded against employer resistance, confirming that authoritative intervention may be required even where its outcome might conceivably have been voluntarily adopted by rational economic actors in their own interest. The same holds for an institution like the German training regime, where self-defeating temptations on the part of employers to limit their efforts to the creation of narrow, firm-specific skills are kept in check by a host of regulations and enforcement agencies, making employers act as they conceivably might themselves want to act in pursuit of competitive advantage.

THE LIMITS OF RATIONAL ACCOUNTING AND THE COSTS OF EXCESSIVE RATIONALITY

Economic performance may require that producers not be excessively calculative, "economistic," or "hyperrational" – i.e., that their behavior not be exclusively motivated by rational-economic objectives.[10] Economic actors that are too singlemindedly concerned with "making money" may find themselves making less money than less economically rational competitors; "greed," it is often observed, "is not enough." The reason appears to be that markets often value aspects of products and services whose provision is not easily motivated by economically rational considerations, i.e., that require production inputs that rational cost accounting would be inclined to regard as excessive or "fuzzy." Such inputs are therefore more likely to be provided if their provision is socially or culturally mandated.[11]

Nonrational, norm-bound behavior seems to be particularly beneficial economically when it comes to *investment decisions.* Individuals who invest in knowledge in order to increase their earnings capacity in the labor market, rationally limiting their efforts to learning what they will "need," tend to learn less, and often subsequently to earn less, than individuals who learn for other than economic reasons – because they identify with their teachers or because they have been socialized into a culture of learning. Similarly, firms that have a choice to train or not to train workers, and to train only insofar as this "makes sense" to them economically, tend to train less than they should in their own rational interest, due to the difficulties of calculating with any degree of certainty the costs and benefits especially of training at the workplace and in the work process (Streeck, 1992, Chapter 1). Note that workplace training, while undoubtedly economically beneficial, flourishes only where its provision is largely removed from rational-economic calculation by a socially or legally obligatory training regime.

More generally, where accountants, as organizational representatives of economic rationality, are allowed to enforce rational return-on-investment calculations on investment decisions, ranging from worker training to the acquisition of new technology, investment will often fall short of the economically optimal. This holds in particular where high economic performance requires *redundant capacities,* i.e., excess production resources that are kept in reserve for coping with as yet unknown future contingencies. An example is a broadly based vocational training regime, like the German one, that generates skills, including the skill to acquire more skills, far in excess of present needs. Excess skills make possible an organization of work capable of flexibly restructuring itself in response to fast-changing, highly uncertain environmental conditions. Such capacity, which tends to be costly to build and whose productive contribution is difficult to measure directly at any given point in time – because it contributes only indirectly to production and remains unused most of the time – is always in danger of being rationalized away under pressures for detailed cost accounting, even though such rationalization may deprive the organization of crucial capacities for flexible adjustment.

While the costs and returns of redundant capacities are particularly hard to assess, the principle would appear to hold also for less intangible and less "useless" production factors. Given the requirements of rational calculation, productive investment determined exclusively by its foreseeable return is likely to be underinvestment. That investment decisions may in this sense be excessively rational, and therefore suboptimal, is consistent with the insight that rational principles alone are not sufficient to instruct organizational behavior or, for that matter, social behavior in general. As the neoinstitutionalist school of organization theory has pointed out (Powell and DiMaggio, 1991), organizations depend on imitation, social norms, or legal requirements to "close" their structures – i.e., on socialization in a culture. Relying on rational accounting for guidance of investment decisions is just one possible cultural-institutional solution, with the more important drawback that a culture of rational accounting, as prevails in British firms, may be less economically successful and internationally competitive than, for example, a culture of technological perfectionism, like in Germany (Lawrence, 1980) or Japan, where certain investments are socially or legally obligatory and in this way protected from economism and excessive rationality.

ECONOMY AND SOCIETY

In emphasizing the limitations of rational voluntarism as a basis for economic performance, the concept of beneficial constraint posits the indispensability for an economy of a well-integrated surrounding society – i.e., one that has the power to make economic liberties conditional on compliance with social obligations – and to a need for the noneconomic to control the economic, *for the sake not only of the former, but also of the latter.* It thus leads to a view of the "embeddedness" of economy in society that differs profoundly from current sociological models (e.g., Granovetter, 1985), in that social structure is conceived as much more than a mere lubricant for the efficient conduct of economic transactions, enabling individuals to do better and faster whatever they may rationally wish to do in pursuit of self-defined interests. While there is no reason to deny that embeddedness may serve this function, the more fundamental contribution of social structure to economic action is that it *imposes limits on it.*

A perspective like this refers back to Durkheim [1984 (1893)] whose image of economy-in-society is informed by his basic sociological principle that a good society is one that is capable of disciplining its members' pursuit of egoistic advantage. An economy, then, being dependent on social cohesion, can be a good economy only to the extent that it is embedded in a good society, and may decline in performance if the surrounding society allows its rational actors to become excessively rational – for example, defect for short-term advantage from long-term relations of reciprocity, make trusting behavior conditional on its economic payoff, or avoid uncertainty by requiring exact calculations of return on investment instead of submitting to cultural expectations. The uncomfortable implication of this, which is indeed inseparable from the notion of beneficial constraint, is that rational actors may not always be the best judges of what is in their rational interest, that they may need to be governed for protection from themselves, and that they may have to be constrained to do what is good for them.

Beneficial constraint, that is to say, is a *dialectical concept,* suggesting a relationship of *both mutually subversive and mutually supportive conflict* between the economic and the social, ruling out any lasting harmony between the two, and harboring a permanent possibility of pathological decay in both. Social structures that are streamlined to support rational-voluntaristic economic action are likely to be less supportive of it than social structures that defend their distinctive, nonvoluntaristic logic by subjecting economic action to collective social obligations. Nevertheless, economic action in pursuit of self-interest will always work to undermine social cohesion, and, to the extent it is successful in liberating itself from social constraints, will in turn undermine its own success. Just as on Durkheim, the notion of beneficial constraint draws on Polanyi's [1957 (1944)] central proposition that a self-regulating free market that makes the rational pursuit of economic gain the only maxim of social action, will ultimately destroy its own human, social, and natural conditions. In both theories, rational individualism is described, not just as socially destructive, but as inherently self-destructive and *unable to attain even narrow economic objectives unless properly harnessed by noneconomic social arrangements.*

Rather than a network of loose ties that benevolently facilitates economic exchange,[12] this suggests a more complex image of the embeddedness of the economic in the social. In the metaphor that I prefer the economy is socially embedded, *in the sense of contained and constrained,* like a hot plasma in a fusion reactor – where it is made *productive* by being *pressed together* and *kept in place* by strong *opposing forces.* If these recede, i.e., if the containment becomes too weak, the plasma disintegrates and ceases to produce energy. In fact, I would like to be able to say that if the constraining pressure loses strength, the whole machine, economy, *and* society, is blown apart. I understand, however, that the metaphor cannot model what one might call the "Polanyi effect" since, unfortunately, fission reactors refuse to explode.

As an aside, taking seriously the idea of the *primacy of the society over its economy* may lead one to think anew about the reasons for the collapse of Communism. Received wisdom has it that Communism fell apart because it prevented people from rationally pursuing their individual economic advantage, in the name of social objectives like low income differentiation and high social security. But while it is true that the Communist model of society had no markets, *it is equally true that it had no citizenship.* In Western societies, as Marshall (1964) and others have pointed out, citizenship "distorts" markets in favor of political participation and material equality, containing the domain and the outcomes of self-interested rational economic action within borders defined by social values. As a system of politically generated status rights and obligations that precede and are excluded from voluntary market exchanges, citizenship imposes social conditions on rational-economic action that legitimate it socially.[13] By giving rise to an interventionist politics, it also enables societies to protect themselves from at least some of the dislocations wrought on them by self-regulating markets, just as it safeguards them against economistic temptations to streamline their structures and succumb to a rationalist monoculture undervaluing the nonrational conditions of social and economic action. Allowing for the expression of a *political logic of social integration* balancing and, if necessary, overriding the competing logic of economic efficiency, citizenship not only protects the cohesion of society, but also and at the same time supports the operation of its economy.

In the West, in other words, pluralism between institutional spheres, as enshrined in citizenship, sustains the economy by encasing it in an institutional framework that prevents it from eating into and dominating its surrounding society. No such possibility for *reconstructive opposition* of social norms to economic rationality existed in Communist societies. While Communism had no markets, it had in common with unreconstructed capitalism that it subordinated the social order entirely to rational-economic objectives – if not determined by a blind aggregate of individually rational traders, then by an equally blind central planning bureaucracy. In particular, citizenship was suspended to enable the provision of social integration, not in opposition to rational-economic action, but as its planned result. Deprived of an institutional base for independent political representation, Communism's social values became, in the everyday practice of "really existing" Communism, absorbed into a monolithically rationalized order that, unchallenged by independently articulated conditions and limitations on its operation, was doomed to become both irrational and socially destructive.

Like Polanyi's "self-regulating market," the all-powerful Leninist economy-*cum*-state was unconstrained by social institutions capable of representing a logic other than that of economic accumulation. See, for example, the ease with which Communist bureaucracies were able to override environmental concerns or health and safety regulations at the workplace in the name of increased production. It is true that Communist accumulation was driven by *bureaucratic rationality* whereas capitalist accumulation is governed by *market rationality.* But the really important difference, and the reason for the ultimate superiority of capitalism, may not have been the absence of market incentives in Communist *economies,* but the fact that Communist *society* was too monistically rationally organized to be able to produce economically beneficial constraints on the economy and thereby protect and replenish the social supply of confidence, good faith, trust, long-term obligations, "work ethic," and legitimate authority required for economic performance. As Bendix has shown in his analysis of industrial management in East Germany after 1949 (Bendix, 1956), not only markets, but also bureaucracies require citizenship to prevent pathological overextension of instrumental rationality into core social relationships – that is, as a condition for their own efficient operation. Communism may have had a bad economy, not primarily because it had no market, but because, having sacrificed citizenship to instrumental rationality, it found itself saddled with *a bad society incapable of sustaining a good economy.*

Capitalism, by comparison, having been unable so far – to be sure, not for lack of trying – to dispose of citizenship and the economically unruly social values it articulates, would have prospered, not because it gives free reign to rational individualism, but because, *and only to the extent that,* it has historically developed or retained an ability to contain such individualism within a politically reconstructed or culturally inherited social community. From this it would follow that restoring economic performance to post-Communist societies would require more than the mere removal of institutional constraints on advantage-seeking individuals and the creation of an institutionally unobstructed, "free" market. Instead, the construction of social constraints on rational economic behavior, in particular the introduction of citizenship as a constraining context for the "free operation of market forces," would seem to be as important for the economic performance of post-Communist countries as market making, and may become ever more so as time passes.

In the rest of this paper, I will touch on some rather puzzling implications of the notion of beneficial constraint, as developed in this essay. If to perform well an economy requires social constraints on the exercise of economic rationality, the social institutions it needs for this cannot primarily be created or sustained for economic purposes in pursuit of a logic of economic efficiency, but must legitimate themselves as elements of a good society. (Put otherwise, it would appear that they can be economically functional only to the extent that their primary functions are *not* economic or that their economic functions are unintended.) Moreover, to complicate matters further, obviously not all social constraints on rational-economic action are equally economically beneficial, and some may in fact be the opposite. However, since beneficial constraints are not, and cannot be, designed for economic purposes, both theory and policy face the fundamental problem of how to distinguish benevolent from malevolent constraints, and how the uncertainties of that distinction might be dealt with.

THE FUNCTIONALITY OF THE NONFUNCTIONAL

While an economy can perform well only within an integrated social order, a social order cannot be integrated for the purpose of good economic performance. This is just another way of saying, with Weber (1978: 31, 213, *passim*), that there can be no purely instrumentally rational (*zweckrational*) legitimacy. A social order that is not based on principles that are sufficiently different from, and even opposed to, those governing its economy will be unable to contain and thereby sustain that economy; instead, it will gradually be decomposed by it. Economic rationality, in turn, that is allowed to decompose the society in which it is embedded, undercuts itself.

Social institutions that are to support rational economic action by governing it must have other *raisons d'etre* than economic efficiency alone. Social constraints on economic action that are justified on the ground that they help individuals maximize their perceived advantage are impossible to defend against individuals refusing to perceive their advantages as advantageous. For example, if individuals prefer short-term over long-term gratifications, constraints that force them to forego the former and seek the latter cannot be "sold" to them as increasing economic performance: Unless and until their preferences have been resocialized in response to the constraints, they can always rightly insist that *for them,* at least, performance is clearly not improved. While constraints might be legitimated by distributional or general welfare objectives, these are social and political in character, even though as a side-effect their pursuit may result in higher economic output overall or over time. In this case as in others, the contribution of social institutions to economic performance is not intended and manifest, but unintended and latent.

In fact, and certainly in most of our examples, social constraints on economic rationality, beneficial or not, are typically created for noneconomic, i.e., political or moral, reasons. While removal of constraints for economic purposes – "deregulation" – is possible although, if excessive, self-defeating, imposition of constraints cannot in principle be motivated economically even though it may have economically beneficial effects; if it was so motivated, trying to be *directly instead of dialectically supportive* of economic performance, this might make it less supportive than it could be. The uncomfortable implications of this include not only that the beneficial economic functions of social institutions cannot easily be directly targeted as institutions are built, but also that whether or not a social institution will be economically productive is hard to know beforehand. This holds in at least three ways:

1. As has been said, important economic benefits often accrue as *nonintended consequences* of institutional arrangements created for noneconomic reasons. An example is the legal protection of artisanal firms in Germany in the late nineteenth century, which helped preserve the apprenticeship system and enabled it to develop in a way that later, especially after World War II, contributed greatly to German economic performance and competitiveness. At the time, the legal constraints on *Gewerbefreiheit* (freedom of enterprise and trade) that saved the artisanal economy were attacked by liberals and economists as an economically wasteful political distortion of markets and free competition, and as sacrificing the modernization of the German economy to the political purpose of creating a reliable base of support for conservative parties.
2. Social arrangements that may be economically irrelevant or counterproductive under given conditions *may unexpectedly turn out to be beneficial as conditions change.* In the 1960s the predominance of small artisanal family firms in Northern Italy was widely deplored as a sign of economic backwardness. When the technological and market environment changed in the 1970s and 1980s, favoring flexible producers of semi-customized high quality products, the embeddedness of the economy of the Third Italy in dense family ties and local networks of parties, unions, and employers' associations came to be regarded as a principal source of the region's suddenly impressive competitive performance in national and international markets. Hardly any of the social structures that were now found to be economically beneficial had originally been devised for economic purposes; the solidarity between Communist party members in the various interconnected spheres of Bologna's civil society was not based on a shared desire to get rich. Prosperity ensued

as a *secondary effect* of a social system that happened to find itself well-aligned with a specific period's economic opportunities and requirements. There is no guarantee, however, that this will always be so; as conditions continue to change, the favorable conjuncture for the social structure of *Terza Italia* may well disappear, and continuing prosperity may depend on discovery of a different noneconomic rationale for a social compact that also happens to support economic performance.

3. When first imposed, social constraints on economic action may seem nothing but economically stifling, and it may *take time* for rational actors to discover the economic opportunities they entail. Turning institutional constraints into opportunities may in fact be one of the most important functions of Schumpeterian entrepreneurialism. Generally, advantage-seeking individuals may be credited with an *unpredictable, creative capacity,* both to work around social constraints by circumventing or breaking insufficiently enforced rules, as well as to detect unforeseen possibilities of using them productively. A high minimum wage may at first detract from a firm's or economy's competitive performance; but as time passes it may also make employers realize that high wages can lead to high profits if products and processes are redesigned for high product quality and diversity.

One of the most disturbing conclusions this suggests is that, even in economic life, it is often the nonfunctional that is the most functional, and indeed that where everything is functional, functions may be less than optimally performed. Protecting the nonfunctional from rationalist pressures for functionalist streamlining, even though its benefits can, at best, only be guessed, may well be the most difficult challenge today for societies and decision makers, economic and noneconomic, private and public. That challenge is difficult because protecting a society's "requisite variety" is ultimately impossible under a functionalist rationale, even an enlightened, long-term prudent one, given that some of the most important social contributions to economic performance can be ascertained only ex post.[14] Preservation of economically beneficial preeconomic resistance to the dictates of the economic requires preeconomic and prerational tolerance of social objectives that, *to the best of the available knowledge,* may have negative or uncertain or no economic consequences at all. Such tolerance, where it is not prescribed by religious respect of the "sacred," must be politically constitutionalized, that is, secured by independent forces, such as a politics or culture, that refuse to be enlisted for the pursuit of economic rationality. Just as individuals need protection from hyperrationality, so do modern societies, the former through social constraints and the latter through constitutionally guaranteed pluralism.

POLICY AND POLITICS

A well-integrated social order capable of sustaining a well-performing economy may be inherited from tradition, or constructed through politics, or both. Traditional and politically constructed institutions seem in principle equally capable of imposing beneficial constraints on economic behavior. At the same time, the fact that some social constraints may be economically beneficial does not rule out that others may be economically counterproductive. What seems worse, since the economic functions of social institutions are often latent and unintended, or cannot be directly intended at all, and in fact are frequently contradictory and "dialectical," telling productive from counterproductive constraints in advance may more often than not be difficult or impossible.

The consequences of this for policy, and for theory that tries to inform policy, appear at first more unsettling than reassuring. In the abstract, it may be interesting to know that good economic performance is often an unintended consequence of a social order supported for noneconomic or, if the word exists, countereconomic reasons, and that excessive economic streamlining of social arrangements may undermine performance. But since it is no less the case that *not all* constraining social institutions are economically beneficial, this seems to offer little guidance for practical action, especially compared to the sense of accuracy and certainty conveyed by technical economics. While I agree with this in part, I wish to argue in the remainder of this paper that insight in the economic benevolence of some social constraints on economic action, and in our limited ability to predict the latent economic functions of social institutions, is of potentially great practical value, and that the impressive certainties of functionalist economism are deceptive and may be dangerously misleading.

To begin with, that some social institutions improve economic performance by refusing to be economically rational is simply true, and knowing the truth is better than not knowing it. Recognition of the economic benefits of *some* social constraints immunizes against the received wisdom that *all* constraints are counterproductive by definition, which implies that a good economic policy is always one that replaces institutional constraints with free markets. There is no doubt that accepting the possible benevolence of social constraints makes theory less elegant and practice more complicated. But it also makes theory more truthful and practice potentially more successful. Instead of simply destroying social cohesion to eliminate restraints on trade, "collusion," "price fixing," "monopoly," "market distortion," etc., a more enlightened economic policy knows that it may face a double task: to preserve or create social order through institutional constraints, and then put such order to good economic use by preventing constraints from becoming economically counterproductive. An example would be the imposition of codetermination by legal constraint on German firms, contributing importantly to cooperation between management and labor, and its association with a liberal trade and tough competition policy exposing labor–management coalitions to relentless efficiency pressures and preventing them from using their cooperation for joint rent-seeking (Streeck, 1992, Chapter 6).

Similarly, knowing that good economic performance may hinge on latent or unintended functions of constraining social institutions, and realizing that such functions may be difficult to plan or even to ascertain, may as such improve policy. Uncertainty over the economic consequences of social institutions is not necessarily due to bad theory, but is an essential and inevitable element of economic life. Rather than trying to eliminate it with the help of theories that pretend to be what no theory can be – a manual for economically correct institutional engineering, or deengineering – uncertainty must be incorporated in political-economic practice as one of its defining conditions. This will restore to its rightful place the shrewd, experienced, common sense judgment of the practitioner, as distinguished from the deductively-based knowledge of the expert, emphasizing the importance of political skills such as empathy, tolerance of compromise and ambiguity, capacity to bargain, sense of legitimacy and power, and intuitive appreciation of intangible assets like goodwill and consensus. Most importantly, understanding the essential but uncertain economic contribution of constraining social institutions will foster a sense for the preciousness of social order and cohesion in a rapidly modernizing world, inhibiting easy recourse to deregulation and marketization, and supporting a general presumption for conservation of social cohesion where it still exists, and for restorative institutional gardening instead of rationalist-constructivist institutional engineering.

Perhaps most importantly, insight in the complex institutional conditions of economic performance reminds one that economic policy, as conventionally defined, covers only very few of a wide range of conditions responsible for an economy's performance and competitiveness, and very likely not even the most important ones. While far from offering a magic solution, the notion of beneficial constraint implies that restoring performance to an economy through economic policy as we know it is likely to work only in the simplest of cases. Just like an enterprise, an economy is not a machine, and governance, just like management, is not an applied science consisting of pressing the right buttons. At the minimum, good economic policy must be embedded in family policy, social policy, and educational policy, all having to do as much with the socialization as with the satisfaction of preferences, in the same way as the economy is embedded in the society. Rather than

merely offering incentives for desirable rational individual behavior, good economic policy must be involved in the creation of social obligations as well as individual opportunities, and in institution building as well as market making. To the extent that economic policy needs to strengthen the social fabric as a condition of strengthening economic performance, there is no simple technique it can apply, and there cannot be one. However, that the problem is messy and not well understood, and indeed may appear so daunting that one would like it to go away, does not make it go away.

Finally, it is only after the existence of economically beneficial social constraints has been recognized that systematic efforts can be made to understand their nature, and to assign them a place on the economic and sociological research agenda that corresponds to their importance. While distinguishing between benevolent and malevolent constraints will for intrinsic reasons always be difficult, this does not mean that more focused empirical research could not uncover important differences and similarities, or generate useful analytical concepts, typologies, and even theories. Similarly, there is no reason in principle why economic theory should not for once try to escape from the prison of laissez-faire voluntarism, give up parsimony for realism, and include the economic effects of benevolent noneconomic constraints in formal models – instead of treating constraints as exogenous or as theoretically irrelevant anomalies.[15]

Short of a theory, two general conclusions stand out concerning the relationship between the political and the economic, both allowing for and indeed demanding a measure of autonomy of the former from the functionalist dictates of the latter. First, since economic rationality is inherently incapable of instructing the design of a viable social order, since furthermore the economic consequences of social institutions are often unpredictable, and since above all some of the most economically functional institutions – like the Asian family – are sustained by principles of social organization that are decidedly noneconomic, or even antieconomic, policy and politics may just as well not even try to become "economically rational," and indeed may have to refuse to do so precisely in order to produce good economic results. Economic rationality alone cannot define social institutions; to the contrary it needs itself to be defined by them. A society that fails to provide such definition will suffer from low economic performance. While the same applies to a society whose social institutions suffocate its economy, it is also true that the kind of social embedding good economic performance requires can be built only for reasons other than good economic performance, enabling it to support rational-economic action by containing it. While letting politics operate on its own terms may sometimes go wrong economically, making politics subservient to economics always will.

A good society can only be constructed for its own sake; economic benefits may or may not ensue, but they cannot be the purpose. Political governance must above all provide for the construction and reconstruction of a legitimate social order, protecting social commitments from erosion by excessive rationality ("greed") and safeguarding a space in which people can be expected to treat each other and their community as ends and not as means. Such politics will often also, unintendedly, be good economic policy. For example, the pursuit of social justice *as an end in itself* may be supportive of economic action to the extent that it safely establishes the limits within which it may take place. And by foreclosing certain strategies of rational interest maximization, norms of social justice may stimulate a creative search for alternative, possibly more economically productive strategies. Where, however, justice is pursued only insofar as it fits "economic needs," it will very likely fail to generate the legitimacy and trust an advanced economy requires to perform well. The space for political choice and for autonomy of politics from the economy, this suggests, may easily be underestimated.

Second, if social institutions may generate beneficial economic consequences by constraining rational economic action, economic policies that aim at improving economic performance are not in principle required to accommodate the expressed preferences and perceived interests of "the marketplace." The notion of beneficial constraint points to an inherent need of economies to be *governed,* as opposed to just *supported,* by public policy, recalling the essential sociopolitical constructedness of markets emphasized in Polanyi's [1957 (1944)] work. This need is clearly *not* satisfied by negative policies of liberating "market forces," or not by them alone. Nor can it be filled by simple subsidization of market participants helping them attain their self-determined objectives, for example through the provision of infrastructure or through public research and development projects. Governance implies that society, through culture, politics, and policy, must retain the power to review the self-chosen objectives of rational economic actors *under other than rational economic criteria.* Government, that is, must be more than, however technocratically intelligent, service provision. Turning the interventionist state into an "entrepreneurial state," and thereby depriving it of its distinctive status as wielder of public authority, falls significantly short of what may be required for good economic performance.[16]

Imposing and enforcing constraints requires power, and there is no guarantee that such power can always be mobilized. Where, as in today's global financial markets, mobile economic agents can credibly threaten to exit to more accommodating political jurisdictions, taking vital productive resources with them, they stand a good chance of protecting their current preferences, even if economically suboptimal, from public intervention, and

may ultimately succeed in forcing the political to become subservient to the economic. Insight in the economic benefits of social constraints may not as such be able to prevent this; at the minimum, however, it can warn us against celebrating it as progress towards a more "responsive" economic policy or a less "bureaucratic" state. The fact that a decline of the public power may lead to an institutional politics and economic policy with economically suboptimal results does not mean that it cannot happen; but it is also true that the fact that it may already be happening does not mean that its results cannot be suboptimal.

ENDNOTES

1. However, there are economists who would like to see the Chicago Mercantile Exchange quote baby futures alongside soybean futures, in order to provide adequate information for production to match demand.
2. I am referring here to the Durkheim of *The Division of Labor in Society* [1984 (1893)] and *The Rules of the Sociological Method* [1964 (1895)].
3. Such constraints may be based in formal law or in a common culture; what is important is that, where they exist, individuals who are subject to them, especially if they are inclined towards rational cost-benefit calculation, may typically experience a *conflict* between what they would be doing if they were allowed to maximize their utility, and what they are expected to do by "society" or by the ethical code with which they identify.
4. That is, institutions that wield *power,* and indeed *authority,* in a Weberian sense.
5. I am aware that the position I am presenting here can easily be denounced as socialist, paternalistic, authoritarian, etatistic, bureaucratic interventionist, or something similarly old-fashioned. I also understand that many, while not wanting to sit with the economists, may not want to be seen as any of the above either. The unpleasant truth, however, is that one cannot have it both ways, and that even a mixed economy cannot be founded on muddled concepts. Ultimately, one can have either a contractual or an institutional theory of social order, not both at the same time. Softening up institutionalism by recasting institutions as contractual, or hiding the ugly face of the voluntarist state of nature behind cosmetic assumptions on the innate farsightedness or benevolence of human beings, or on the civilizing potential of business school courses in "management ethics," may make one feel better, but only at the cost of confusing the issue.
6. Some are reported in Streeck (1992), especially in Chapters 1, 5, and 6.
7. As anchored, in Germany, in a law that, not by chance, is called the Works Constitution Act (*Betriebsverfassungsgesetz*). Compare this to the American unilateral practice of "unionism without unions" (Garbarino, 1984) and its comparatively low capacity to generate trust between employers and employees.
8. More precisely, whether redefinition of their identity would serve a yet to be discovered *extended interest* that would make it rational for them to have *different interests* from those they have now.

9. Put otherwise, actors may be worse off for having more options. For a similar argument, see Herrnstein and Prelec (1991).
10. It is interesting to note, incidentally, that this principle is widely recognized with respect to workers, but much less with respect to managements, investors of capital, or business organizations.
11. In his comparative ethnographic study of British and German management, Lawrence notes that, "perhaps paradoxically, German ideas of *Technik* have conditioned the approach to profits, *this approach being both less overt and more successful.* German companies show an implicit grasp of the fact *that profits are not to be pursued directly.* ... Companies do not make money, only the mint does that; they make goods and services and if people want to buy them, *profits ensue.* In the author's experience there is far less obsession with the various indices of performance and profitability in German companies. ... The German corporate obsession is products. Their design, construction and quality ..." (1980: 187; italics mine, WS).
12. And that can conveniently be presented, explicitly or implicitly, as owing its origin to the desire of prudent economic actors to reduce their "transaction costs" (Williamson and Ouchi, 1981).
13. See, for example, Marshall's famous description of citizenship as "a single uniform status" providing "the foundation of equality on which the structure of inequality could be built" (1964: 87).
14. As Eva Pichler has pointed out to me, this amounts to a Hayekian rationale for protecting collective nonmarket institutions from being dissolved into markets.
15. For an interesting attempt to model the effects of works councils on economic performance, and especially to demonstrate that legally mandated councils are economically preferable to voluntary ones, see Freeman and Lazear (1985).
16. For example, if vocational training policy in the United States were to serve the presently perceived skill needs of American employers, it would limit itself to reproducing a skill structure that is internationally not competitive. An effective training policy would therefore have to be linked with a technology transfer and work reorganization policy aimed at reshaping the demand side of the skill equation, politically creating a "market" for the kind of skills that are needed to raise economic performance to a socially desirable level. This, in turn, may require imposition of institutional rigidities on work organization, and limitations on managerial prerogative, through "culture" or, more likely, trade unions, to rule out resort to a traditional "Taylorist" organization of work.

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