Rent Seeking and Failure of Collective Agency in the Age of Free Markets

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We live in an era of deepening crises caused by monumental collective action failures, the most important of which are undoubtedly the anthropomorphic climate change and the global failure to regulate financial risk. A general sense of malaise permeates our times (Judt 2011). In exploring their deeper causes some historians write about decaying political and social institutions (Fukuyama 2014, Ferguson 2013, Mishra 2014, Oreskes & Conway 2013), political scientists about 'political gridlock' and "sclerosis" (Thurber & Yashinaka 2015; Mann & Ornstein 2012) and 'plutocracy' (Bartels 2010, Gilens 2014, Hasen 2016), where a general failure of 'collective agency' is the common theme. For economists the problem is all about externalities - or, more precisely, failing to correct for the market failures they cause by provisioning the right set of public goods. That of course begs the question why, making one wonder if the externalities/market failure is big enough a lens when such failures are looked at not one by one but at a macro level.

Textbooks blame externalities on poorly defined property rights and suggest defining them fully to solve the problem. That of course leaves out why the government is what it is and why it does what it does, which blinds us to the role market incentives play in corruption when private agents clamor to have governments define property rights in their favor. Government failures or governance deficits might be actively sought out by some agents who privately profit from them. The social cost of such rent seeking can be significant as competition for property rights often dissipates the rents they are supposed to protect (Anderson & Hill 1983), not to mention the more lasting damage inflicted on the political process. Rent seeking is thought to result from *governance deficits* but the causation can just as well run the other way. When markets *fail* they fail in producing a socially optimal outcome, but at the same time reward some well-situated private agents. The way markets *work* when they *fail* can thus incentivize maximizing agents to seek or bring about *g*overnment failures, turning rent-creation into a market driven process. If indeed the dynamic interaction between market and government failure is the driving force behind *collective agency failure*, what would be its power underpinnings? The objective of this paper is to explore this question.

The discussion proceeds in two stages. It first explicates how government and market failure can be intertwined in the context of rent seeking, and then uses this conceptual framework to discuss the causes and implications of the said *collective agency failure* in our era of deregulation and liberalized markets. Stiglitz (2012) has famously blamed rent seeking as the main culprit behind the steep rise in inequality, explaining the myriad ways in which it has distorted the political process ever since the deregulatory trend gained momentum in the 1990s. However, a question arises as to how rent seeking could have become so pervasive and why it would continue to persist since it eventually harms everyone including even its initial beneficiaries. The following discussion draws insights from North and Polanyi to suggest a conceptual framework that can provide a possible answer. Before describing the organization

of the paper as customary, the brief introduction below lays out the conceptual framework that motivates the order in which the discussion proceeds.

An Introductory Conceptual Framework

In an early effort to incorporate the government in economic analysis, *public choice* theorists had asked why public office holders should not be expected to act in their self-interest like everyone else. If, at a minimum, getting reelected is at least as important for politicians as public service, the question was why the two objectives should always overlap (Tullock 1987; Buchanan 1990). Why would maximizing agents stop short of bending the rules in their favor if that has a high enough expected payoff and government officials of obliging if their interests are so served? Self-seeking behavior could thus turn into *rent seeking* with negative welfare effects unlike profit seeking in ideal markets. The conceptual benchmark public choice theorists had in their minds was invariably the frictionless market with costless, perfect enforcement, and thus rents and rent seeking had ultimately the government as their source.[1] *Profit-seeking* remained axiomatically welfare enhancing, except when government intervention in otherwise perfect markets caused distortions that turned it into socially costly *rent seeking*.

Yet, strategic bargaining among private agents can be socially costly independently of any government involvement. Agents use whatever pricing power they might have in real world markets to improve their payoff at the expense of others, irrespective of its social welfare cost. The term *opportunistic profit seeking* – as, for instance, used in this connection in *transaction cost economics* - underscores how welfare reducing rent seeking can arise from private strategic maximizing behavior when enforcement or information is less than perfect. Thus, rather than positing that government intervention (failure) gives rise to rent seeking which then causes market failure, we can more broadly think governance deficits and opportunistic profit seeking interact to produce collective action failures that result in socially suboptimal market outcomes. Two questions then matter: (i) whether institutions (government as well as non-government) provide cooperative solutions to PD type interactions in economic life such that agents do not find it in their interest to resort to uncooperative (strategic) bargaining; and, (ii) why and when (governance) institutions fail to secure cooperative solutions.[2]

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[1] Following Austrian forerunners such as Mises and Hayek, they believed that a market order would spontaneously emerge provided that the rule of law ensured the sanctity of private property and freedom of contract (Buchanan 1985). However, whether rule of law could survive rent seekers interacting with self-interested government officials was never explored in depth. Modern Austrian economists on the other hand seem to hold that markets can themselves create the rules and regulations they need to function (Stringham 2014).

[2] I believe a similar conceptual reorientation motivates the rise of governance economics (Dixit 2008, 2009). The tendency in the early literature was to approach governance as a "technical"

I propose to entertain these questions on the basis of a simple premise: institutions' ability or capacity to sanction opportunistic profit seeking is of central importance in whether they can secure conditions that enable cooperative bargaining, and when such capacity is lacking that is ultimately a collective agency problem for those who can vie for political power – i.e., the political elite. For instance, how do the elite avoid no-holds-barred power struggle that can harm them all? How do they manage to *commit* to abiding by rules and restraints that are mutually beneficial only when they are uniformly observed? But, also, when they acquire a capacity to act in their collective interest what refrains them from acting opportunistically towards non-elite groups?

Approaching *governance* as a collective action problem of the political elite makes it possible to focus *directly* on the power underpinnings of governance institutions, where political power can be seen to derive from group *coordination* in the context of collective action.[3] Two general cases can be distinguished. The first arises in the context of competition among members of the elite who are locked in a *Prisoner's Dilemma*. They all potentially benefit if they refrain from jockeying for political favors but benefit even more if they are the sole beneficiary. Yet, when they all strive for invidious advantage they inevitably clash and risk internal strife, and moreover lose much of their bargaining power *vis a vis* the state. They thus need a cooperative bargain among themselves before they can act in unison to safeguard their collective interest and ensure that the state serves their collective interests. A second type of collective action problem exists at the level of society. Once the elite manage to avoid internal strife and succeed in making sure the state is willing and capable of promoting their collective interests they can potentially act opportunistically towards non-elite groups. Thus the question is whether they would act in a predatory way and impose extractive onerous rents on others, making a cooperative social bargain unreachable? So, put differently, what does it take to reach a mutually beneficial cooperative bargain between the elite *cum* state and the non-elite at the social level?

The rest of the discussion is organized as follows. Section I defines the nature of the collective action problem of the elite and draws on the theory of *club goods* (Buchanan 1965) to explore

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problem, paying little attention to its political dimension, which might however be changing. See, among others, Cioffi (2010), Scott (2011) and Wilke & Wilke (2012).

[3] This draws from the tradition of political theory that relates roots of political power to group coordination, developed most notably by Russel Hardin (1990, 1995, Chp. 2), whose intellectual roots go back to David Hume (Hardin 2008). See also Sabl (2008).

the nature of *coordination* that paves the way to its potential solution and alignment with state power. Section II focuses on the collective action problem that can arise at the level of the society. It explores if and when the elite *cum* state can find it in their interest to act opportunistically towards the non-elite. As North conjectures an *extractive* strategy is bound to be self-defeating for those in power as it involves imposing inefficient property rights that can backfire by causing economic stagnation. Yet the elite and the broader social interest can alternatively be both divergent and in alignment. As Polanyi's *double movement* suggests *extraction* can simultaneously serve elite interests and promote economic growth while harming the non-elite and especially the poor. But, it fails to last for long as economic growth is eventually scuttled in the long run just as North thinks it would, forcing a jarring realignment of elite interests. Section III uses this conceptual framework to look at the post welfare state era, focusing on its unintended adverse effect on elite *coordination* in relation to the deepening *collective agency failure* that defines our times.

1. Uncooperative Profit Seeking, Type I: Collective Action Problem of the 'Ruling Class'

Capitalism's capacity to self-organize in pursuit of self-interest is considered historically unique. In anything that came before the organization of economic activity had to rest on some form of collective agency that rested on direct coercion or its threat, where the suppression of the pursuit of individual self-interest remained a perennial problem. With the rise of capitalism the *market* could replace *despotism* as the predominant mode of social *coordination*, harnessing the pursuit of individual self-interest rather than suppressing it.

Marx would have disputed that the rise of capitalism ended coercion by political power, but recognize that it brought about an important difference nonetheless. Back breaking work was coerced out of the worker no longer by the threat of master's whip, but the cold calculus of a dire circumstance s/he found himself in. Being divorced from all *means of production and subsistence*, workers had to seek employment with those who owned the income generating assets, giving rise thereby to a labor supply responsive to market signals and thus "self-regulating" labor markets.

In this view, capitalism did not eradicate the need for collectively organized coercion as such but simply pushed it a step back into the background. As the enforcement of work relied more on 'coercion-by-force-of-circumstance' than direct coercion, the latter had to be kept in store and used to quell any challenge *workers* could collectively pose to *owners* (capitalists) who held the income generating *assets* (means of production). That however meant the *owners* faced a collective cost that had to be discharged through some form of collective action. Organized coercive power was required not only to protect the relations of exclusion private property rested on, but also deter individual asset owners from free riding on the collective expense or otherwise acting opportunistically. Moreover, individual elites who sought competitive

advantage through over-exploiting workers had to be checked lest it increased the collective cost of enforcing private property.

But, how could this be achieved? Given the decentralized, competitive nature of market economy individual capitalists would want to free ride and act opportunistically, yet their collective interest required to sanction those who did. In his *Communist Manifesto*, Marx famously refers to the state as the "executive committee" of the capitalist class. Yet, before capitalists could use the state as their instrument they must have developed a capacity for collective agency, which is easier said than done since economic power is dispersed among them and they are locked in competition with one another. Before they can act in their collective class interest they must first manage to self-organize in such a way as to circumscribe the harmful effects of opportunistic competition between them. But, how?[4] The answer arguably revolves around *coordination*, a *second order* collective action problem that requires solution itself before the *first-order* problem could be tackled with its aid. I suggest that *club* theory can help us conceptualize the modality of the elite, i.e., asset *owner*, *coordination*.

The Elite Club and the Owner Coordination

The types of economic goods are distinguished by whether they are exclusionary and rivalrous in consumption. Public goods are non-exclusionary and non-rivalrous, while private goods are both exclusionary and rivalrous. There are two additional possibilities represented in the off-diagonal of Table 1, which are club goods, characterized by exclusion but no rivalry, and open (or common pool) resources which are non-exclusionary but rivalrous.[5]

Consider a public roadway as an example of public goods at the lower right corner. Initially a public good, the roadway turns into an *open resource* when traffic exceeds a certain threshold such that each additional driver on the roadway begins to reduce the travel time of everyone else. While there is still no exclusion, there is now consumption rivalry as well: one's level of consumption cannot be increased without reducing that of others. Preventing the overuse of the roadway at this point requires putting in place some form of *exclusion*, either by turning it into a private or a club good. In the former, exclusive property rights are assigned to some private owner and the roadway is closed off to everyone except at the owner's discretion. The roadway's services are also now rivalrous (when most profitably utilized at the threshold of overuse). Alternatively, exclusion can be through *political* means and creation of a group of *insiders* whereby all outsiders are excluded. This is the club solution. Travel on the roadway is then non-rivalrous for club members in so far as they observe club rules designed to prevent its overuse along with free riding or opportunistic behavior.

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[4] With the notable exception of Poulantzas the question is generally ignored among Marxist writers (Jessop 2015).

[5] Cornes & Sandler (1996) survey the origins of the template reproduced in Table 1.

Types of Economic goods

	Exclusionary	*Non-Exclusionary*
Rivalrous	Private Goods	Open or Common Pool Resource
Non-Rivalrous	Club Goods	Public Goods

Table 1

Governance services can also be considered in terms of the type of good they are. For instance, according to the influential North & Weingast (1989)[6] view of the state the central political dilemma is said to be the fact that a state that is powerful enough to enforce property rights is also one that can violate them. This suggests that the state's enforcement services can alternatively be either public or private good. When the ruler respects and protects the property rights of all its constituents his services are a public good – they are neither exclusionary nor rivalrous. When he maximizes his own payoff by extracting onerous rents on his constituents *enforcement* becomes both rivalrous and exclusionary, a private good. The public good configuration might be socially optimal but not necessarily the ruler's first choice if abusing power has a higher payoff. In addition to these two possibilities that North/Weingast view highlights other configurations can be considered as well.

For instance, we might instead start out from a situation where the state is not strong enough to effectively enforce rights, which implies that neither the public nor the private good configuration is viable. This would correspond to the top right corner of Table 1. Not able to fully *exclude*, the ruler is an *equal opportunity bribe taker* as it were. His services (legal entitlements) resemble an *open resource* the individual elite can buy or grab hold of opportunistically. But, given that he cannot enforce effective *exclusion* his favors are oversold and poorly enforced. With a rough balance of power a Nash equilibrium might hold, and yet be

[6] See also Weingast (1997)

unstable given that organizing and wielding coercion entail increasing returns. When disrupted a different configuration, a private or a club good, can thus emerge.

When a particular member (or faction) of the elite captures the state and succeeds in eliminating or suppressing all rivals we end up with the private good configuration, already mentioned above. With no organized opposition to deter him the ruler might not be interested in the public good option given that maintaining power is costly and past losses (investments) incurred in power struggle have to be recouped (made good). He might want to extract the highest rent possible directly if he has the requisite organizational capacity or provide protection to the highest bidder as long as that does not help create a future rival. Changes in the power distribution can replace the ruler by another power contender or there could be a return to the initial situation where no single player is powerful enough to consolidate power. Thus the configuration of *enforcement* can be subject to repeated cycles, oscillating between the top right and left corners in Table 1, arguably a more recognizable pattern in history than recurring cycles along its diagonal.

The other possibility involves a move towards a *club good* configuration, the bottom left corner in Table 1, where the elite manage to broker a permanent truce. Rather than a no-holds-barred race to monopolize power, here, their competition acquires permanence as it is simultaneously bounded and safeguarded by a political compact based on mutual deterrence. A set of mutually agreed upon uniform restraints lower the expected payoff of trying to monopolize power, which alters the nature of strategic interaction among the elite making a cooperative bargain viable. The ruler's power is underpinned by their compact and thus derives from *coordinating* the elite with whom real power resides. His ability to sanction opportunistic defections works as a commitment device, enabling the elite to *commit* to acting in cooperative self-restraint, and thus safeguards their coordination.

At the same time, the ruler is deterred from using his power in a way that could harm elite interests by the implicit threat of a prohibitive coordinated reprisal, which is all the more credible when his rule depends on resources they control. A liberal political order and traditional civil liberties reduce the elite's coordination costs and thereby lower the ruler's expected payoff from usurping their wealth, which makes a credible commitment on his part to a cooperative bargain more likely. However, his power is ultimately constrained not so much by the liberal order *per se* but the political equilibrium that makes the implicit threat of coordinated opposition (with its aid) credible.[7]

[7] That also explains why emulating political institutional forms (and constitutions) seldom proves effective in developing countries where marked power asymmetries make the threat of an effective, coordinated reprisal to power abuses by the ruler less than credible.

Any significant change in the distribution of power can thus cause the *club* solution to falter, resulting in either a return to the top right or a shift to the top left corner in Table I. Both outcomes involve a *predator* state of a sort with the ruler eschewing both the collective interest of the elite and the wider social interest. The question is whether the *predatory* ruler ends up harming his own enlightened self-interest by doing so as well. As remarked, North argues that an extractive strategy inevitably distorts the incentive structure and risks economic stagnation. That clearly is not in the best interest of the ruler, so the question is why would it ever come to pass? In the *open resource* configuration (top right corner in Table 1), the ruler might reasonably discount the future very heavily, and thus the political uncertainty implied by internal strife and the suppressed potential for an open conflict can plausibly force a shortsighted extractive strategy on the ruler. But, in the *private good* (top left corner) case the ruler's power is well consolidated by assumption and thus political uncertainty need not be acute. That leaves the question open as to how *extraction* can become a rational strategy for the ruler: Short of irrationality, uncertainty or cognitive failures why would the ruler opt for a shortsighted *extraction* just because he can. This is the question North addresses in his theory of the state.

2. Uncooperative Bargaining, Type II: Reading North and Polanyi Together

North (1981) traces the state's roots to a form of *exclusion* that roughly corresponds to the emergence of settled agriculture in early antiquity around eight thousand years ago. With the gradual transition from hunting/gathering to farming that accompanied population growth land became *scarce*. The land and its resources populations relied on for their sustenance were gradually transformed from *public goods* into *open resources* (Table 1), necessitating some form of exclusion to prevent their over-extraction, and, more importantly, to enable capturing the returns on investments in them. The successful development of agriculture thus required the establishment of *exclusive communal rights*, which North argues produced the common need to organize defense and violence, giving rise to the emergence of the state with an organized capacity to wield coercion. (Tilly 1990). Though North does not use the term *club* that is what the state in his account function as given that its very essence is *exclusion* through political means – i.e., keeping foreigner *outsiders* out while imposing on citizen *insiders* restrictions in the form of a set of obligations that apportioned its costs. North singles out the central role played by such exclusions in the drastic increase in productivity in agriculture which could not have taken place in their absence.[8]

[8] "The emergences of the state with its concomitant body of rules to order internal structures and its coercive power both to enforce those rules and compete with other states was the most fundamental accomplishment of the ancient world" (p. 94).

In fact, it might make sense to talk about two distinct forms of exclusion, and two different *club* formations that enforce them respectively. The primary exclusion, responsible for the emergence of the state according to North, is *lateral*, enforcing a territorial boundary separating *us* and *them*. Territorial defense, the usual textbook example of a *public good*, is really a *club good*. It excludes all foreigner outsiders and is non-rivalrous for (*citizen*) *members* who identify and abide by its rules. Historically the more recent second form of exclusion is by contrast *vertical*. It rises with internal social bifurcation between *asset owners* and *workers*, excluding the latter from the income generating assets/resources (most notably land) monopolized by the former.[9] Thus, in any class bifurcated social structure including capitalism, it is reasonable to think of the state as comprising an *elite* (owner) club embedded in the older all-encompassing *citizen* club, where the former relies on the legitimacy and the coordinated power of the latter in enforcing the *vertical* exclusions private property rights require. It is thus sensible to think that there are three, rather than two, distinct sets of interests that might be in or out of alignment: the ruler's or ruling clique's factional interest, the broader collective interest of the elite or ruling class, and the broader non-elite or social interest.

North holds axiomatically that the ruler's enlightened long term self-interest (along with the elite's collective interest) overlap with the imperatives of economic growth and that with social interest. In his argument the state can raise its own payoff at the expense of social return by a margin determined by the second best alternative of its constituents.[10] But, again, does not the ruler end up shortchanging himself when he maximize its short run revenue, imposing what are inevitably inefficient property rights? North argues that if it were not for transaction costs the ruler would have preferred to set efficient set of rules first and then bargain for its revenue.[11] When North discusses transaction costs from a developmental point of view his emphasis is often on *monitoring* and *measurement* costs. Economic development increases division of labor and specialization raising the importance of *anonymous exchange*, creating new commitment problems that call for new institutions to enable agents make credible commitments. In his discussion of the state North's emphasis is on bargaining costs, mainly on the agency problem the ruler faces with his underlings which create organizational constraints and deficits in the state's administrative capacity.

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[9] Veblen's (1898) crisp *speculative* history gives an account of how relations of *vertical* exclusion might have risen.

[10] Thus what ultimately distinguishes a *predator* state from a *contract* one is how unevenly violence potential is distributed within society and what outside power contenders exist.

[11] "Under the condition of zero transaction costs, the ruler could always devise, first an efficient set of rules and then bargain for his rents, but this postulate from welfare economics simply ignores positive transaction costs, which is what the game is all about" (North 1981, ft. 12, p. 28).

The ruler acts as a discriminating monopolist because his constituents are not one big homogenous block but are rather distinguished among themselves in terms of their opportunity cost. Those with higher opportunity set than the rest are the elite. They pose a more immediate power threat since their richer opportunity set gives them a superior *coordination* ability and thus higher bargaining power despite their smaller numbers relative to the non-elite groups. Moreover, the ruler's organizational capacity might depend on the resources they control and thus serving his own objectives requires him to be able to align their interest with his. This is the agency problem he faces, and its flipside is the collective action problem of the elite (uncooperative profit seeking, Type I) considered above.

But, if the elite and the state have successfully aligned their interests what refrains them from acting opportunistically at the expense of everyone else? Why cannot the elite having "captured the state" use it to further their collective interests to the detriment of non-elite groups or society at large? Would that be self-defeating and irrational as North seems to assume? Put differently, cannot the elite benefit collectively at the social expense without harming themselves? North conjectures that they cannot; that, what is in the collective interest of the elite must also be in the wider social interest. This implies that the two collective action failures must go together – i.e., failure at the social level presupposes failure at the level of the elite.

Polanyi's Double Movement

Compared to North a more nuanced picture emerges from Polanyi's *double movement*, often depicted as comprising long pendular swings during which the elite's collective interest can variably be at odds with the social interest even when consistent with the imperatives of economic growth. North's conjecture holds only intermittently, or rather asserts itself fleetingly during these long swings. The periods of market expansion that often are associated with growth spurts refer to the first leg of Polanyi's *double movement* where the elite and non-elite interests are generally divergent. While growth is socially beneficial it is also socially costly, and both are unevenly shared. The social welfare loss arises from the harm inflicted on *fictitious commodities* by the expanding bounds of market competition.

Polanyi's term (fictitious commodities), interpreting to an economist, refers to economy wide resources over which it is impossible to assign full private property rights. A case in point is the overall state of labor supply in terms of its level of education, skills and health. Because the cost of upkeep and investments in them are external to market exchange, they take the form of *open* (or common pool) resources for individual private producers whose strategic interaction (competition) involves a PD in relation to their use. All capitalists benefit if they invested in a better educated labor force but benefit even more if they could free ride on the required collective expense. The environment is likewise a similar and perhaps a better recognized example. Polluting for competitive advantage is similar in principle to employing underpaid

child labor in violation of labor standards as in both benefits are private and entail costs that are borne collectively. Financial risk is yet another example because it also cannot be fully privatized.[12]

Market expansions stimulate economic growth in part because they raise capitalists' expected return on private investment by externalizing the social upkeep (and investment) cost of common resources (*fictitious commodities*). Individual capitalists experience such costs in the form of sluggish and uncertain market adjustment. Institutions of social protection husband common resources but also blunt private agents' responsiveness to market signals by shielding them from market competition. They thus turn into obstacles that the state has to use coercive power to dismantle, albeit in the name of free markets. Social change, power induced and directed towards the creation of a homogenous market space, promotes growth while its speed robs those in need of social protection of protection leaving them exposed free of a safety net to the vicissitudes of market fluctuations. Contrary to North's conjecture, here, the state power is employed to further the collective interests of the elite in a way that promotes economic growth while being at odds with the broader social welfare. The same conditions that favor private wealth creation also harm the poor and mounting social costs disproportionally fall on the non-elite. These collective costs have two basic sources; one, distributional and the other social. In the first, the economy-wide resources are exposed to over-extraction as they are gradually transformed from regulated club goods into open resources – i.e., their market (rental) price tends to fall short of their long term maintenance and reproduction cost. These costs are almost exclusively borne by lower classes. In the second, which is more relevant in an advanced economy, the potential collective gains from investing in common resources (fictitious commodities) are foregone because they cannot be captured in private investment given their often large prerequisite scale and associated network effects.

As these collective costs cumulate over time the elite interests are eventually hurt as well, and a point might eventually be reached when North's conjecture – i.e., what is not in social interest cannot be in elite's collective interest - seems to hold. Most importantly, the elite's ability to safeguard their collective interest is jeopardized as their strategic interaction gets gradually transformed. Some elite interests are served at the expense of others when market competition begins to reward those who can extract from open resources (environment, labor, social insurance against financial risk) more and faster. The fissures such intra-elite divergence of interests crate complicates the elite's capacity for political coordination, which makes it harder to sanction opportunistic profit seeking and provision for collective costs. With *cooperative self-restraint* thus pushed out of reach externalities mount and the elite risk losing their cohesion.

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[12] Elsewhere, I argue that the social insurance against *systemic* risk is an *open* resource, which incentivizes over-extraction in the form of excessive risk taking when it is not regulated as a club good (Erturk 2016).

The progressive retardation of common resources and the resulting social protection deficit can trigger a popular political backlash which culminates in the imposition of new institutional restraints on market competition, which Polanyi calls the *countermovement* or the second leg of *double movement*. Political re-coordination makes it possible to recoup collective gains through renewed social investments in *common resources*. During market expansions *crowding* gradually depresses the return from opportunistic profit seeking just when shifts in technology[13] and political factors[14] might be raising the potential social return on investing in common resources. The potential benefits of cooperation or cooperative self-restraint can thus eventually exceed the attractions of opportunistic profit seeking.[15] The shift in relative payoffs is however unlikely to be sufficient for reregulating common resources as club goods. A new *polity* capable of exercising effective collective agency is also required, and that might fail to emerge without going through a deep political crisis.

Polanyi's account suggests that once a new institutional framework emerges with a new polity at long last, it comes under strain before long as well. As regulation becomes more complex the overall cost of provisioning *club* goods rises and with it the relative attractiveness of trying to circumvent its restrictions increases as well. This is understandable since *club* as an organizational form is effective only to the extent it can uniformly enforce its rules and restrictions on its members. That above all requires an ability to sanction free riders and rule breakers. But, as the potential payoff from circumventing its restrictions rises maximizing agents are incentivized to expand the bounds of profit seeking that can be socially costly, while making it ever more costly to prevent that. Such can give rise to strategies that make *club* boundaries more permeable to escape sanctions against opportunistic practices, raising

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[13] A case in point is the rise of public education at the turn of previous century. Education remained an elite privilege as long as the general level of technology did not require the average worker to be literate. However, once factory work began to replace the farm the potential (collective) productivity gains from workers with a basic level of education became palpable (Goldin & Katz 2009), turning the dismal condition of the working class into a badly mismanaged *common resource*. But, better resource management called for putting in place a generalized system of public education, which in turn gave rise to a new conception of citizenship. The politics of the 'Progressive Era' and the new norms it engendered were effective in apportioning the collective costs that had to be incurred.

[14] Political changes that made club coordination both at the level of the elite and the citizenry were not any less important. The rise of organized labor and universal suffrage increased the urgency with which the elite had to attend to their collective class interest. In the same vein, the Great Depression and later the Cold War were significant catalysts in the historical rise of the big state within which the two "clubs" could cohere during the so-called 'golden-age' of capitalism.

[15] In game theoretic terms, the example of universal public education implies that the PD interaction between the elite turns into an Assurance game, where the reward of cooperation exceeds the temptation payoff; while crowding (opportunistic profit seeking) gradually reduces the *temptation* payoff to the level of *punishment* payoff.

thereby the relative burden of rule compliant, *foot-stuck* agents. Also, if the state tries to stem the tide by becoming heavy handed in its enforcement, it can unwittingly scare the elite into becoming supporters of *laissez faire*, which for them signifies strict state impartiality in their internal competition and unequivocal partiality in their favor *vis a vis* all else. Once the elite can *coordinate* to dismantle regulatory restrictions more easily than to reinforce them, a new wave of deregulation might be underway.

3. The *Collective Agency Failure* of our Times

Many authors have applied Polanyi's *double movement* to understand the rise of neo-liberalism since the 1980s, though with perhaps less explicit emphasis than here on its power dimension.[16] The basic idea revolves around capacity for collective agency. The yester welfare state regulated market competition in the collective interest of the elite, and bounded it as social welfare required.[17] The *polity* was capable of sanctioning opportunistic profit seeking which made it possible not only to proscribe behavior harmful to the *commons* but invest in them. That historically democratized collective agency and transformed workers from dispossessed *outsiders* into middle class citizens. National borders and citizenship as its corollary institution were crucial in capturing the return on such investments, which made the social wage an important part of the drastically improved living standard workers enjoyed. *Voice* bred *loyalty* and *loyalty* supported civil engagement, which in turn checked opportunistic self-seeking – or, at least, made it a potential political liability. It paid off for the elite to invest in (citizen) club goods because they enhanced profits. The *citizen* and *elite* clubs cohered and North's conjecture held.[18]

A couple of the themes that are commonly raised in explaining the decline of the welfare state can be briefly re-traced here.[19] One of these is the squeeze rising labor costs and bargaining power, the result of two decades of high employment, exerted on profits. Along with the diminished threat of unemployment and a strong safety net the market's ability to discipline workers waned. Labor's political weight also grew with its increased economic power. That combined with the rising social demands and aspirations of the lower classes pushed to

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[16] See, among others, Fraser (2014), Vogel (1996), Stiglitz (2001), Block & Somers (2014), Dale (2012), Gills (2008) and Cahill (2014).

[17] Neo-Marxist writers call the institutions that enable this the "social structures of accumulation" (Kotz 2015). A similar approach is taken by the French "Regulation" school (Aglietta 2015).

[18] As Mizruchi (2013) argued, the elite were unified and could act in its enlightened self-interest during this era, which also meant that the elite and social interests were in relative harmony. The existence of 'collective' external threats made political coordination easier to accomplish both at the level of the elite and the society. The working class movement unified the elite while the Cold War unified the nation.

[19] See, among others, Streeck (2011), Stiglitz (2010), Palley (2012), Kotz (2015), Harvey (2007), Dumenil & Levy (2004, 2013), Agglietta (2015) and Howard & King (2008).

transform the state into an agent of social welfare, steadily increasing its cost for the elite.[20] The oil price shock only raised the fiscal burden, making Keynesian aggregate demand management ever more difficult. The elite and non-elite interests further diverged when the Federal Reserve waivered in its commitment for *sound money* in the face of rising cost inflation, slow to sacrifice high employment. As the Fed lost the confidence of wealth owners in financial markets monetary *fine turning* became even less effective, and the ground was set for a political re-coordination of the elite with opposition to the welfare state as its *focal point*. The *policy ineffectiveness doctrine*, whatever its merits otherwise, became the "scientific" manifesto of this political re-coordination.

Rising global mobility of capital and i*nstitutional arbitrage* was another important driver of the process that over time emaciated the welfare state. The complications rising price inflation posed for financial regulation put in place in the 1930s forced its piecemeal phasing out in part because of it. The alternative could have been expanding bank regulation across national borders, which did not seem feasible in the wake of successive failures to revive *Bretton Woods* and privatization of international credit. As piecemeal deregulation proved politically expedient a new era of market expansion could unfold in successive waves of market liberalization that eventually gave rise to globalization as we know it.[21] Cutting organized labor to size broke the wage-price spiral and provided a fix for the problem of inflationary weakness of the dollar as well. The US (and England) led Europe in abrogating the post WWII social compact that made it hard to impose market discipline on labor, and the Fed could regain the confidence of financial markets and conquer price inflation.[22]

Free market ideas were uniformly ascendant by the 1990s as the fall of the Berlin Wall and the excitement of globalization gave rise to an era of capitalist triumphalism (Fukuyama 1992).[23] Market expansion gradually substituted private goods for *citizen* club goods, commodifying many public services. The basic infrastructure of democracy as embodied in the political

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[20] Many observers at the time talked about the problematic fiscal consequences of what Bell (1976) called, the 'revolution of rising entitlements". See also: O'Connor (1973), Offe (1984), Wolfe (1977).

[21] Krippner (2011) gives a compelling account of the concomitant *rise of finance* during this process.

[22] The monetary tightening and fiscal stimulus under Reagan produced a strong dollar and ballooning trade deficits. Yet, unlike before, rising US trade deficits no longer undermined confidence. The political reconfiguration that broke the back of labor unions provided all the backing the dollar needed as the increased threat of unemployment proved a better anchor than gold. The crisis of confidence was over. Still, it took about a decade for the new neoliberal world order to come into its own. Eventually, advancing globalization and the triumphalism that ensued after the fall of the Berlin Wall clinched the trend that was set in motion a decade before.

[23] Among the many critics of neoliberalism at the time Gray (1998) was perhaps the most prescient.

machinery bequeathed from the welfare state was still intact, yet no longer effective in bounding market competition in defense of social welfare. Democracy went through a transformation from within.[24] The new market friendly political *coordination* of the elite disavowed placing constraints on market forces to attain social ends, which became a precept above party politics. The 'winner-take-all' ethos of markets (Hacker & Pierson 2010) clashed increasingly with that of 'social solidarity' citizenship rested on (Hind 2010). But, because the resulting popular anger and frustration was aimed at the state it could be channeled into support for further market reform. In the meantime, public spending lost much of its effectiveness as national borders became increasingly irrelevant for capital and porous for labor. As globalization progressed and offshoring blue collar jobs became a realistic option there was no escaping the fact that taxes on profits became a net burden. With the resulting global race to the bottom (Singh & Zammit 2004; Olney 2013; Kiefer and Rada 2014) aggregate demand regulation at the level of individual nation-states became increasingly difficult, which also meant that investments in many common resources such as public education could no longer be recouped in higher profits. As the overlap between profits and public investments in human welfare shrank, the citizen and elite clubs no longer cohered and North's conjecture failed to hold.

Deregulation and market liberalization seemed to work well for a time. Yet, over time the wedge between private and social cost kept increasing as the *common resource* problem re-emerged. A long term market driven *tragedy of the commons* was set in motion with steadily escalating collective costs and decaying common resources (McGarity 2013). An ever worsening malady of social ailments followed in the wake of rising income inequality and insecurity (Wilkinson & Picket 2009, Hacker 2006), and opportunistic profit seeking increasingly became the norm. Those who could raid their employee's pension funds, offshore labor to escape environmental and labor standards, camouflage and pass on financial risks to their unsuspecting customers were different manifestations of this fact: in each, maximizing agents were arguably responding to its higher relative payoff, the corollary of which was the growing inability to capture in profits the return on social investments, and the depressed return on *cooperative* self-restraint.

However, the steep rise in inequality and concentration of wealth at the top camouflaged a deeper weakness in the form of *coordination failure*, an unintended consequence which sapped the elite's capacity for effective collective agency. Since acting on one's enlightened self-interest does not pay unless others also do same, the individual elite were compelled to act myopically because they could not credibly expect others would not.[25] That narrow short term

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[24] See among others, Galbraith (2008), Hedges (2010) and Brown (2015).

[25] A recent study by Piff et al (2012) find that people at higher income group are more prone to be driven by opportunistic self-interest, whether that takes the form of breaking rules or

self-interest became the elite's guiding principle of action was a symptom of their fracturing. As Mizruchi (2013) put it, having won the "class war" against labor and the state the elite ended up losing their unity.[26] Related to this was why individual capitalists' stature was paradoxically diminished during the age of capitalist ascendancy and concentration of wealth. As Reich (2008) remarked, the corporations that are fixated on shareholder value today are in sharp contrast with those of the welfare state era whose leaders wielded power at the national stage as "corporate statesmen". The elite's growing inability to cohere, betrayed by the growing political paralysis, excessive lobbying and campaign money, and the void it created has been increasingly filled by financial markets (Davis 2011). But, the rise of markets also meant that the elite lost their ability to override and tame market forces when safeguarding their collective interest so required. Excessive financial deregulation and its eventual massive collective cost, deemed avoidable by FCIC (2011), is the obvious case in point. Many market players had *known* that the level of risk taking deregulation licensed would not end well, yet took part in the mad gold rush it created anyway as each assumed that acting collectively to change course was not an option under the circumstances (FCIC 2011, Chp.1; Tett 2009).

4. Conclusion

Classical capitalism had little capacity to organize corrective collective action for the costs it externalized, and, arguably, owed its vibrancy to this very fact. Paraphrasing Polanyi, economic progress rested on public improvements the elite desired and profited from privately, while the social dislocations it caused "doomed the hovel the poor men clung to out of tragic necessity." Such progress wagered its future on borrowed time as the damage it inflicted on human and environmental landscape threatened to scuttle it in time, eventually forcing elite interests to realign with that of society, albeit again temporarily. The enhanced potential for corrective action, created by the very resources and social networks produced at a higher scale during market expansions, would lie dormant until a deep crisis midwifed the right constellation of political forces that could coalesce and act collectively.

The erosion of capacity for collective agency in the face of escalating crises is once again the leitmotif of our times. Whether it is the crisis of social protection, environmental or the financial crisis, in each some mismanaged *common resource* is at stake with cumulating long run collective costs, contributing to a sense of despair about our capacity for collective agency. This is in sharp contrast with the yester welfare state and reminiscent of 'classical capitalism' it had replaced. That an old pattern might be at work has made it seem "Polanyi is speaking

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cheating and behaving in other unethical or opportunistic ways. Peterson (2012) gives a short synopsis.

[26] Rodgers (2012) observes a broader process of *fracturing* at the social level during the neoliberal era.

directly to present day issues" – no longer just in relation to developing countries as suggested (Stiglitz 2001) but advanced ones as well.

Yet, all formulaic sounding formulations ultimately beg the question and Polanyi's *double movement* might not be an exception. The conceptual framework sketched above, informed as it is by reading Polanyi along with North, can perhaps offer a clue to its inner workings. What causes market expansions including ours to eventually exhaust themselves might be their adverse effects on the elite's capacity for political coordination. The *dominant strategy* within the elite is altered, and collective agency impaired, when one cannot assume that opportunistic profit seeking is going to be effectively sanctioned. Mutually beneficial outcomes based on mutual cooperative self-restraint are gradually pushed out of reach, such that market competition no longer rewards those who self-restrain and play by the rules. With opportunistic profit seeking ascendant market and government failures intertwine. The optimal standard against which markets can fall short ceases to exist, while malleable *enforcement* and governance deficits become market driven – all, traceable to maximizing behavior that is rational under the conditions defined by the elite's coordination failure and impaired collective agency.

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