COMMUNITY AND ECONOMICS

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0. SHOULD COMMUNITY HAVE A BAD NAME?

“Community” has a generally bad name in economics and allied social sciences. Since Mancur Olson, we associate groups – everything ranging from informal, traditional communities to organized groups – with a range of growth-limiting vices, including rent-seeking and blocking of change, the frustration of preference attainment through principal-agent problems, and the creation of insider-outsider dynamics that prevent the factor mobility held to be the key to long-term economic growth. There is substantial evidence in favor of this view.

Much of economics and political economy, by contrast, is favorable to “institutions.” This generally refers to broad rules of the game which, when appropriate, provide the order and stability in which markets can function and the ongoing adjustments to the economy that make development possible can take place. And, most importantly, they limit the damage that groups, or the “players of the game” can do, through such things as property rights, the rule of law, constraints on the executive, individual rights, anti-monopoly rules, and so on. Thus, in economics, the treatment of
group life is overwhelmingly biased toward the blockage effects of communities – principal-agent problems, rent-seeking, defense of narrow interests.

In contrast, community has a rather good name in other quarters. Some economists and economic sociologists argue that such things as “trust,” “social capital,” and “networks” are good for economic development, a view buttressed by a large case-study literature, and increasingly by large-scale data analysis.¹ They nonetheless limit themselves to the ways that communities link individuals to markets; how market exchange is underpinned by non-market group mechanisms; and more generally, how trust and community lower transaction costs and improve the efficiency of economic coordination.

These are valuable contributions to the study of community and economics, but they are still too narrow. In this paper, we will emphasize: (a) the ways that communities, by making certain forms of coordination easier, widen the possibilities for formal, distanced exchanges in the economy; and (b) how communities affect the definition of preferences, choices and decision-making behavior of economic agents. In other words, the socially-mediated connections between people in communities allow them as individuals to have possibilities that they would not identify, or act on, as isolated individuals. This changes the way that we see the potential aggregate effects of

¹ In addition, any examination of the question of community has to try to distance itself from its highly-charged political meanings. In the Anglo-Saxon political world, community conjures up images of “natural” social bonds, the mobilization of underprivileged groups, and the healing of the wounds of a highly fragmented society through the involvement of community-based organizations and other NGOs in the political process. International organizations have come to embrace these “communities” for the work they supposedly do in implementing development programs. In other regions, such as social democratic Europe, “community” tends to be viewed with suspicion, as a form of particularism, weakening the pursuit of the common social good.
group life, because it means that groups don’t just get in the way of private incentives, but in some critical ways complement them.

Community is a broad category. It includes both “primordial” forms of bonding, such as ethno-linguistic groups, and more modern ties, such as professional networks or communities of practice. A number of attributes apply to both of them, but not all.

1. **INTERACTION: INTERPERSONAL RELATIONS AND IMPERSONAL EXCHANGE**

In the 11th century, the Maghribi traders around the Mediterranean faced a problem. These descendants of Jews who had fled the Baghdad region in the 10th century had a close knit community, but they needed distant agents for their commercial transactions, agents whom they could not monitor directly. Avner Greif (1993) shows that this community functioned according to the Merchants’ Law, such that any agent who cheated would not be rehired by any member of the community for a long time, and the options available to such an agent were substantially reduced by such potential exclusion.

From the vantage point of economics, anything that minimizes transaction costs per unit output is going to raise potential output. Such costs can be associated with information-gathering, as well as evaluation and determination of the reliability of information and possible moral hazards. Group membership can assist in all these dimensions of transacting, through reputation effects, signaling, and gatekeeping/filtering.

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2 In this paper, we will consider groups in a well-functioning, developed market economy. The role of primordial communities has been considered in economic history, in how they affect possibilities for constructing transparent market exchange and democracy, but that’s not the subject of this paper.
of participants. The production possibility frontier from a given stock of factors is raised if, all other things equal, there are increased possibilities for impersonal exchange and hence a deeper division of labor. Along these lines, Fukuyama (1995) argues that economies with greater generalized trust will more easily build large firms, extending the circle of exchange beyond what it could achieve through direct managerial control. In recent years, the world high-technology economy emanating from Silicon Valley has been extended to China, India, Taiwan and Israel through ethnic communities that Saxenian (2006) calls the “new argonauts” -- extensions of impersonal exchange that would not be able to take place without underlying communities. Standards in many areas of the economy are initially developed by communities of practice, and as they are formalized, they then permit greater impersonal exchange to develop.

Little effort has been made to theorize or measure systematically these gains, whereas huge efforts have been devoted to showing that groups reduce welfare. In empirical institutional studies, we have little indication of, for example, the comparative dynamics of how much, and how, group life allows specialization and exchange to grow (with attendant effects on productivity and wealth), as opposed to when it restricts factor mobility and blocks exchange. Such research would help explain certain patterns of path-dependent economic development, and better account for a possibly important source of long-term productivity development.
2. DISCOVERY: KNOWING WHAT WE WANT

Does belonging to groups help or hinder us in achieving our preferences? There are several parts to this question: knowing what we want (the formulation of preferences), acting on what we want, and aggregate choice of what we want (making choices).

Until recently, economics eschewed the question of knowing what we want, preferring to assign it to subjectivity, the domain of psychology. Social choice theory claims that we cannot know the preferences of others and hence we cannot expect, in any meaningful way, to align our actions to achieve common goals. Public choice theory holds that merely being interested in what others want (except strategically) is likely to involve us in stifling our preferences, because it requires deference to others and to the – necessarily limited – goals we perceive as being jointly achievable.

There is wide agreement that social context and preferences are intimately related. Sociology stresses the role of socialization, and group experience is demonstrably very important in socialization, but says little about how socialization relates to the wide diversity of choices made by individuals in the same social groups.

Behavioral economics emphasizes situations, the idea that individual decisions are based on very local influences, rather than long-run well being. Local stimuli trigger emotions and these emotions influence decisions (Romer, 2000). Ross and Nisbet (1991) argue that the central lesson of a large body of psychological research is the importance
of situational factors in decision-making. Prospect theory tells us that people put enormous weight on reference points that are quite local, arbitrary and ephemeral (Kahneman and Tversky, 1979). Mental accounting theory suggests that people make decisions and ignore events and consequences out of a narrow, local domain (Thaler, 1985). Hyperbolic discounters place extreme weight on the present and cue-theory stresses ephemeral situational forces.

Membership in communities, groups or networks can be thought of as an important component of the supply of situations in which individuals find themselves. How does such group life influence preference formation and what are its economic properties? One obvious aspect of this is whether the role of groups in defining situations helps their members to know what they want, and in a non-coercive way, so that they can be said really to clarify things for their individual members, and not merely to inculcate group values in them, or otherwise short-term welfare-distorting values and preferences. We are a long way from fully understanding what this could mean.

For example, it might be simply that the supply of situations is a parameter for individual maximizing behavior. If my neighbors are all members of a racist community, then my payoffs to being racist will rise. If, on the other hand, there is an anti-racism group in the area, my payoffs to being not racist are altered. It could well be that joining the anti-racism group changes my perceptions of race by giving me information I would otherwise not have. A more subtle distinction, however, is that interaction within and between groups doesn’t just provide me more information, it also provides me with experiences and examples that intersect with my own view of my self, and hence exercise

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3 I owe this review of situationalism to Glaeser, 2003.
an impact on how I define my preferences. This process of discovery is not considered in standard approaches.

Sen (2002, Goals, Commitment, Identity) distinguishes between self-centered welfare (involves no sympathy or antipathy toward others); self-welfare goals (maximizing may or may not involve attaching importance to the welfare of others); and self-goal choices (not restrained by the recognition of other people’s pursuit of their goals). The first thing to note is that these three requirements – generally imposed jointly in economic models of choice – are in reality independent of one another. For example, one can violate self-centered welfare (someone else’s misfortune affects our welfare), but this doesn’t tell us whether or not their self-welfare goal will contain this criterion or not. There are obviously differences in subjectivity, as well as differences in situations, which make some people’s self-welfare goals take into account the reality of others’ lives more than others.

In both the case where self-welfare goals conform to the standard definition – they do not take into account the welfare of others – and where they do take into account the welfare of others -- an external reality may still be an instrument to understanding and defining these goals. We are speaking here not of membership as a simple sympathy device – sensitizing us to others’ welfare and integrating it into our own welfare goals – but rather as an instrument of learning and understanding ourselves, and hence of defining our preferences, whether those preferences turn out to be strictly selfish or more generous. Sen argues that “we all have many identities that are….depending on the context, crucial to our view of ourselves, and thus to the way we view our welfare, goals or behavioral obligations.” (215). Dworkin (2000) argues that a liberal community, one
which allows individuals the autonomy to engage in self-discovery and, as we are suggesting here, helps them to do so, is not a “superperson, (which) embodies all the features and dimensions of a human life.” (227). Community is an important source of resources for self-discovery, in this view, not a crushing, all-encompassing machine of total socialization. When it works in the way described here, it is precisely because community is partial and we can be members of many communities.

Note that this has nothing to do using the social world as a device for defining one’s preferences as those that will be more likely to be achievable and hence to be more achievable (more “efficient” preferences); we return to this below. It simply holds that groups may help us know what we want, irrespective of whether we are likely to get it or not and that in addition we may want things that have to do with the welfare of others or with our joint welfare. For example, certain things are only achievable as network externalities in production or consumption. What we lack, however, are good theories about precisely when group membership obscures such self-welfare goals and when it clarifies them.

The notion that under some circumstances membership in groups helps actors to know what they want implies that larger-scale patterns of institutional development will differ according to the tissue of group life, because there will be different opportunities for “principals” to learn what they want. Innovation, for example, can be pulled by the demand of consumers for design, performance and quality, which they only learn and sustain through communities, which enable them to learn and have network externalities. It can be pushed through producers’ communities of practice. One can easily think of fashion and design producers (at all levels), or of technical communities such as the
engineers that graduate from France’s Ecole des Mines or Ecole Polytechnique, who give a strong imprint to the conception of infrastructure and the techniques used in building it in France, a strong innovation export of the French civil engineering industry. These preferences do not emerge spontaneously or individually. Of course, this is just the first step: getting from them to any large-scale pattern of production or consumption involves aggregation, to which we return in the following section.

Groups could equally well contribute to the “distorted decisions” of behavioral economics; they could simply enforce interests, monopolies, or group think. Looking into patterns of group membership and their effects on preference discovery would help us to take on a central question of welfare economics, i.e. the extent to which self-centered goals enhance welfare as opposed to other influences on self-welfare goals, including social ties.

Returning to the case of the Maghribi traders, they seem to combine both interaction and discovery. Group membership enhances discovery, which in turn is an incentive for each agent to pursue her ends; it also helps extend collective activity through impersonal exchange and productivity growth. The combined effect should be an important contribution to economic efficiency and output.

3. GETTING WHAT WE WANT: AGENCY AND VOICE

Any eventual contribution to economic efficiency by communities that help in discovery must be weighed against the costs of group membership in making choices. These are not just limited to the well-explored case of principal-agent dynamics, where
there is a problem of aggregation of heterogeneous preferences. Even in the ideal case where no such agency problem exists, there are costs in defining the end collectively, and this would be true even where some kind of collective action or decision is needed for any individual to get what she wants. The most favorable combination is: big gains from community as a means to reaching our ends, combined with small losses from group life in defining those ends.

The canonical case from economics, where group membership stifles action by imposing big transaction costs on the realization of goals, or by stifling the pursuit of preferences through principal-agent dynamics, certainly covers an important set of real world cases, especially at high levels of social aggregation (big groups, big institutions). But as we move down in scale, toward membership in the smaller groups that constitute the finer tissue of economic action, there is less probability that they describe real welfare losses, and more that there are real gains. A key issue is how any economy affects the supply of such situations, notably through the way it structures the transaction costs of group membership. Different such supplies could generate huge variations, from one economy to another, in the aggregation of preferences and hence in their satisfaction.

What types of preferences are these?

First, some outputs are indivisible and lumpy. They cannot be produced without aggregation of supply. Public goods like public transport fall into this category, as do virtually all consumption goods with strong network externalities. They can be detected through proxies (public opinion polls) or through organizations (lobbies). But the organizations only emerge in some cases, so an agent is needed.
Second, some preferences are obscure, even to those who hold them, until they get clarified through group membership and agency – as in discovery, discussed above. Groups translate them into understandable preferences and give them voice. Vague desires become realities through group process and access to others with similar desires and agents who assist them. Demands for public services or certain kinds of culturally-specific goods don’t emerge spontaneously from private preferences; nor do certain work methods, ethics, or standards of quality.

Third, some preferences are shameful or stigmatized, when they remain strictly private. Many minority rights or tastes fall into this category. In the 1960s, when Black Power emerged as a cultural theme in America, it was shameful to affirm one’s blackness in looks or behavior. Until recently, a taste for pornography was shameful, as were many lifestyles considered “atypical.” They are only initially voiced if they are transformed from fragmented individual desires to aggregates, and often it is the agents who see that this is occurring, who first break the taboo. They will possibly then emerge into the mainstream and at some later stage no longer need group mediation (the market for culturally-specific goods and services can become mainstreamed in this way).

Fourth, some preferences are geographically or socially fragmented, so that their holders don’t communicate. They become too marginal, within the boundaries of any effective market area, to be satisfied. On their own, they will probably not happen because the transaction costs will be too high. But if they correspond to “strong bonds,” then such groups may sufficiently reduce such transaction costs or rank them high enough to bridge time and space, thereby overcoming aggregation costs and giving existence to these preferences.
One additional aspect of aggregation in these cases is refers back to our analysis of discovery. Such preferences are likely to be discovered in smaller groups where preferences are strong and homogeneous, and risks are lower. But such preferences may be widely distributed in the society. So, there’s a double aggregation problem, of getting from the small-group discovery and aggregation to the larger scale. This has of course happened many times, when minority movements start small and local and become big coalitions and ultimately become big social identity categories. But the process of getting there is uneven and not guaranteed.

The supply the group or community membership opportunities that facilitate aggregation should depend on transaction costs in relation to the incentives and payoffs to supply and demand. Incentives correspond to the payoffs for group/community “entrepreneurs” or leaders to supply membership opportunities, as well as for individuals to belong to them. This is also the response of mainstream economics to behavioral economics: even if people make situational choices, in the aggregate situations are supplied according to rules that conform to rational culmination outcomes.4

Historical institutionalists such as North (2005), however, argue that there is something beyond the payoffs to supply, allowing an independent role to cognitive frames and belief systems. Political scientists draw our attention to agents that do not merely reflect narrow interests, which they call “strategic constructivism” (Jabko, 2006). Moreover, there appear to be significant lags between changes in payoffs, specific types

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4 As noted, behavioral economics shows that, in certain kinds of situations, people will make choices that bear little resemblance to standard rationality (that which achieves “culmination outcomes”) (Glaeser, 2003:8, after Della Vigna and Malmendier, 2002). But it says little about how such situations are supplied. Group life supplies some situations. What are they, in
relationship to choice?
of belonging, and the beliefs and frames that lead people to bond with other people into groups. And if this is so, then beliefs and membership – i.e. social interaction -- could change the payoff matrix. I may believe something that leads me to be a member, and this ultimately enables me either to discover preferences or to realize preferences I couldn’t have gotten without being a member, or even that are different from what I expected to get by becoming a member. Certainly, religious groups, high-tech entrepreneurs, and certain communities of practice fit this mold. The average non-expert cook does not become part of a culinary tradition expecting a payoff, but the collective payoffs change as a result of network externalities, and there are feedbacks that change individual payoffs as well, in ways that are not anticipated up front. This is true of many sets of skills, as they first appear in an economy, before the payoffs can be estimated and codified. Interaction affects learning, and learning transforms.

A final point that can be made about how membership facilitates preference expression has to do with the intrinsic value of being able to have a voice. Sen (2004: 159) argues for the fundamental relevance of the choice act itself. Accordingly, maximizing behavior is different from non-volitional maximization (as in ecological theory). Behavioral economics has found that people are acutely sensitive to whether they have choice, and will often opt to make choices that affirm their rights to make choice as opposed to those that maximize their pecuniary interests. The possibility of choice responds to other criteria, such as “fairness” or “honor” or “responsibility.” This is another layer to the definition of preferences. If choice means total independence from social constraint, then groups have no role in it; but if it means being able to express
things that cannot be achieved individually, then group membership will have this intrinsic value for individuals.

To summarize, we could benefit from knowing more about the supply structure for membership that leads to certain kinds of preferences receiving expression because they reach the minimum aggregation threshold for becoming feasible options. If this is the case, then there should be a powerful incentive effect for the individuals whose preferences are made feasible in this way: we are a long way away from being able to measure such an incentive effect. Associated with this, we would also need to know whether there are times when the “right” agents are present, and others where the supply is distorted toward the “wrong” agents, in terms of welfare. If non-distorting aggregation is weighted toward small groups or networks, are they likely to be parochial, and if so, do they “turn around” and limit large-scale aggregation choices elsewhere by “taking up the social choice space?” These are, to say the least, thorny questions for research.

4. THE EMERGENCE OF CHOICE

In many cases, no special coordination among actors is needed to insure that the right large-scale aggregate choices are made (emergence of supply). Individuals choose and in a world where markets are large, a diversity of outputs can be produced. Moreover, we can change our minds and be reasonably certain that most demands will find a supply, such that when individuals make mistakes they can reverse them. The overall configuration of outputs will be roughly “right” in spite of the fact that individual
choices don’t need any special collective wisdom embodied in them. This is the standard case for markets and individuals.

Surowiecki (2004) argues that good large-scale choices come about when certain conditions are satisfied, including diversity, independence, decentralization, and aggregation. He dubs this “the wisdom of crowds.” Markets sometimes do well on all four conditions, as noted above. They do especially well on the first three, although there are times when even there, they have problems. On the fourth, however, markets often fail when private judgments have to be turned into a collective decision ex ante rather than after-the-fact, where irreversibility is present, or very high costs to reversibility. When large-scale non-rival goods or any public infrastructure provision is required, there is a need for aggregation. When any large organization needs to make a major decision, up front aggregation is required.

Institutionalized aggregation is precisely what a lot of institutional theory dislikes, seeing it as inherently beset by intractable principal-agent problems, impossibility dynamics, group think, social pressure, and impacted information. But this is only part of the story. By “crowds” Surowiecki seems to mean something that is in-between small groups – such as families – or groups with “strong” internal ties (such as ethnic minority diasporas), and large (internally anonymous) markets. In our terms, these are loosely-structured communities, but communities nonetheless.

The reason they may help in choice processes is what Granovetter calls “the strength of weak ties.” On the one hand, they have certain attributes which mimic the search features of markets and thus help in identifying good outcomes. These are internal cognitive diversity in search and reasoning behavior; and independence and
decentralization in expressing preferences and opinions on the part of members. The weakness of these ties resembles markets. On the other hand, how does membership help in securing good decisions, where markets might fail? One of the strong points of highly decentralized, market-based decision-making is that it allows for trial and error. The mechanisms of trial are initiative, mimicry and imitation. Information cascades provide for sequential imitation. But they also are fraught with many problems, notably hysteresis, herding, and overshooting. In many markets, this isn’t a long term problem, because the failures that result are resolved ex post, although when they are macro-economic or financial they can have hugely undesirable outcomes and become more difficult to absorb than we would like. That is why, for example, government regulatory authorities try to get financial markets to be more simultaneously – rather than sequentially – reactive, through immediacy and transparency.

There are two situations in which group membership can be helpful in avoiding the ex post “fix it” solution, with its huge costs. One is that it can speed up the feedbacks, and hence enable corrections that weed out emerging bad information cascades to be set into place before the system goes down the wrong path. Trust, norms and conventions, meta-information, and generally anything that facilitates more rapid and transparent exchange of information – these are consequences of weak ties. In cases where technological change involves high sunk costs or high costs of reversibility, then such feedbacks can raise the probability of good choices. Another situation where membership helps is that sometimes bad choices are actually not very observable until it’s too late and their consequences are hopelessly magnified. We don’t have enough access to the consequences of the choices because the costs of obtaining them, or access
to observing them, are too high. In this case, ties to the others who have made them, and the possibility hence of observing the consequences, makes the feedback work better. Many private electoral choices fall into this category.

Of course, nothing guarantees that these feedbacks are always going to lower the rate of bad choices. It might be that everyone involved in even these relatively large circles of feedback stands to gain from choices that aren’t so great, and so they perpetuate them because they will be big gainers, even if the overall consequences will be bad. So, the old questions of parochialism and rent-earning are present. Still, the larger the circles, the higher the probability that they will be porous, hence open to those who can see their wider consequences. This is certainly the tension in the financial derivatives industry, where large, loosely-tied networks can hide certain bad decisions and information cascades, but where sometimes they are large enough for light to be shone on them by regulatory authorities before it’s too late. Dispensing with networks altogether, however, is a utopia that won’t work, so we are stuck with the problem of getting “wisdom” without too much hysteresis and rent-seeking.

Even in situations where reversibility is not a problem, but extreme complexity is, communities help in guiding the complex system. Electoral behavior is an obvious case: we vote on some issues that don’t affect our lives directly, but do affect those of other people. We hold non-private values and we hold strong preferences for certain non-private consequences (Sen). There is a lot of quibbling in social theory over whether, for example, I can care strongly about whether women have right to abortion, even though I will very likely never have a private interest in access to abortion.\(^5\) We might think that

\(^5\) Dworkin and other philosophers take up the possibility that our “comprehensive consequentialist preferences” could be illiberal, i.e. wanting to deny someone else rights and
the right choice was made if we didn’t have ties to people who had been directly affected and could tell us that we voted for the wrong thing.

All in all, weak ties would seem to square the circle of ensuring diversity of inputs, independence, avoidance of group think on the input side, but allow better choice by facilitating aggregation.6

Membership – weak or strong – might help in achieving the “wisdom of crowds” in some conventional ways as well. For example, if many people can make choices that are in some way bad for themselves or for the society, but if the costs of making those choices are low, then chances are they will continue to make them. Thus, referring to an earlier example, it’s easier to be racist if one has little contact with members of other groups, where there is low likelihood of having to act on one’s views, and little ability to obtain first-hand information that could influence those views. Interacting with others may not cause us to stop hating them; but interacting in relatively intensive and structured ways can make it more costly to us to act on our preferences. Another example: we can allow others to choose poor quality goods, thereby leaving a smaller market for high quality goods, with the further indirect effect that those goods become an elitist and more expensive output to have for ourselves (because it reduces economies of scale and network externalities), and if the low quality goods of others don’t impinge on our freedoms, or to impose a morally homogenous vision on a heterogeneous world. In any case, Dworkin also points out that none of the positive benefits of community as a form of coordination require moral homogeneity within the group; it simply requires that the weak ties be useful in allowing us to make choices we want over certain kinds of private and comprehensive outcomes. The questions of whether that involves illiberal behavior on the part of the group, or illiberal outcomes, are important, but beyond the scope of this paper.

6 This might not be limited to cases where we don’t feel the impacts directly. We could unwittingly make choices that have an indirect, but unpleasant impact on us, but not be able to connect the dot of our choice to this outcome. This is certainly the case with such things as traffic. Only by comparing experiences with others might we be able to draw the lines between the dots.
environment. But group ties that raise community norms of quality could reverse these
dynamics, making high quality goods cheaper for all.

Some choice processes depend on the ways both suppliers and demanders of
options are organized. In some markets, the producers have greater incentives to be
organized than the buyers; one can think of political markets in this regard, so that the
political parties and lobbies are more organized than the citizens. In government and
services markets, unorganized consumers are at a disadvantage in influencing the choice
menu and the overall evolution of choice. On the other hand, where producers are
organized as communities of practice that enforce learning, skill acquisition and
standards of quality, then the choice set for consumers is altered in a potentially welfare-
enhancing direction. By contrast, if group structure, for whatever reason, creates
situations that are prone to distorting decisions through short-term and short-sighted
imitative reasoning, hyperbolic discounting and so on, and if the penalties to such group
think are relatively low, or if they have endogenous effects that raise payoffs over time by
drawing in others, then groups would seem capable of doing significant harm to potential
welfare.

5. ECONOMIC DEVELOPMENT AND COMMUNITY

We have suggested that the potential benefits of community in the economic
process have been underestimated by principal-agent theory and public choice
economics. A simple way to summarize this case is as follows:
Welfare outcomes of community = (increased impersonal exchange/productivity + discovery/incentive + increased agency/incentive + emergent choice/productivity) + (social capital/trust/lower transaction costs) – (higher transaction costs/coordination + principal-agent costs + parochialism + rent-seeking).

We are light-years away from being able to operationalize anything like this in assessing the contributions of this “social organization of the economy” to the economic process.\(^7\) In addition, much of this is beyond the reach of policy, so it is an interesting intellectual subject, but of little practical relevance.

But not all of it is beyond the reach of policy, and in this concluding section, I want to explore a few ways in which the question of community is close to practical concerns that are affected by policy. The central issue is how the level and distribution of communities relates to the process of competition between ideas and outputs in the economy, and hence to innovation and growth.

The starting point for thinking about this is to realize that the distribution of groups tends to be territorial. There are some groups that are not securely anchored to a particular territory (city, neighborhood, country, region, continent), such as international

\(^7\) Some analysts might be tempted to engage in infinite regress on this question. This would involve arguing that the supply of community is itself endogenous, and the outcome of some sort of payoff matrix. Undoubtedly, some of the supply of community-based situations is the result of payoffs to organizing groups, to group entrepreneurship, to individual choices to belong. But my guess is that a lot of community doesn’t work this way, or at least that we don’t really understand much about the tissue of group membership and that it would be premature to assume that the array of communities we do have represents some kind of equilibrium supply.
networks of professionals. But most groups are, and in any given territory, a complex matrix of groups shapes its economic environment. The consequence is that such group life, combined with formal institutions, shapes the outputs and productivity levels of territorially-based economies. At a higher scale, in an economy based on exchange within and between territories, the array of group life will in turn influence the diversity of ideas and outputs in the economy that enter into exchange, and with that, have a strong influence on the supply of ideas and outputs that enter into competition, with a probable strong effect on innovation and growth.

Two aspects of this can now be illustrated: “diversity between” and “diversity within.”

5.1. Diversity and trade

The European Commission’s official line about European integration is that it should reconcile exchange with diversity: a “Europe of regions.” This specifically refers to the promotion of durable collective differences between the European economies, preserving their specificities, supposedly for the benefit of all Europe. Economic theory is more ambiguous. On the one hand, generating fluid factor mobility and exchange presupposes a certain institutional harmony and leveling between places; on the other, given different factor endowments, we can expect efficiency-based specialization that expresses comparative advantage. Diversity based on standard comparative advantage generates a mosaic of specializations that allow economies to function efficiently, and most importantly, they change over time in concert with the new possibilities for combining inputs into outputs.
European policymakers are particularly two-faced when dealing with this subject, some emphasizing standard, comparative advantage diversity, others collective institutionalized diversity. They rarely tell the public that the two sources of diversity are radically different and that their policies pull in two different directions. American federalists and public choice theorists like to think that they square the circle by emphasizing certain forms of harmonization and free trade, while allowing different territories to make their own, locally-appropriate institutional choices in many areas, but as we shall see, this is not entirely valid.

Moreover, the institutionalized diversity that comes from having a different array of communities – hence, interaction, discovery, voice and choice – is not the same as that which comes from having different organized interest groups, political coalitions, state structures, and development policies. Their durability comes about for different reasons; in general, we might say that if the four properties of community emphasize here are strongly present, then they should make positive contributions to welfare and performance, whereas the standard institutional differences can have many negative effects on development.⁸

Is the collective diversity of something akin to a “Europe of regions” likely to enhance welfare and development? Assume that the differential distribution of communities leads to an array of territorially-specific specializations in output, in addition to those generated by comparative advantage. These specializations reflect the effects of interaction, discovery, voice and choice within different territories on what and

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⁸ Except in the varieties of capitalism literature, where many of these institutional specificities contribute to positive performance of their respective economies.
how they produce. There is an analogy here to the production of culturally-specific goods and services by different places.

In a multi-regional world economy, it is difficult to say whether this is greater variety than would be obtained under the condition of institutional/community homogeneity and free trade; this is because the “diversity between” places it generates might be at the price of “diversity within.” Collective life could enforce more homogeneity within, even as it preserves diversity between places. A fair guess is that the diversity is different in the two cases, where the diversity generated by differences in institutions/communities between territories is slower to change than strictly efficiency-based diversity. Output and consumption inside territories probably changes faster when it is the result of comparative advantage, because institutions – including communities – are slower to change than markets. Data on economic convergence for Europe suggest that it has institutionalized/community diversity, because growth differentials between regions are persistent, with unaligned economic cycles. In the USA, by contrast, the states are simply at different points in the same economic cycle, suggesting that their pattern of specialization and diversity is more tipped toward comparative advantage.

Each type of diversity – comparative advantage, or institutionally-generated – has its price. Indeed, something like a Europe of Regions or a world of culturally/institutionally differentiated territories trading with each other will generate winners and losers from the different types of diversity they generate. The literature on cultural diversity and globalization has developed analytical models of this type of question (Cowen, Trindade, Rauch, Janeba). Thus, if the world is very diverse under
autarky, and trade leads to the breakdown of collective structures and more imitation of
the dominant goods/services pattern – which happens when costless trade and
communication exist – then trade might be inferior to autarky by reducing diversity.
Consumers of imported “cultural” goods tend to gain, while consumers of exported goods
will lose. If the latter are greater than the former, there is potential overall welfare loss.
The process of imitation occurs under certain market conditions, notably when there are
network externalities in consumption, and possibly (though less so), when there is
convergence toward the extremes or toward the dominant taste, and all this is aided by
low communications and trade costs.

If what we have said about community is valid, then two points follow. First,
insofar as differences in output and consumption result not from institutional “barriers”
but from interaction, discovery, voice and choice, then the value of a world of different
regions rises because the output and consumption diversity it contains reflects “real”
preferences, not second-best (“we are old fashioned because we don’t know any better or
can’t have anything better”); and correspondingly, if integration reduces this diversity, it
is likely that the post-integration equilibrium will reduce both intra- and inter-territorial
welfare.

It is likely that for homogeneous goods, integration increases welfare, whereas for
strongly heterogeneous or specialized goods based on community values, and especially
those with consumption externalities, the effects of integration could be more mixed
(Janeba, Trindade). Theory and policy have a real interest in understanding these
dynamics and in getting the right post-integration equilibrium. Though the “Europe of
Regions” is mostly just a politically-correct moniker, there is a serious issue behind it
when it comes to diversity of production and consumption, just as there is at a world scale in the negotiation of trade rules.

5.2. Diversity, innovation and development

In summarizing the roots of European success in development, North (2006: 138) notes that “it was the dynamic consequences of the competition among fragmented political bodies that resulted in an especially creative environment.” More recent literature on the size of nations emphasizes the internal gains from appropriately sized and hence, coordinated units (Alesina). Taken together, they suggest that development is facilitated by internal coherence at some scale, but diversity and exchange among units. Let many ideas emerge and then competition and exchange will select and refine them.

This is different from the view that we could extrapolate from standard theory, since it suggests collective diversity “between,” in addition to individual factor mobility and diversity “within,” as key to development. One of the biggest puzzles of historical development is why the fragmented European states managed to develop so much virtuous, competitive exchange, instead of allowing their internal collective structures to block it. Of course, at times they did block it, and the very long periods of European regression or stagnation attest this, along the lines of the standard literature on institutions: rent-seeking, blockage, and exclusion.

A world of diverse communities, then, can only maximize its potential contributions to development with mechanisms of exchange and openness that place them in competition with one another, while not destroying the virtuous aspects of their diversity. Historically, this has occurred in the presence of certain kinds of state
structures and political regimes, on the one hand, and outward-looking “bridging agents,” on the other. The Maghribi traders come to mind again, but so do what Saxenian (2006) has recently termed the “new Argonauts,” the international high-tech communities that spread the Silicon Valley from California to Israel, Taiwan and China, by linking these different communities through cross-membership. Without strong community structures, the wider processes of impersonal exchange and specialization that spread development geographically, but also that stimulate innovation within the world high tech economy as a whole would be weaker. Oddly enough, the most “globalized” of systems, the international high technology production and innovation system, is really a composite of intricate, territorially-rooted, community structures.

5.3 Scale and diversity

In one sense, these questions of diversity within and diversity between are just side-effects of the scale of the units of observation. For example, as we reduce the scale of territorial units, there are strong chances that they will become more internally cohesive and homogeneous and hence that diversity is obtained through exchange with other places. As scale gets bigger, then there will be more internal diversity. But, in fact, these are not just artifacts of the size of units of observation. The units are real social systems, enshrined in legal boundaries, custom, and culture, which delimit the functioning of communities. So it won’t do to claim that if we had homogeneous units of observation, the issue would disappear. In the real world, communities reflect the varying territorial scales of real, accumulated practices and social bonds. Thus, the Europe of
Regions is a set of fairly small units, with rather high levels of collective organization “within” and a lot of exchange between. The USA, in spite of its federalist system of government, is socially and economically more a case of big regions with a lot of factor mobility, so that the diversity of production methods and consumption styles is found more “within,” reproduced from place to place, than from a diversity between places, with a certain homogeneity at the large scale.

This means that attaining the best developmental effects will depend on the starting point. In the Europe of Regions, it involves insuring that the process of exchange, or bridging, between regions is strong and dynamic, and that regions do not become closed off, stagnant, rent-seeking community structures. In a system such as the USA, exchange and mobility are strong, but sometimes this comes at the price of the strength of community structures in situ, more “bonding:” widening in one, deepening in another. 9 Neither public choice theory nor social capital theory allows policymakers to appreciate this difference.

There are some communities that are not strongly rooted in territories. International professional networks are emerging that are not strongly rooted in particular territories. They are not yet entirely “deterritorialised;” even in the case of high technology networks, there are strong local nodes: Silicon Valley, Taipei, Bangalore, Ireland, Israel. But an interesting question presents itself: with their further globalization, could there emerge world monopolies in certain types of community functions? Could these networks enforce parochialism and rent-seeking and limit competition and innovation? One could argue that a certain global plutocracy already does some of this,

9 For more detailed analyses of the question of bonding and bridging in relationship to economic development, see: Storper, 1995; Rodriguez-Pose and Storper, 2006.
especially with the weakening national identities of the top world elite. In any case, understanding the ways that such widely-dispersed networks contribute to the economic process along the lines suggested in this paper, is likely to be a key question for institutionalist economics and economic sociology in the decades to come.

Merely asking these kinds of questions suggests how far the more policy-oriented branches of institutionalist economics are from being able to help us with knowing what, if anything, to do about groups and communities. In practical terms, so many economies have needed a strong dose of rent-destroying openness, that up until now, the existing tool kit has been useful. But in many areas of the world, we are asking more and more questions about how to keep the “good” side of community while throwing out the “bad” – from the Europe of Regions to the problem of “exit” in the USA, to the “need for social underpinnings of development” in emerging countries. A reintegration of the question of community into economics thus deserves its place on the agenda.

6. RESEARCH AGENDA

To conclude, it will be helpful to summarize the research agenda that emerges from its analysis. Very briefly, here are some of the questions that could benefit from a research program:

1. The systematic effects of community on interaction, and its influence on how economies shape their divisions of labor, specialization, and exchange, and hence long
term productivity development. This is particularly relevant to the effects of communities of practice on economic development.

2. The impacts of group membership on the discovery and revelation of preferences, its impact on incentives, and how this affects economic welfare.

3. How the pattern of group life affects the expression of preferences, through the supply of situations, and hence the types of preferences that emerge, its incentive and welfare effects.

4. The ways in which the choice of outputs is shaped by the pattern of group life, in both standard political economy ways (interest groups, principal-agent) and in terms of the effects of weak ties in sharpening the “wisdom of crowds.” Presumably, this would emerge as an aggregate dynamic productivity effect (X efficiency).

Moving from these basic microeconomic issues to broader outcomes on development, several other important research questions are suggested in this paper:

5. The contributions of institutionalized diversity based on patterns of group life to the overall economy-wide array of outputs, especially in the context of economic integration, the welfare effects of such diversity, and the winners and losers it creates in consumption.

6. The role of institutionalized diversity based on patterns of group life to broad, long-term patterns of economic development, especially in relation to the question of competition, innovation and growth.

Research on these topics faces formidable methodological obstacles, especially how to “measure” group life, to index it in a meaningful way, how to track its effects on
the four microeconomic areas stressed here, and how to extend that to broader patterns of comparative development.

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