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Comment on “The Complex Economic Organization of Capitalist Economies” (by Richard R. Nelson)

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Capitalist societies have existed for several hundred years, yet historically capitalism has been a broad and vague concept. It is a very dynamic system comprised of inherently contradictory forces that drive its long-term development. Its vagueness and its contradictory elements necessitate analysis that is time and space specific. Because of the ever-changing character of capitalism, most analysts believe that they must first define it – and Richard Nelson is no exception. For him – like many others – capitalism is an economic system in which a “free market” coordinates the primary actors. Throughout his paper Nelson emphasizes the complexity of a capitalist economic system, but my argument is that the dynamics of a capitalist economy are in fact far more complex than he suggests.

I will place Nelson’s analysis of capitalism within a broader context by (1) discussing capitalism’s inherent dynamism, self organizing tendencies, and instability, (2) focusing on various forces which attempt to regulate capitalism’s dynamism and ever-expanding tendencies (which occasionally threaten its existence), and (3) emphasizing capitalism’s tendency to penetrate its entire society as well as those of other countries. In some respects, Nelson is aware of these general tendencies insofar as they occur in the United States, yet we need to recognize that the processes by which these tendencies play out are time and place specific. At the same time, we should also attempt to understand these processes within a comparative and historical framework. I will attempt to do this with Nelson’s essay.

As a system, capitalism must constantly expand – pursue ever more growth – in the process creating tendencies toward instability which, if left unchecked, can threaten its sustainability. To survive it needs regulatory forces to constrain its expansionary tendencies – even though the system tends to resist the forces of regulation.

There has never been a widely shared theory of capitalism. Adam Smith, Karl Marx, Max Weber, Joseph Schumpeter, and many others who attempted to develop a theory to explain the dynamics of capitalism longitudinally within and across societies failed, for capitalism is time-specific. In the United States there was an eighteenth century capitalism and a twentieth century capitalism, but they were fundamentally different from each other. In the contemporary world there are different types of capitalism: that of Germany, Japan, Sweden, France, Turkey, Russia, China, etc.

Many analysts believe that systems of capitalism tend to be self organizing, though there is little understanding of the mechanisms by which self organizing processes work. This is indeed a perplexing problem, as capitalism is not a universal phenomenon, having begun in the West only a couple of centuries ago (Braudel 1979).

Nelson is aware that the dynamic forces of capitalism must be constrained by various types of regulatory mechanisms. Indeed, his essay provides a good description of such mechanisms in contemporary American capitalism. However, he does not explicitly discuss the dialectic operating between the underlying need of a capitalist system to expand and the continuing need for constraints to ensure the stability of the system. Investors in capitalist economies tend to be extraordinarily innovative, constantly attempting to escape the shackles which attempt to restrain the dynamism of the system. However, the implementation of new forms of regulation, however much called for, tend to be outdated by the time they are adopted. Numerous actors proceed on the premise that everything not explicitly forbidden is allowed (Streeck 2011, p. 147).

For the purposes of this essay, regulation, coordination, and governance are synonymous terms. Governance of a capitalist system is important in "coordinating" relations among actors, though variation in the role of the governance is both time and place specific. As Douglass North has suggested, norms and rules are among the most important institutions of a capitalist system and play an important role in coordinating actors. When certain kinds of norms and rules are widely shared, particular forms of state action are not necessary. Thus governance takes different forms in different times and places.

It is often forgotten that Adam Smith – an eighteenth century moral philosopher often considered the "father of capitalism" – believed the most important force coordinating relations among competing actors was not the state, but widely shared views about morality. For markets to work effectively it was necessary for buyers and sellers to have trust in one another. In the early history of capitalism, trust between buyers and sellers was the glue which held the system together. Trust was facilitated by traditional principles shared by both buyers and sellers. And in Western capitalism this kind of trust emerged from the ethical norms of the Judeo-Christian tradition.

Over time, however, the success of capitalism unleashed the forces of industrialization and modernization, which undermined the strength of religious institutions and traditional obligations. Slowly there came to be a need for new mechanisms to coordinate the forces inherent in the system, which would otherwise generate systematic disorder. At that point it became necessary for the state to become ever more involved in coordinating actors within the system in order to constrain the system's tendencies to self destruct. While the activities of the state vary across societies, in almost every capitalist system – as implied in Nelson's essay – the state provides a system of law for establishing and protecting property rights, is the ultimate enforcer of laws, and protects its citizens against alien forces and violent uprising. The capitalist state also establishes incentives for actors to engage in activities which promote the society's wellbeing.

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The coordination of a capitalist economy is performed not only by the market and the state but by other institutions as well. Others – not treated by Nelson – are networks and associations. For example, the auto and computer industries' relations between producers of parts and final assemblers are coordinated in part by networks. In fact, networks have become one of the most important governance mechanisms in a modern economy.

Associations also play a vital role in coordinating actors in a capitalist economy. Whereas markets tend to coordinate activities among different types of actors (e.g., producers, suppliers, capital, labor, consumers), associations tend to coordinate actors engaged in similar kinds of activities.

Many associations result from collective action on the part of labor and business associations. Of course, the nature and role of associations vary from society to society. For example, Sweden – a society with a small population – has relatively low levels of ethnic and religious heterogeneity, and thus historically it has been much easier there than in the United States for labor to become highly mobilized into unions. High mobilization and low fragmentation facilitated a labor movement in which unions had considerable power throughout the twentieth century. In response business firms engaged in their own organizing activities. As a result, both labor and business associations became major forces in regulating and stabilizing capitalism in Sweden.

In contrast, both American society and its economy are much larger and more diverse, making it much more difficult historically for both labor and capital to engage in the same degree of collective action as they do in Sweden. Hence, labor unions and business associations in the United States have been relatively weak institutions for coordinating actors in American capitalism. Because of the inherent weakness of associations in the American economy (relative to in Sweden), the American state has played a more important role in regulating the American economy – a condition generally not recognized by most Americans. Although American labor and capital are weakly organized relative to Sweden, they are sufficiently organized that they have the power to make it difficult for the state to develop coherent policies for the coordination of the American economy – resulting in what Mancur Olson called institutional sclerosis (Olson 1982). With weakly organized associations in the United States, the American economy is more innovative, but the system can be much more unstable from time to time, e.g., subject to the bursting of huge bubbles.

While the argument here is that the relationship among actors in a capitalist economy may be coordinated by the market, the state, associations, and networks, the process by which this is done is extremely complex. First there are numerous kinds of states, markets, associations, and networks. Second, certain kinds of markets are associated with only certain types of states. For example, markets in contemporary China are associated with a particular type of state –

quite different from the market and state which exist in the contemporary United States. The economist Robert Boyer (1997: 55–93) demonstrates that there are at least seven different kinds of markets. Certain kinds of markets are linked with specific types of states. For example, the Soviet Union was an authoritarian/totalitarian state. Associated with this state were black markets, not neo-classical markets.

One of the challenges in studying capitalism comparatively and historically is to determine how and why specific governance structures are attracted to each other. Do specific types of governance structures bind to each other tightly or loosely? And for what duration? There is no precise, one-to-one relationship between any particular type of state, market, or association. A particular kind of market can be associated with different kinds of states. Particular kinds of state structures are more likely to be attracted to particular kinds of markets. There is no perfect fit among different governance structures. Is there some underlying logic as to how different governance structures are attracted to each other, or is the process by which governance structures fit together in particular societies simply the result of chance? Each governance mode has its own distinctive logic, but no particular governance structure exists in a pure or ideal form. Each governance mode usually exists in combination with other forms of governance, thus constituting a distinctive governance configuration. Because each type of governance may exist in combination with many other types, the possible combinations of governance structures is very large, although small in comparison to the numbers of combinations which computational biologists are facing.

Most analysts of capitalism tend to write as though capitalism exists only at the level of the nation state. Nelson is no exception. And while there are national styles of capitalism – as the above discussion suggests – we should also be aware that capitalism is a multi-level phenomenon. In recent years social scientists have become increasingly involved in multi-level analysis. Regardless of the discipline, more and more analysts are studying capitalism at multiple levels: at the level of the firm, at the economic sector level, local governmental levels, subnational regional levels within nation states, the national level, the transnational regional level (e.g., the European Union), and the global level. There are different configurations of governance at each of these levels. Most theorists and analysts of capitalism have long been confident that one level dominated the others, and that they knew where the most important decisions were made. Indeed for most of the last couple of centuries, theorists have assumed that the dominant form of coordination of capitalism took place at the level of the firm and the nation state. And it is at this level where most students of capitalism focus their attention. Nelson follows in this tradition.

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But at present, the degree to which most important processes of governance take place at the level of the nation state is a matter of increasing interest and discussion. At the global level, governance is coordinated primarily by markets, networks, and state-based confederations (e.g., GATT, WHO, OPEC, the Basel banking agreements). NAFTA and the European Monetary System are examples of coordination at the transnational regional level. Coordination is conducted by a combination of states, associations, markets, and networks – none of which is dominant.

Undoubtedly, the governance of contemporary capitalism and the interconnections among different levels of governance of capitalism are far more complex than most analysts heretofore recognized. In the contemporary world, no single level is decisive in determining the performance of a particular capitalist economy. Rather, different levels are nested and linked with each other. One of the great challenges of our time is to comprehend the nature of this nestedness and to understand how the processes of governance are linked across different levels. As the institutions of capitalism are increasingly nested in multiple levels of the world, we are faced with the perplexing problem of how to govern a capitalist society which is embedded in a global system. Clearly one of the great challenges of our time is to create a new theory of how to coordinate/govern the institutions of capitalism which are nested in a world of unprecedented complexity, one in which individual actors, sub-national regions, nation states, continental and global regions are all intricately linked.[1]

I have no fundamental criticism of Nelson's paper. I view it as an important statement about contemporary American capitalism. My effort here has been an attempt to place his paper in a broader historical and comparative framework. To understand capitalist societies, we need not only his kind of perspective, but also one that looks at his within a much broader outlook. Ideally, I consider our perspectives complementary, rather than antagonistic. Indeed, over the years Richard Nelson has enriched my thinking about capitalist societies – in many unintended and indirect ways – and for this I am extremely grateful. I consider him one of my mentors, and I alone am accountable if I have become a somewhat wayward disciple.

[1] I am deeply indebted to Robert Boyer for my insights about the governance of capitalist societies at multi-levels. For further commentary on this subject see Boyer and Hollingsworth, 1997.

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