

The Free Market is Not Readily Transferable : Reflections on the Links Between Market, Social Relations, and Moral Norms

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Introduction

It is a striking feature of the diagnosis currently put forward by economists to account for growth failures in Third World and Eastern European countries that government's behaviour and excessive interference with economic activities is considered the source of nearly all the existing troubles. Consequently, the prescribed remedy is to free market forces, to create or strengthen market-supporting institutions, and to drastically reduce the role of the state. The way the recipe is usually presented implies or suggests that the market is a system that can be planted with guaranteed success in any soil at any time. In other words, the market is portrayed as a socially neutral mechanism which does admittedly require certain institutional conditions to be fulfilled (such as the establishment of private property rights and the law of contract) yet, inasmuch as the possibility or effectiveness of these institutions is not deemed to depend on the social setup in which they operate, there is no place for doubts about the transferability of the market complex to grounds in which it did not emerge spontaneously.

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The aim of the present paper is to call the above view into question and to argue instead that the foundations of the market are possibly shaky with the result that the market mechanism can function more or less smoothly only if it is embedded into an appropriate social structure. Emphasis will be put on two crucial preconditions of the market : the pervasive incidence of abstract, impersonal relationships and the existence of generalized morality. When considered thoughtfully, the problem appears to be a very vexed one : these are indeed conditions which (1°) are not easy to bring about in a society and (2°) cannot even be assumed to sustain themselves once they are satisfied (as far as the second condition is concerned). As a consequence, economically advanced countries cannot take for granted the long-term viability of a system essentially grounded in laissez-faire policies. Far from being the strong self-reproducing system which it is often thought to be, the market appears as a delicate mechanism which may possibly break down if the social and cultural fabric in which it is embedded comes to be significantly modified. On the other hand, policy-makers concerned with reforming poor countries' economies entrapped in relative stagnation (at least as compared to their 'technical' potential for growth) ought to question the appropriateness of abruptly imposing market mechanisms and rules (e.g. private property rights) on these countries. As a matter of fact, things may turn out as though the latter's social structure would vengefully react to this 'institutional rape' by actually subverting the market and thereby causing significant unintended effects to arise not only on the plane of equity but also on that of efficiency.

Not surprisingly, the problem of absent or imperfect markets is the broad analytical theme which runs throughout this paper. As a matter of fact, the personalized character of economic relations and the lack of a code of generalized morality to back trust have the effect of restricting the scope of economic exchanges, segmenting (output and input) markets, distorting terms of exchange, and causing significant transaction costs to arise. This theme is obviously not new and it has in fact received a lot of attention in the development literature during the last decades. In this respect, it is worth noting that economists working within the framework of the neoclassical paradigm (that is, a paradigm based upon the assumption that social phenomena can be analyzed as the outcome of interindividual interactions between rational selfish agents) but

dissatisfied with some key assumptions underlying standard neoclassical models (particularly that of perfect information) have recently directed their efforts towards understanding 'structural' market imperfections in developing countries (market imperfections are 'structural' when they do not tend to vanish of themselves and when they cannot be removed - if at all this is possible - simply by establishing private property rights and by enacting contract and anti-monopoly laws). By so doing, they have actually contributed to revive the Latin American structuralist tradition which was much in vogue during the fifties and the sixties. Moreover, they have helped to strengthen the structuralist case by providing it with a sound micro-theoretic foundation which was lacking. Admittedly, this strengthening has not been without cost : when this new literature (increasingly referred to as the New Institutional Economics) takes explicit account of social and political structures, it tends to view them as so many rules that serve to coordinate individual behaviours, and it presumes that they correspond to optimal (albeit second-best, given significant transaction costs) institutions arising spontaneously from the independent decisions of maximizing individuals.

Even though the present intellectual effort is clearly inspired by a structuralist or neo-structuralist outlook, and even though it is essentially based upon the assumption that information is imperfect in a real world of anonymous agents, it also challenges part of the NIE's paradigm. We are indeed going to argue that institutions (in the sense of devices that constrain individual behaviour) are not necessarily benign or do not necessarily evolve in what is presumed to be a socially beneficial way. Rather, they may act in a perverse way and they may not adapt to changing external circumstances. The fact of the matter is that culture matters and there is no a priori reason to believe that it will generate the kind of conventions, rules or institutions that economists consider rational. One of the main contentions of this work is precisely that the kind of trust needed to back up a market system may not only fail to exist but it may also fail to evolve.

From the above, it should be evident that the central argument developed in the following pages is basically rooted in economics. In effect, game theory is considered as a privileged tool of analysis that can be used to frame some important questions which we have

to ask when trying to explore the issue of the social foundations or preconditions of the market. Game theory is particularly useful in view of the fact that it allows for multiple equilibria, including equilibria corresponding to perverse or 'bad' conventions/institutions. However, ample reference is also made, whenever appropriate, to the works of other disciplines in the social sciences, particularly social and economic anthropology, general sociology, psychology, and history. Still, since our competence is essentially limited to economics, these references will certainly appear incomplete or insufficient to many readers more acquainted with other social sciences. The appeal to other fields than economics is a direct result of the fact that the topic addressed in this paper is by nature interdisciplinary. For reasons that will become clearer as the argument unfolds itself, no single discipline can honestly claim to have a decisive advantage in providing answers to the questions involved.

On the other hand, partly because of this multidimensional character of the problem and partly because of its intrinsic complexity, the reader must not expect to find here a satisfactory account of it. The objective pursued is more modestly to offer a preliminary discussion of a number of issues that we believe have not received the attention they deserve given their extreme importance for any development policy-oriented thinking. This is especially true today when there is so much talk about quickly implanting the market system not only in Third World countries but in Eastern Europe as well, and when active steps are in fact being taken towards achieving this end, mostly through the structural adjustment programmes devised by the World Bank and the International Monetary Fund.

The paper is divided into four sections. In section 1, the problem of the social foundations of the market is approached from a theoretical perspective with a view to throwing into relief the stringent conditions on which the possibility of the market hinges. The problem of trust retains most of our attention. While in precapitalist societies this problem has been solved by genuinely fabricating tight and enduring relationships of interpersonal dependence, modern market economies comprise a large number of transactions without which division of labour could not be pushed very far. In game-theoretic terms, to pose the problem of trust with

reference to abstract societies where people meet at random and where a person's history of past behaviours is not known by anyone boils down to analyzing a one-shot game. Since the production of a cooperative equilibrium within the framework of supergames is thereby precluded, the only escape from the apparent deadlock is to shift from a Prisoner's Dilemma to a coordination game where multiple equilibria become possible (including the Pareto-optimal honesty equilibrium). There remains the pivotal question as to how one can expect the honesty equilibrium not only to emerge but also to persist in a dynamic setting where players may possibly adjust their expectations on the basis of past experiences in the marketplace. It will be shown (1°) that a number of conditions are required for honest behaviour to be established and sustained on a significant scale and (2°) that the fulfillment of these conditions largely depends on the prevalence of norms of generalized morality in the society. These moral norms tend to be most effective when they are backed by strong religious beliefs inculcated during early childhood. Otherwise, they need to be reinforced at later stages in life lest they should not resist to erosive influences.

In section 2, precisely, the possible operation of a self-destructive process within advanced market societies is highlighted. Two kinds of explanations are advanced to account for the gradual erosion of moral norms in these societies. Before turning to this issue, the difficult problem of norm emergence is approached from the vantage points of both eighteenth-century Scottish philosophy and modern game theory. Particular attention is paid to the evolutionary theory which is much in vogue nowadays. The conclusion is reached that this is a field where our knowledge is still very poor and where much more research needs to be done. In section 3, the focus is shifted to the developing countries. The perverse effects of an abrupt superimposition of a market mechanism on an uncongenial social matrix are brought to light, first at a rather general level, thereafter with special reference to the operation of the land market. In the concluding section, the main issues raised in the paper are summarized and a few guidelines for research and policy are tentatively offered.

1. The social conditions of the market

1.1. Independence and freedom of transactors

It is a well-known feature of the market mechanism as conceived in the standard version of perfect competition that it consists of the free play of *abstract* (supply and demand) forces linking *anonymous* agents together in a decentralized way. Of course, personal or social relations can exist among participants in a market economy, yet these relations have no bearing on economic transactions and terms of exchange : individual identities and social backgrounds do not matter, and this is precisely why allocative efficiency of the society's available productive resources can be attained. The role of self-interest as a propelling factor in economic exchanges actually conveys the idea of motivational dispositions that do away with any kind of other-regarding considerations : insofar as they are engaged in economic transactions, agents are exclusively driven by what Marx and Engels have suggestively called 'naked interest', that is, by a cool calculating spirit that has banished any idea of chivalrous glory or social commitment [Marx and Engels, 1969-70]. According to Hirschman, it is precisely this characteristic that made market transactions so appealing in the eyes of philosophers and social thinkers of the 17th and most of the 18th century : the sort of methodical, prudential and moderate action implied by interest-guided behaviour was deemed vastly preferable to actions dictated by the violent, wild and destructive passions such as those triggered off by the foolish seeking of social leverage and political clout or by religious, ethnic, and other kinds of deeply involved feelings [Hirschman, 1977, 1982, 1987].

By explaining how the market represents a specific mode of socialization that differs radically from the way social existence is produced in preindustrial societies, Marx has probably made one of his most important contributions to the field of social science. At least, he has succeeded in drawing the most remote social implications of the market conceived as an impersonal mechanism². In traditional or preindustrial societies, individuals occupy definite

2 In the subsequent presentation of Marx's ideas, we have closely followed the interpretation proposed by Deleplace (1979 : 209-225).

positions in the social matrix and the functions which they fulfil are thus determined by an *a priori* definition of what they socially are (most commonly, from as early as their birth). As a result, the concrete discharge of these functions serves to confirm or manifest their socially differentiated existence rather than generate it. Therefore, an individual is not socially recognized because he performs this or that particular task; in fact, he performs it in accordance with an *a priori* social rule defining his social identity. In such a context, persons matter because everyone is personally dependent upon the social agency (the community, the clan, the guild, the state, the priesthood, etc.) which ascribes them from the very beginning to their 'natural' place. In the words of Deleplace, "it is as a person distinct from all other persons that a man or a woman is integrated into the society and he (she) is therefore immediately aware that this society is a network of relationships among people" [Deleplace, 1979 : 215]. Thus, for example, up until recently in family-based European agriculture, "the function of the household head was inherited from the family's patrimony and mixed up with it" [Barthez, 1982 : 69]. In other words, a man exercised the economic responsibilities attached to that function not because he was comparatively efficient in accomplishing them but because he was the holder of the family's land and other assets on the basis of traditional ascriptive principles.

In the capitalist, market-based society, by contrast, individuals are abstract actors in the sense that they are not socially differentiated before entering into the exchange process. By producing a particular good or service, an individual does not any more manifest his membership of the society since it is not by virtue of an *a priori* social rule but through a more or less hazardous process that he has come to accomplish such a task. In this society, individuals are *a priori* free and independent insofar as no order (natural or socially codified) determines *ex ante* the choices they will make in the market place. Laws and rules exist not for the purpose of differentiating individuals in the society but for that of defining the rights and duties of abstract agents considered as strictly equal (their personal histories and the peculiar circumstances of their lives are completely dismissed as irrelevant). How can individuals achieve a social existence in such a society where all are *a priori* equal and, therefore, socially undifferentiated? Marx's answer is that people can socially exist only *after* having

objectified themselves in money values : money "unifies a society of independent beings" [Deleplace, 1979 : 223]. The crux of the matter is that man is socially a number and his socialization is preconditioned upon his being evaluated (in quantitative terms). As argued in the 1844 Manuscript, "money is man's alienated self, since it reduces all human qualities to quantitative, interchangeable values devoid of any specific value" [Avineri, 1968 : 110]. As a socializer, money is actually so powerful that it can even invest its possessors with qualities missing in them. "In this inverted world man's faculties are determined by his money. His personal attributes become a function of his purchasing power and not of his immanent self" [ibidem : 111].

The main message to be derived from Marx's analysis is therefore that the market system has the formidable power to transfigure persons by erasing or concealing their original personal traits and by substituting new qualities acquired with money. Such is the essential meaning of mobility in a world where *anybody* can purchase *anything* he wants (within the limits of his budget constraint) since money is used in every transaction and represents a generalized purchasing power. And it is precisely because personal traits can be so easily reshuffled in the marketplace (to quote Marx's example, an ugly man can become beautiful if he is rich enough since thanks to his wealth he can buy the most beautiful girl) that personal identities become devoid of any meaning : personal traits being so volatile and so artificial, one does not know any more who *is* the individual with whom one is dealing, in fact one only knows his superficial traits that can be quantitatively gauged or assessed (he is the man of so much income). Money thus appears as the concrete instrument which enables individuals to abstract or detach themselves from their personal background and to meet as impersonal beings.

It is interesting to note the parallelism between the above analysis by Marx and the more recent contribution of two sociologists who have also contrasted market-dominated with traditional societies in terms of the mode of socialization :

"Maximal success in socialization is likely to occur in societies with very simple division of labour and minimal distribution of knowledge. Socialization under such conditions produces identities that are socially predefined and profiled to a high degree. Since every individual is

confronted with essentially the same institutional programme for his life in the society, the total force of the institutional order is brought to bear with more or less equal weight on each individual, producing a compelling massivity for the objective reality to be internalized. Identity then is highly profiled in the sense of representing fully the objective reality within which it is located. Put simply, everyone pretty much *is* what he is supposed to be. In such a society identities are easily recognizable, objectively and subjectively. Everybody knows who everybody else is and who he is himself. A knight *is* a knight and a peasant *is* a peasant, to others as well as to themselves. There is, therefore, no *problem* of identity. The question, 'Who am I?' is unlikely to arise in consciousness, since the socially predefined answer is massively real subjectively and consistently confirmed in all significant social interaction... A society in which discrepant worlds are generally available on a market basis entails specific constellations of subjective reality and identity. There will be an increasingly general consciousness of the relativity of *all* worlds, including one's own, which is now subjectively apprehended as '*a* world', rather than '*the* world'. It follows that one's own institutionalized conduct may be apprehended as 'a role' from which one may detach oneself in one's own consciousness, and which one may 'act out' with manipulative control" [Berger and Luckmann, 1971 : 183-184, 192].

1.2. The problem of market order : is there an answer from GE theory ?

At a later stage, we shall return to these insightful analyses of the fundamental nature of society in traditional and market economies. For the time being, we have to confront the difficult problem of the possibility of social order in market economies. Indeed, we have so far understood that a multitude of individuals independent in Marx's sense or able to make choices from a sort of manipulative distance (as suggested by Berger and Luckmann) are expected to produce (unconsciously) allocative optima at the level of the whole society insofar as their behaviour is free from any social constraint. Yet the question naturally arises as to how the exchange interactions of a large number of free and independent individuals can yield social order and cohesion instead of leading to anarchy and chaos. What is there to prevent a society characterized by the unbridled pursuit of self-interest from flying asunder ? The question is dramatically pertinent as soon as one stops conceiving

transactors as candidly selfish individuals who do not use fraud and deceit to achieve their self-regarded ends³.

Standard General Equilibrium (GE) theory in the Walras-Arrow-Debreu tradition has assumed the above problem away by considering implicitly that exchange takes place between individuals acting honestly : they always meet the obligations they have chosen to undertake, they do not steal or cheat, they do not spend more than their wealth, they "do not try to walk off without paying after a tax-ride" [Basu, 1983], etc. "Splendidly neutral to others", they are incapable of sympathy, benevolence or love but also of envy, malevolence or hatred [Collard, 1978 : 6].⁴ There is, however, another possible way of interpreting the strategy of GE theorists : the participants in the market are not necessarily honest egoists, yet this does not really matter because the assumption of perfect competition, which comprises that of perfect information, has the effect of preventing any *actual* manifestation of dishonest behaviour. In actual fact, when agents are perfectly informed about everything which they need to know (namely, the price and nature of all goods and services), they have simply no possibility of behaving opportunistically, however intense their desire to so act.

3 It deserves to be noted, however, that the problem of market order arises not only when agents are selfish but also when they are altruistic in a *particularized* sense (individuals are concerned about the lot of *some* other individuals). Under the latter circumstances, there is no a priori reason to expect that altruistic individuals would refrain from renegeing on contracts, violating property rights and the budget constraint, etc. This is attested by the well-known case of "social bandits" who rob the rich to help the poor. If altruism is of a *generalized* kind (everybody is concerned about the lot of everyone else), there is intuitively a possibility for a market order to be sustained insofar as all agents would then abstain from (opportunistic) acts that harm the interests of other people. This line will not be pursued in this paper because it leads to serious conceptual problems [Griffith and Goldfarb, 1988]. Since morality is basically a concern about the generalized other, generalized altruism has a moral connotation. Now, it is not very satisfactory to think of altruistic predispositions or moral values as a preference, especially because such an approach implies that they are then considered as given. As a result, it is impossible to allow for the fact that concern for the others' lot might well turn out to be endogenous to one's economic experiences (events which the individual experiences and observes may lead him to modify his existing values). Values are clearly to be distinguished from ordinary tastes : as pointed out by Hirschman, "a taste about which you argue, with others or yourself, ceases ipso facto being a taste - it turns into a value" [Hirschman, 1985 : 9].

4 Formally, the reason why an agent does not steal another agent's initial endowment is simply because such an act is not in his feasibility set. Individuals are allowed to choose only consumption bundles (i.e. points in their budget sets) : they may not choose between stealing other people's commodities and not doing so [Basu, 1986a : 1894].

Parametric rationality is the kind of behaviour which obtains in a world of perfect information (prices are unique and exogenous to agents) since no room is left for strategic and conflictual behaviour calling for negotiated or cooperative solutions. Competition makes force or fraud unavailing since it determines the terms of trade in a way that individual traders cannot manipulate [Granovetter, 1985 : 484]. As pointed out by De Villé, "perfect competition turns out, paradoxically, to be the absence of all interaction among individuals", so that "at this stage, 'market' and 'competition' as foundations of the social order appear as unfortunate metaphors" [De Villé, 1990 : 16]. The exchange process is the unique socialization process and there is no macro-social structure linking the actors. To sum up, economic theorists in the above tradition have succeeded in demonstrating the logical possibility of the market as a self-ordering system (social order can spontaneously emerge from the pursuit of selfish interests even in the absence of any a priori coordination of such interests), but only at the price of assuming "a total transparency of the whole economic system for each agent" [Boyer and Orlean, 1991 : 1], that is, by eliminating the coordination problem altogether⁵. Hahn has frankly conceded the point by stressing that the invisible hand only operates benevolently under conditions that are impossible to meet in the real world [Hahn, 1982]. In virtually all real world's economic exchanges the scope for cheating is present if only because there exists a time-lag, however brief, between each agent performing his side of the exchange [Basu, 1986a : 1894]⁶.

During the last decades, awareness of this fundamental difficulty has prompted GE theorists to try to account for the emergence of the market order on the basis of more realistic assumptions. To this date, however, their attempts have failed in the sense that they have not been able to prove the possibility for the market system to be produced and reproduced in a totally decentralized way from the

5 In the words of De Villé again, the fundamental ambiguity inherent in the concept of perfect competition lies in the fact that this concept cannot be understood as a description of the nature of interactions among agents but must rather be viewed "as a state of the system which would result from an interaction process left unexplained by the theory itself" [De Villé, 1990 : 23]. See also Bianchi, 1990 : 1.

6 This important feature was first underlined by Hume who observed that since "mutual performances cannot be finish'd at the same instant", it is necessary "that one party be contented to remain in uncertainty" [Hume, 1740 : 519].

free interaction of rational selfish agents. At some point of the logical argument, some (unexplained) rule, institution or supra-individual mechanism must be posited in order to show that a coherent economic disposition of resources can be effectively attained. This is particularly evident when a market auctioneer plays behind the stage to make prices converge towards their equilibrium values. But hidden institutions cannot be avoided by replacing the assumption of parametric rationality by that of strategic rationality (instead of being price-takers, agents determine prices which are specific to them) such as is done, for example, in the work of Fisher (1983). Indeed, there then arises the difficulty that multiple adjustment paths become possible (thus, arbitrage possibilities are almost infinite when futures' markets are assumed to exist and speculation is allowed for). Stable order can be produced in the markets only by assuming the existence of social rules or norms constraining individual behaviour. This applies, for instance, to the budget constraint which requires that individuals be always able to finance the transactions, whether actual or anticipated, in which they get involved. Note that the original notion of perfect competition becomes quite blurred when strategic rationality is assumed to replace parametric rationality. Moreover, since the interaction of the strategic behaviour of a great number of agents is so complex, since so many configurations of other agents have to be contemplated and information is costly to acquire, the theory could be made still more realistic by assuming that rationality is not only strategic but also limited [De Villé, 1990 : 22-29].

Game theory, which models strategic interactions among agents, does not lead to different conclusions. As a matter of fact, one central contribution of the theory of cooperative games (in which agents are allowed to make binding agreements) is to have shown that, when the number of agents becomes very high, the core tends to competitive equilibrium. What is especially worth bearing in mind in the present context is that cooperative games require a considerable amount of information to be played⁷. In other words, the competitive market order is possible only if agents are well-

⁷ Thus, for example, in the fixed threat bargaining model of Edgeworth, transaction costs are assumed to be nil, the negotiation process is completely transparent, and agents trust each other.

informed about each other, a condition largely unsatisfied in the real world.

Whatever the analytical path followed to solve the Hobbesian dilemma (and to simultaneously avoid the solution of the Leviathan advocated by Hobbes himself), the problem of institutions cannot be evaded. This is a serious matter insofar as we can no more be sure that the question of the emergence of the market order is answerable through an approach exclusively based on methodological individualism. True, the research programme of the blossoming New Institutional Economics (NIE) has precisely set itself the task of explaining rules and institutions within the neoclassical paradigm, that is, as the outcome of rational choice by individual agents : there would thus be markets for institutions and contracts as there are markets for goods and services⁸. Yet, this new approach is fraught with difficult and numerous problems⁹. In particular, and for various reasons which cannot be detailed here for lack of space, individuals choose in the marketplace, in shops, in labour markets but they do not choose between institutions, customs, and social norms : in other words, it is not legitimate to apply the market analogy of competitive equilibrium to the social choice of institutions [Basu, Jones, and Schlicht, 1987 : 9; Bardhan, 1989 : 8; Van Parijs, 1990 : 62-63]. In actual fact, the determination of supply of, and demand for, rules and institutions is a considerably more complex task than the definition of demand and supply schedules for goods and services, and it is far from certain that the problem can be solved in a satisfactory, meaningful way. Furthermore, it is hard to imagine that agents are able to continuously renegotiate institutional arrangements so as to make them, at any moment of time, an efficient response to whichever coordination failure arises in the markets.

An extreme version of methodological individualism such as that implied in the NIE is therefore likely to be sterile and one is tempted into concluding with De Villé that "it is impossible to think the social dimension of society, that is, to bring out its dynamic

8 See, for instance, North, 1981, 1984, 1990; Langlois, 1986; Bromley, 1989; Nabli and Nugent, 1989a, 1989b; Eggertsson, 1990.

9 For a review of these problems, see Langlois, 1986 : 7-21; Basu, Jones and Schlicht, 1987; Bates, 1988; Nabli and Nugent, 1989a : 40-42; Bardhan, 1989; Platteau, 1991a : 28-35.

coherence exclusively on the basis of the analysis of its micro-elements" [De Villé, 1990 : 32; see also Boyer and Orléan, 1991 : 2]. As a minimum, fundamental constitutive rules must be posited that constrain the agents' behaviour. A loss of their social legitimacy would then result in a social crisis instead of leading to their renegotiation by the agents concerned [De Villé, 1990 : 32].

The importance of this conclusion will perhaps become more apparent as we proceed with the analysis. In the remainder of this section, the Hobbesian problem is tackled at a less abstract level so as to be better able to introduce into our discussion a number of crucial considerations that are not easily modelled within a GE framework. In particular, the problem of trust as a necessary foundation of the market is explicitly raised with a view to going further into the understanding of the foundations of the market order.

Before turning to these issues, it is useful to note that, among sociologists, Durkheim has been the first to emphasize that the increasing division of labour which accompanies capitalist development creates a fundamental problem of social order : how can social links be maintained between people who have become so different due to their economic specializations and so much given to acquisitive urges in a society based on the cult of the individual ? For him, adherence to a new set of norms and values would form the basis of an 'organic solidarity' which could effectively support the market order [Durkheim, 1893]. This 'organic solidarity' is reflected in a body of norms, customs and rules which have not been the object of any agreement among the contracting parties themselves but are socially 'given' : by posing the existence of these social rules, Durkheim stresses the necessity of non-contractual elements in all market exchange relationships [Parsons, 1937 : 312-313; Hodgson, 1988 : 157-160]. Nonetheless, the emergence of the new system of solidarity takes time. During the transitory period when capitalism has not yet become a complete social form, the moral order has not caught up with a merit-based system of allocation of talents to positions : a crisis of 'anomy' results from this transient discrepancy.

1.3. Trust-making in traditional societies

As soon as it is admitted that in the real world (1°) a sufficient number of agents are opportunists and (2°) information is imperfect, a problem of trust arises and there is a possibility for economic transactions to be seriously impeded. Indeed, if individuals do not trust others to fulfill their terms of an agreement, they will not wish to enter into exchanges with one another and economic specialization will not develop. Of course, if the gains of specialization are high enough, it is in their interests to lay down rules that constrain individual behaviour. Nonetheless, if they are rational actors, it is also in their interests to disobey those rules whenever an individualistic calculus of benefits and costs shows that they will incur a loss by following them. To the extent that monitoring of rule conformance is imperfect and costly, the problem of the possibility of a decentralized economy based on voluntary exchanges thus remains unsolved. Before delving into this issue in the specific context of market economies, it is useful to consider one more time the situation obtaining in traditional societies.

Such societies are characterized by their restricted size and the highly personalized nature of interindividual relationships. In this setting where people are in almost continuous interaction with each other, there is at least some theoretical reason to believe that social order can be established and maintained in a spontaneous way. Members of small-scale societies have indeed an incentive to refrain from committing dishonest actions because this would run against their long term interests. Suppose that the problem of social order is represented as a noncooperative game (binding agreements are not allowed), more specifically as a two-person prisoner's dilemma (PD) game where defect means some cheating while cooperation means abstaining from any fraudulent act. As long as this game is a one-shot or single-period game, we know that the unfortunate result of mutual war (both players cheat) happens with the predictability of an iron law (given the payoff structure of the game) : individualistic free riding or non cooperation is a dominant strategy with the result that both players are worse off than they would have been had they instead chosen to cooperate. It is noteworthy that even if the players could communicate and reach an agreement to cooperate (that is, if preplay negotiations are

permitted), they would still have an incentive to break the agreement and to defect. This is a result of the fact that the equilibrium is a dominant strategy equilibrium implying that the information structure of the game (played once) does not matter¹⁰. Within such a framework, cooperation therefore appears unstable insofar as each prefers that the others cooperate (be honest) while he or she defects (cheats). If there are many players and a sufficient number of them are opportunists, non cooperation is a defensive strategy for (the minority of) players who would like to cooperate but do not want to be continuously 'suckered' by unrepentant free riders [Runge, 1986 : 626-628].

This being said, it is an equally famous result of game theory (usually known as the 'folk theorem') that cooperation may be or emerge as a (Nash) equilibrium outcome if one assumes that the game is repeated, thereby creating what is called a supergame¹¹. The fundamental reason why cooperation may then be consistent with self-interested behaviour is that "repeating the game opens the door to expectations of others' behavior" [Runge, 1986 : 633 - note 5]. More precisely, to show that cooperation is possible, the assumption must be made that the game is repeated infinitely or that information is incomplete - there is some uncertainty about the others' strategies (either because their payoffs or the degree of their rationality are imperfectly known) or about the length of the game (the game horizon is finite but indefinite). Thus, using a simulation approach, Axelrod (1984) has shown that, in a version of the extended PD game where invited players were free to choose the strategy of their own liking, the simple tit-for-tat strategy emerged as the winner¹². In other words, when the number of rounds is sufficiently high and different strategies are played against one

10 Therefore, if one player is allowed to know the other player's move before taking his own, the equilibrium is unchanged (for a clear exposition of the concepts and analysis involved in the PD game, see Rasmusen, 1989 : 19-34). It is interesting to note in passing that, since expectations about others' behaviours do not play any role, all models yielding such a dominant strategy equilibrium are the game-theoretic analogue to perfect competition in traditional economic models.

11 Another condition is that players discount their future benefits at a low enough rate (and this is common knowledge).

12 A 'tit-for-tat' strategy is defined as follows :

- 1) Start by choosing to cooperate
- 2) Thereafter, in period n choose the action that the other player chose in period $(n-1)$.

another in a kind of tournament, an 'adaptive' behaviour pattern may converge towards a tit-for-tat function which sustains a cooperative equilibrium in the PD game.

The analytical approach has also yielded interesting results that demonstrate the possibility of cooperation in the extended PD game. An oft-quoted result is that of Kreps and associates according to which a suspicion by one party that the other may practice a 'tit-for-tat' strategy induces the other to adopt the same and both have then an incentive to cooperate until the other does not [Kreps and Wilson, 1982; Kreps *et al.*, 1982; Kreps, 1990 : 536-543; see also Friedman, 1990 : 190-194]¹³. This result has been recently generalized by Aumann and Sorin (1989) who show that, under certain analytical conditions (recall is bounded and there is a positive probability that the other player follows a strategy of recall zero, that is, his current actions are not influenced by the outcomes of his past moves), all equilibrium outcomes are close to the unique cooperative outcome when there is a radical uncertainty about which strategy the other player is going to play. Another set of results worth mentioning have been obtained by using an evolutionary framework of analysis. As shown by Sugden, in games which on average have many rounds, a convention of brave reciprocity (a family of strategies that comprises tit-for-tat and implies that players are prepared to cooperate in advance of any evidence that the opponent will reciprocate) has a good chance of

13 A particularly interesting conclusion that emerges from the work of Kreps and his associates is that the set of Nash equilibria is not robust to slight perturbations. Thus, "A one-in-one-thousand chance that one's opponent is generous, or that one's opponent assesses a substantial probability that oneself is benevolent, isn't much of a 'change' in the game. Yet it completely changes the theoretical prediction", implying that we must be very wary of the theoretical prediction [Kreps, 1990 : 542]. This agnostic conclusion can be actually tied back to reputation in the following sense :

"In the finitely repeated prisoners' dilemma, suppose one player assesses a small probability that the second will 'irrationally' play the strategy of tit-for-tat ... In a long-enough (but still finite) repetition of the game, if you think your opponent plays tit-for-tat, you will want to give cooperation a try. And even if your opponent isn't irrational in this fashion, the 'rational' thing for her to do is to mimic this sort of behavior to keep cooperation alive ... We can think of these effects as 'reputation' in the sense that a player will act 'irrationally' to keep alive the possibility that she is irrational, if being thought of as irrational will later be to that player's benefit through its influence on how others play. That is, in this sort of situation, players must weigh against the short-run benefits of certain actions the long-run consequences of their actions" [Kreps, 1990 : 542-543].

evolving¹⁴. In other words, when the probability of meeting an opponent again is fairly high, even if initially the great majority of players are unconditional defectors, the latter may do less well than the small minority who are following strategies of brave reciprocity, and there may then be a self-reinforcing tendency for the minority group to grow. Evolution is also found to favour strategies of brave reciprocity if cautious strategies (one never cooperates unless one's opponent has previously cooperated at least once) are possible. Even if initially *almost everyone* is unconditional defector, cautious reciprocators will gradually emerge and their presence will help to bring about conditions causing brave reciprocators to eventually invade and take over [Sugden, 1986 : 116-120].

A serious analytical difficulty inherent in the repeated game formulation is that games are characterized by multiple (Nash) equilibria. Unfortunately, the 'profusion' of equilibria possible (to use Krep's expression) also means that non cooperative equilibria are as likely as cooperative ones. In particular, as long as everyone follows cautious strategies of one kind or another, all cautious strategies produce the same result : no one ever cooperates [Sugden, 1986 : 109]. Moreover, not only is defection always a possible equilibrium strategy but, contrary to cooperation, once established, it is stable [Bianchi, 1990 : 15]. The point remains however that, as noted by Kreps : "A good way to interpret the folk theorem, when the players can engage in explicit preplay negotiation, is that it shows how repetition can greatly expand the set of self-enforcing agreements to which the players might come" [Kreps, 1990 : 512]. Consider the tit-for-tat again. It is evident that such a strategy is highly unstable : if one player defects once (for example, he makes a mistake) and then plays tit-for-tat while the other player does the same but starts by cooperating, cooperation will never occur. Now, it is easy to show that modified tit-for-tat strategies of the kind 'Cooperate if your opponent is in good standing, or if *you* are not. Otherwise, defect' - that is, strategies that prescribe one or several rounds of reparation following any unjustified defection - allow cooperation to start again after a breach of convention. Such strategies are stable equilibrium outcomes provided that the

14 Strategies of brave reciprocity have two defining characteristics. First, against an unconditional defector, these strategies defect in every round except the first. Second, if two brave reciprocators meet, they both cooperate in every round.

probability of mistakes is sufficiently small [Sugden, 1986 : 112-115]. It must nevertheless be borne in mind that we do not get rid of the fundamental analytical difficulty that attention is limited to a few basic types of strategy while there are innumerable possible strategies in repeated games. The above kind of argument, albeit interesting, cannot therefore be compelling.

To the extent that individuals in traditional societies are in continuous interaction, the situation confronting them may be thought of as approximating that of a repeated PD game with infinite or indefinite horizon. Furthermore, insofar as they live in close proximity, they are rather well informed about each other's acts and positions so that the framework of their interactions closely resembles a game structure : common knowledge prevails (each player knows the payoff functions and strategy spaces of all players) and rule-breaking behaviour is easy to monitor. Under these circumstances, cooperation becomes possible. People may refrain from behaving dishonestly or from breaking rules that forbid fraud and deceit because they have a strong incentive to consider the more indirect and long term consequences of their choices instead of paying exclusive attention to immediate costs and benefits. Several centuries ago, Hume (and Adam Smith as well, who spoke about the "discipline of continuous dealings") had already well understood that, in small-scale social settings, considerations of what is sometimes called reciprocal altruism but really amounts to selfishness with foresight, should lead people to cooperate. The same considerations help explain why they are quite reliable about keeping promises when no legal sanction requires them to do so and when keeping them is inconvenient or costly :

"We can better satisfy our appetites in an oblique and artificial manner, than by their headlong and impetuous motion. Hence I learn to do a service to another, without bearing him any real kindness; because I foresee, that he will return my service, in expectation of another of the same kind, and in order to maintain the same correspondence of good offices with me or with others. And accordingly, after I have serv'd him, and he is in possession of the advantage arising from my action, he is induc'd to perform his part, as foreseeing the consequences of his refusal ... After these signs [i.e., promises] are instituted, whoever uses them is immediately bound by his interest to execute his engagements, and must never expect to be trusted any more, if he refuse to perform what he promis'd" [Hume, 1740 : Book III, Part II, Sect. V, 521-522].

The crucial aspect of the situation which tends to favour cooperation is thus that agents can use a set of credible strategies whereby they refuse to deal with someone who has behaved opportunistically or non cooperatively. In actual fact, traditional (village) societies have often devised formal or tacit rules or mechanisms that support or reinforce cooperation, an important feature given that, even in infinitely repeated games, cooperation (honesty) may be an unstable strategy (see supra). One such mechanism operates through reputation : sanctions imposed on defectors in the way of loss of reputation make everyone wary of the future consequences of his (her) free riding. Insofar as the costs of reputation loss exceed the cost entailed by the suspension of cooperation in the domain where defection has occurred (for instance, a defaulter is deprived of the possibility of getting any new loan), the payoff structure of the game is changed. This happens, for example, when a breach of promise in one sector of life is followed by sanctions that spill over into many other sectors in which the free rider is involved : social ostracization is typically a phenomenon of that kind. Recourse to such practices is all the more likely if defection in one particular set of circumstances has a signaling value, that is, if it contains information about the future behaviour of the defector in a wide variety of situations [Axelrod, 1986 : 1107]. Another mechanism partly related to that of reputation loss comprises all the sanctions of approval and disapproval (including those operating *via* gossip, ridicule, shaming, and even witchcraft) which a small community has available to it to wield pressure on deviant members.

For another thing, *metanorms* - that is, rules according to which one must punish not only the defectors but also those who do not punish them [Axelrod, 1986] - often exist to support or reinforce cooperation : a good illustration of this possibility is provided by the caste system of India [Akerlof, 1976; Basu, 1986b]. Under conditions where cooperators thus punish anyone who refuses to punish defectors, Axelrod has shown, with the help of computer simulation techniques, that cooperation (honesty) can be sustained provided that the population starts with a sufficiently high level of vengefulness [Axelrod, 1986; see also Basu, 1986a]. When individuals can communicate, another solution is for them to devise some design mechanism, that is, to lay down some set of explicit

rules and sanctions designed in such a way that they are motivated to make safe, advantageous, and credible commitment to rule compliance and mutual monitoring [see, e.g., Taylor, 1987; Ostrom, 1990 : chaps 3 and 6, where contingent commitments are analyzed]. In such circumstances, the payoff structure of the game is again obviously modified by the players.

Turning now more specifically to the problem of trust, let us follow Dasgupta by defining this concept "in the sense of correct expectations about the *actions* of other people that have a bearing on one's own choice of action when that action must be chosen before one can *monitor* the actions of those others" [Dasgupta, 1988 : 51]. It can then be emphasized that in traditional societies trust plays an essential role in creating and supporting cooperation (honesty in dealings), more particularly by assuring each transactor that the others will also start by cooperating and will normally not defect as long as he himself cooperates (keeps his promises). The *making* of trust is typically achieved through strategies aimed specifically at establishing and upholding close relationships between the people concerned. These strategies, as anthropologists have abundantly shown, are essentially based upon the exchange of gifts the main role of which is to help cement enduring relationships between persons who are destined to transact with one another. In other words, gift exchange serves to *create* small groups of trustworthy agents among whom repeated interactions take place, a function all the more important to be fulfilled if transactors are not tied by close family or kinship bonds. Therefore, the principle of reciprocity underlying the exchange of gifts can be considered as a least-cost trading solution where no viable system of enforcing the terms of exchange between transactors exists [North, 1977 : 713; in the same vein, see also Polanyi, 1957 : chap. 5; Posner, 1981 : 147-148; Bourdieu, 1980 : 168-182, 216; Etzioni, 1988 : 75; and Platteau, 1991b].

That reciprocal gift-giving serves to establish and support trust in order to reduce the risk inherent in economic transactions when there are no adequate enforcing institutions (bear also in mind that illiteracy usually prevails so that written contracts cannot be used) has been well illustrated by Belshaw's interpretation of the *kula* system discovered by Malinowski in the Trobriand islands [Malinowski, 1920, 1922]. According to this interpretation, the

exchange of gifts with candidate partners "opened channels of substantial trade and social intercourse". As a matter of fact, "persons visiting their partners took advantage of the opportunity to engage in trade". "In addition to *vaygua* [ceremonial gifts], partners would exchange gifts of a trade character" and "the security afforded by the partnership would make it possible for the visitor to make contact with other persons in the village and trade with them". This latter trade, however, included "a greater element of bargaining" since the cushion of direct gift-giving was no more present [Belshaw, 1965 : 16, 19].

The *hxaro* system practiced by the Kung San hunter-gatherers of the Kalahari provides another instructive example. Here, we are told, *hxaro* relationships - which involve vital insurance-motivated transactions - are built up and maintained with great care using a well-established ceremonial. Thus, a person initiates a *hxaro* by giving a gift to a prospective partner, and the latter can express his willingness to enter the proposed relationship only by returning a gift of similar worth. However, it is only after a trial period of at least one year, during which several gifts of non-food items flow between the partners, that the relationship is eventually considered firm. Thereafter, gift exchanges which are both balanced and delayed (it would be an insult to return a gift immediately) must continually take place to inform the partners that the relationship is still intact, a practice that is all the more important the longer the distance between the camps in which they live, if they live far apart. These continual flows of ceremonial gifts serve the important function of cementing strong bonds of friendship backed by a powerful ideology or moral code of generosity and equality. Note that, once a relationship is firm, a person is said to 'hai' the partner in his heart, meaning literally to hold and figuratively to be responsible for that person : from then on, each partner can call on the other in times of need [Wiessner, 1982 : 66-67].

It is also worth noticing that, for an outsider, access to localized productive resources was usually preconditioned upon the establishment of personal links of allegiance to the local chief and/or of friendship or godparenthood with some resident family. Again, it is found that these relationships were supported by continuous or periodical exchanges of gifts. First, consider the case of asymmetrical relations. It was a well-established custom for

African village chiefs to give land to outsiders (provided that land was available) in return for a periodical due *which is not to be equated to a rent* : these dues have instead to be interpreted as symbolic gifts manifesting an act of political allegiance that had to be continuously renewed [Gruesnais, 1986 : 290]. In the instance of symmetrical relations, the mechanism can be illustrated with respect to (informal) sea tenure arrangements among artisanal fishermen on the southern Bahian coast (Brazil). We learn that "becoming a godparent is one strategy to gain access to new territory and to fish safely in waters of an adjoining community"; the fishing rights thus acquired may "endure for many years". As a consequence, a large number of informal contracts are entered into with a view to establishing sea rights and they result in wide-ranging circles of fishermen bound by a same ethical code of good conduct. These "huge personal networks with many godparent connections" often run through a series of villages and make for a ritualized extension of sea rights that "restores an element of flexibility in fishing opportunities where waters are otherwise exclusively used and claimed by single villages" [Cordell and McKean, 1986 : 89, 91-93, 95-96]. Similar arrangements have been actually observed in Lake Titicaca where fictive kinship ties and coparenthood ties are established to gain access to scarce aquatic resources [Levieil, 1987 : 74-85].

In view of the above-described function of gift exchange, it is not surprising that it has been considered by Sahlins as the social contract of the primitive world, a practice that binds men together by ties of mutual obligation and thereby ends the state of latent war among willing transactors [Sahlins, 1974]. There is thus nothing automatic about the emergence and persistence of honest dealings. To make them possible in the context of precapitalist societies, trust must be genuinely fabricated and 'friendship' ties established. Moreover, it is at the price of a considerable reduction of individual freedom - since mutual obligations and dependence underly the tightly knit networks of personal relations that make up the traditional social universe - that economic transactions can be sustained. The compulsory element inherent in traditional social relations has been well captured by Gregory who astutely built up on both Marx and Mauss to draw a neat and illuminating contrast between traditional and modern market economies. According to him, traditional economies are gift economies and gift economies

are debt economies. The aim of a transactor in this context "is to acquire as many gift-debtors as he possibly can" and what a gift transactor desires "is the personal relationships that the exchange of gifts creates, and not the things themselves" [Gregory, 1982 : 19]. Indeed, as was seen by Mauss, the essential feature of gift exchange systems is "the indissoluble bond of a thing with its original owner", as a result of which a thing that is given away must always be returned. Because of the inalienable nature of the thing transmitted, "the alliance contracted is not temporary, and the contracting parties are bound in perpetual interdependence" [Mauss quoted by Gregory, 1982 : 18-19]. To sum up, gift exchange appears as "an exchange of inalienable things between persons who are in a state of reciprocal dependence... [it] establishes a relationship between the subjects" [ibidem : 19; in a similar vein, see Bourdieu, 1980 : 179-182]. By contrast, as we have learned from Marx (see *supra*), commodity exchange which characterizes market economies is "an exchange of alienable things between transactors who are in a state of reciprocal independence". This presupposes that a marked distinction exists between things and persons and has the effect of establishing a relation between the objects exchanged, so that price-making markets become possible [Gregory, 1982 : 12, 18-19].

Clearly, the concept of a spontaneous social order is completely alien to the traditional universe of social relations. In traditional societies, indeed, individuals are convinced that the social fabric being profoundly unstable and fragile, it can persist only as a result of a genuine process of 'uninterrupted creation'. In other words, individuals have to work continuously to produce and reproduce social order and, to achieve this end, they use strategies explicitly and directly oriented towards establishing and maintaining enduring relations of person-to-person dependence [Bourdieu, 1980 : 225-226]. Such process may be considerably reinforced through identification with kin or pseudo-kin groups : leaders are then usually father or mother-figures, and the territory is often quasi-parental in the cultural symbolism [Badcock, 1986 : 180].

To pursue the analysis one last step further, it must be reckoned that traditional economies were never completely characterized by only one type of exchange relations. From the above-cited excerpt from Belshaw, it is apparent that the more distant the relationships between transactors the more business-like the exchange process.

This is indirectly confirmed by Marx when he observed that "the exchange of commodities evolves originally not within primitive communities, but on their margins, on their borders, the few points where they come into contact with other communities" [Marx, 1859 : 50]. The clear lesson from the foregoing analysis is nevertheless that, when exchange relations are not based on trust - or when they are only imperfectly so (like in the intermediate case mentioned by Belshaw where transactors have no direct personal ties but are personally related to a third party who put them into contact) -, there is a serious risk that conflict brings the exchange process to an abrupt end. As a matter of fact, what characterizes intercommunity relations in traditional societies is usually unrestrained behaviour in the sense that transactors are allowed to seek their personal advantage (or that of the group to which they belong) by using any kind of means at their disposal.

No wonder then that in such societies trade is often equated to stealing or cheating (to cheat a 'foreigner' even brings social prestige to the trader) and that purely commercial relations (that is, relations unaccompanied by exchanges between subjects) are authorized only with members of other communities [Pospisil, 1958 : 127; Sahlins, 1968; Bourdieu, 1980 : 196-197]¹⁵. Precisely because of this strictly commercial character, intercommunity relations are eminently unstable and can easily break out into active aggression. When economic relations with outsiders assume critical importance (because they involve the exchange of objects deemed essential or because they are needed to cope with temporary food shortages), latent tensions must therefore be "reduced, compensated for, and controlled" [Belshaw, 1965 : 14] in order to ensure more or less regular transactions. Towards this purpose, the societies concerned tend to have recourse to complex procedures such as the meticulous observance of elaborate ceremonials (sometimes comprising large-scale feasting) directed by community chiefs¹⁶; the practice of silent trade in which trading agents never meet physically [Sahlins, 1968; Giri, 1983 : 22-23]; or the system of the 'ports of trade' in which

15 In tribal ideology, to cheat one's clan is equivalent to cheating oneself while cheating outsiders gives strength to the clan of the cheater and weakens the clan of the cheated person [Massoz, 1982 : 87-88].

16 Such practices were also observed in Europe during medieval times like when 'free' trading was allowed between members of two different lordships on the specific occasions of (official) tournaments, that is, in events strictly regulated and controlled by the feudal authorities concerned.

commercial transactions are carried out in special trading centres under the aegis of representatives of political entities [Polanyi *et al.*, 1957; Polanyi, 1968].

1.4. Trust-making in advanced societies

Because traditional societies have evolved ways to establish and maintain trust, stable economic transactions can take place among their members. Nonetheless, inasmuch as presence and persistence of trust depends on highly personalized relationships (sealed by gift exchanges and supported by norms of reciprocity), it follows that the size of the traditional economy is necessarily restricted with the result that division of labour cannot be developed very far. True, economic exchanges can occur on the border of these "community spaces", yet their highly unstable nature prevents them from forming the sound basis of a (new) system of generalized production and exchange, all the more so if they are surrounded by complex procedures of contact-making and negotiation. As has been emphasized by Polanyi, 'transactional modes' grounded in reciprocity and redistribution are dominant in the heart of traditional societies while transactions more akin to commodity exchange remain confined to their periphery and retain a marginal character [Polanyi, 1977; Sahlins, 1968; Dalton, 1971]¹⁷.

1.4.1. Another impossibility theorem ?

In spite of what seems to be an inescapable limitation of the traditional solution to the problem of social order, Granovetter has defended the thesis that dense webs of interpersonal relations are "the structure that fulfills the function of sustaining order" in our modern market economies [Granovetter, 1985 : 491]. For him, indeed, fraud and deceit can be tamed only through the production of trust in economic life and, in generating trust, the role of *concrete* personal relations and structures (or networks) is predominant. This is so because rational individuals "are less interested in *general*

17 In the words of Polanyi : "Domestic and foreign relations are in stark contrast : solidarity here, enmity there, rule the day. 'They' are the objects of hostility, deprecation, and enslavement, 'we' belong together and our communal life is governed by the principles of reciprocity, redistribution, and the exchange of equivalents" [Polanyi, 1977 : 59].

reputations than in whether a particular other may be expected to deal honestly with *them* - mainly a function of whether they or their own contacts have had satisfactory past dealings with the other" [ibidem]. The identity and past relations of individual transactors would thus matter. The obvious problem with Granovetter's thesis is that it entails a contradiction between the two conditions of a market order : that required for mitigating opportunism and that of independence (or atomization) of the agents. Or, to put it in another way, his thesis appears to give rise to a genuine paradox which looks like another impossibility theorem : the market order may not emerge because one of the two essential social preconditions of its existence and smooth working can be established only by destroying the other¹⁸.

For Granovetter, no such paradox exists since he can only view the above statement as being grounded in a wrong premise, namely that the market system consists of the *free* interactions of socially atomized actors. In his own words, "Actors do not behave or decide as atoms outside a social context ... Their attempts at purposive action are instead embedded in concrete, ongoing systems of social relations ... the anonymous market of neoclassical models is virtually nonexistent in economic life and transactions of *all* kinds are rife with the social connections described" [ibidem : 487, 495 - our emphasis]. Granovetter has actually a good point when he questions what he calls the undersocialized conception of human action implicit in much economic theorizing. Indeed, as we know from our previous discussion of the recent evolution of GE theory, when the asymmetrical character of information distribution is taken into account, it is no more possible or legitimate to view the agents as socially unrelated automatons reacting parametrically to the signals of the market. In other words, relations between them can no more be conceived as being exclusively mediated through prices : rules, institutions or direct interactions of some sort must be posited to solve the coordination problems resulting from informational asymmetries (see supra).

18 Note, however, that Granovetter himself has somewhat qualified his thesis by acknowledging that "while social relations may indeed often be a necessary condition for trust and trustworthy behaviour, they are not sufficient to guarantee these and may even provide occasion and means for malfeasance and conflict on a scale larger than in their absence" [Granovetter, 1985 : 491]. Yet, this qualification is hard to reconcile with the main thrust of his paper.

Now, it is undeniably true that, in real world market economies, we may easily observe repeated contacts among transactors or across organizational boundaries. Rather than consisting of single-purpose, self-contained and short term arrangements, trading relationships may have a more lasting character and be based on the personal involvement of the parties concerned. Such involvement in customer market relationships may be seen as a strategy whereby transactors wish to create and maintain incentives for trustworthy behaviour as well as to bring reputation effects into play [see, for example, Williamson, 1975 : 106-108; 1980]. Moreover, as Granovetter has again rightly pointed out, "there is evidence all around us of the extent to which business relations are mixed up with social ones. The trade associations deplored by Adam Smith remain of great importance. It is well known that many firms, small and large, are linked by interlocking directorates so that relationships among directors of firms are many and densely knit" [Granovetter, 1985 : 495]. Finally, an important contribution of the new transaction cost economics is to have suggested that, rather than being specialized units operating across market interfaces (as implied in the neoclassical theory of the firm), firms are hierarchical organizations which internalize economic transactions, thereby transforming open-market relationships into relationships handled within the "governance structure" of corporate entities. Such a contribution is all the more important to note as one of the main reasons advanced by Williamson (one of the pioneers of this new branch of economics) to account for the emergence of the modern firm is precisely the entrepreneurs' motive for attenuating opportunism through the establishment of authority relations [Williamson, 1975, 1985, 1986; Eggertsson, 1990 : chap. 6].

Clearly, what all the foregoing considerations tend to demonstrate is that, far from corresponding to purely decentralized systems grounded in social atomization, market economies are actually made of imperfectly competitive markets where individual agents or organizations strategically interact with one another, whether they are few or many. This being granted, it must be admitted that, despite their indisputable empirical relevance, these considerations alone cannot provide a reliable escape from the above-formulated dilemma. In effect, Granovetter's contention that in (modern) market economies trust is essentially produced by dense interpersonal networks supported by effective codes of *limited*

morality does not appear to be a sound answer to the problem of market order as it leaves too many pivotal questions unattended. For example, how does one unique money become established and accepted over a 'national' space? As De Villé has pointed out (see *supra*), money is probably the key economic institution to be explained in any attempt to demonstrate the viability of the market order. It may be recalled that in traditional economies monies were confined to localized areas and to specific sets of transactions or 'spheres of exchange', and/or they fulfilled only one (or two) of the functions usually ascribed to money. These various kinds of compartmentalization of money did actually fit well into - or reflected - the highly segmented nature of these economies [see Polanyi, Arensberg, and Pearson, 1957 : 64-94; Firth, 1958 : 69; Bohannan, 1959 : 492; Dalton, 1961, 1962, 1965]. In market economies which are, by contrast, integrated spaces, money must serve as an unifying principle. And when money cannot play this role - for instance, because people do not trust it - economic exchanges are severely restricted or curtailed and people tend to cling or return to a subsistence-oriented, more autarkic way of life. Thus, in 18th century Naples, bonds and money were currently counterfeited and people no longer accepted them, causing the collapse of the economy [Pagden, 1988 : 137-138]. For money to exist and persist, it is necessary that everyone believes in it and also believes that everyone else similarly believes in it, so that it becomes a 'self-fulfilling' prophecy [Basu, 1986a : 1895; 1984 : 179]. Generalized trust is therefore absolutely required.

The existence of an unique, full-fledged money is not the only phenomenon that creates difficulties for Granovetter's thesis. Thus, market development has usually meant that many small-scale, highly dispersed retail shops have been gradually replaced by large-scale, more centralized selling points in which relations between sellers and buyers are necessarily anonymous. In a more general way, since division of labour is strongly encouraged under the market system, people are bound to depend upon one another in numerous respects and, particularly if mobility is high (an important condition for the market to be an efficient resource allocator), the scope for impersonal exchanges is bound to remain large and opportunities for dishonest behaviour will abound (for instance, no second-hand market would emerge because every buyer would fear that he will get a lemon). This is true even in the

case of internal transactions (e.g. labour relations) taking place *within* organizations. More importantly, if only limited morality prevails, how are private property rights going to be respected by the people ? The significance of this latter problem will become plainly evident in the third section of this paper when we deal with land market reforms in developing countries.

It could of course be argued *à la Mandeville* that such behaviour, even when its influence is pervasive, needs not cause the collapse of the economy and may even stimulate it : does not theft make work for the locksmith [see McNally, 1988 : 163] ? However, as Hucheson has aptly pointed in his criticism of Mandeville's *Fable of the Bees* (1713), "profit from crime or suffering" does not add to human happiness [ibidem : 165] : in other words, additional incomes thus generated do not reflect enhanced well-being since they have been spent to avoid something bad or regrettable rather than to produce something good or enjoyable [by analogy, see Mishan, 1986 : chap. 5]. More seriously, if the incidence of fraud and deceit is too large, economic transactions will be discouraged and the volume of market activities will shrink. Again, it may be remarked that, as recent economic theories of contractual choice have shown, agents can always use various forms of contracts to control incentive problems of both the moral hazard and adverse selection kinds. Nevertheless, even assuming that they can allow for all possible contingencies, the crucial question remains as to how and at what price can such contracts be devised and effectively monitored and enforced. On the other hand, it is not at all evident that authority relations can actually deflect opportunism (in the form of labour-shirking, asset mismanagement, input pilfering, output underreporting, etc.). As Williamson has himself pointedly observed, the monitoring of the workers' labour inputs and the continuous revision of their rewards according to their productive performances creates the negative externality of a calculative and suspicious atmosphere with detrimental effects on the employment relation. Constant 'metering' is bound to give rise to serious disputes over monitoring observations and reward adjustments that are costly in time and good will and may easily drive the workers to perform their jobs in a minimal or 'perfunctory' fashion [Williamson, 1980; see also Putterman, 1986 : 318-319].

Finally, even if one agrees that many producing or trading units are involved in personalized relations with their main supplier/customers, one must still wonder why networks of interpersonal relations that are mixed up with business interests do not behave like mafias, ceasing to apply their own morality norms and behavioural codes as soon as they come to deal with outsiders (an inescapable event in any advanced market economy where specialization is highly developed). In the absence of any social constraint, is not the temptation to free ride on other networks or on less collectively organized agents be so strong as to become almost irresistible ?

At this stage, it is interesting to pause for a moment and to consider how, in his attempt to construct a theory of the rise of the market in Western Europe, Hicks has positioned himself with respect to the issue under concern. What we then find is that, while recognizing the important role of social relations involving a strong sense of specific identity (such as ethnic identity), Hicks, contrary to Granovetter, has not failed to see that the development of the modern market system cannot be entirely based upon such forces. According to him, what he calls the "mercantile economy" cannot be transformed into a full-fledged market economy as long as a state does not arise that lends his support to the merchants' cause. Let us now unwind his complete argument in a schematic form. Hicks' starting point is that "trading is trading in promises" and "it is futile to trade in promises unless there is some reasonable assurance that the promises will be kept" [Hicks, 1969 : 34]. The problem does not only arise from bad faith but also from the fact that contracts are always necessarily incomplete :

"Though contracts can be drawn up which provide for many of these eventualities, it will not be worth while, in the midst of active trading, to provide expressly for every such possibility in every bargain that is struck. Trading will thus be immensely facilitated ... if there is some general understanding of what is to happen if there prove to be obstacles to the performance of the contract, as it was originally understood by either party, or by both" [Hicks, 1969 : 35].

Hicks actually thought that such 'general understanding' is hard to build up between merchants and non-merchants. Between merchants themselves, things are normally much easier (since they are doing the same kind of business, they 'speak the same language'

and can therefore be expected to interpret an agreement in the same sense), especially so if social ties bind them into a cohesive community :

"Both the protection of property and the protection of contract must be established, at least to some extent, if the mercantile economy is to flourish. They are not provided by the traditional society; but they can be provided, to what (up to a point) may be a sufficient extent, by the merchants themselves ... This, however, can hardly be possible unless the mercantile economy has already acquired some social linkage or articulation. A random collection of individuals will hardly have it ... Merchants who are members of a particular ethnic or religious group, even of one that was not highly regarded among the peoples from whom they have been extruded (or have extruded themselves), may well have their own natural leaders; among those leaders, who are also merchants, the arbitrators who are required may be found" [ibidem : 36-37].

Under the impulse of such closely-knit merchant communities and with no or little assistance from state authorities, "much can be done". Yet, at the same time, "a mercantile economy that is organized on this basis is inevitably confined. It does not have the power of growth, of spreading itself continually into new fields and new applications - a power which it does have in abundance when more regular legal institutions can be used. But for this it is not only necessary that the rulers (whoever they are) should look upon mercantile transactions with some degree of favour ... they, together with their judges and administrators, should have a 'feel' for trade, so that they can give it the kind of help, or rather recognition, that it needs" [ibidem : 37-38]. When can we expect political authorities to support merchant communities ? Hicks' answer is that this happens only when trade comes to acquire "some social importance", which is more likely to occur when external trade opportunities are large relatively to internal opportunities (which a state can more easily seize by using 'command' instruments or channels). Such a condition is the most easily satisfied in a small and independent community with good opportunities for trading outside it. For Hicks, these stringent requirements were met in the European City States which benefitted from a number of favourable geographical conditions ("The city state of Europe is a gift of the Mediterranean"). This is in contrast to Asia where progressive communities (like the Parsees of India) could not rely on the active support of their states : "The fact that European civilization has passed through a city-state phase is

the principal key to the divergence between the history of Europe and the history of Asia" [ibidem : 38].

Evidently, - and quite independently of the way in which one would wish to rate the merits of Hicks' peculiar view of the origins of market development in Western Europe - the main lesson to be drawn from the above analysis is that it is not possible to build up a realistic account of the market that ignores the role of state authorities and legal institutions. If only because it bypasses the political factor, Granovetter's attempt at explaining social order in the market is faulty and unsatisfactory. The importance of the political factor is particularly evident in the case of money since, as noted by Hicks again, "the Monetary Power is one that can only too easily be misused, or over-used" [ibidem : 97]. In the case of its over-use, even if transactors get accustomed to inflation and are able to anticipate it correctly, they will need to increase their nominal cash balances and, therefore, to buy a service from the state which thereby obtains free command over real resources. That this is a crucial issue can hardly be denied in view of the structural hyperinflation that has characterized many Latin American countries during the last decades [see Hirschman, 1981].

1.4.2. From Prisoners' Dilemma to Assurance Game

Since repeated dealings and personalized interactions characterize only a fraction of economic exchanges in market societies, it is no more possible to demonstrate the feasibility of cooperation by referring to the theory of repeated games. In actual fact, the one-period PD game seems to apply with full force to such societies, leaving no way to bring order in the market¹⁹. Leaving aside the

19 Badcock (1986) is therefore wrong in portraying free-exchange economies as repeated games of the tit-for-tat kind, all the more so as he does not appear to hold the same view as Granovetter on the nature of interindividual relations within these economies. This mistake enables him to achieve his end, which is to demonstrate that market economies correspond to a state of civilization where the individuals' *ego* can be fully emancipated from "exorbitant and irrational compulsions of the *superego* and from impulsive and uncomprehending enslavement to the peremptory demands of the *id*". In particular, a society can be built which does rely neither "on the introjection of aggressive drives because of compulsive identification with parental figures" (like in traditional societies) nor on the paranoid psychopathology of revolutionary movements [Badcock, 1986 : 195-197]. In other words, it is only by assuming that reciprocal altruism (in the form of tit-for-tat strategic behaviours) can be the basis of exchanges in a market economy that Badcock can make his extravagant claim that a viable society is possible where man can do away with his *superego*.

collective action problems involved, the agents could conceivably vote for a social contract whereby they would voluntarily restrict their freedom of choice in order to solve the coordination problems created by the market process. As suggested earlier, however, inasmuch as they behave like rational selfish maximizers and costs of detection of rule-breaking are high, agents have an incentive to violate the agreements or rules which they have possibly helped themselves to lay down. We are thus confronted with the well-known Hobbesian dilemma expressed by North in the following terms : "The neoclassical model has an asymmetrical dilemma built into its behavioral function because it assumes both wealth maximization and the Hobbesian model of the state, which will constrain behavior to produce a viable political system. If individuals are acting rationally with respect to the first assumption then they are acting irrationally with respect to the second" [North, 1981 : 45]²⁰.

The difficulty obviously arises from the fact that, when numerous actors are involved, each of them tends to consider others' behaviour as a datum which he (she) is unable to influence. Reputation cannot be lost since a person's past record of choices is not known by anyone : people meet at random to transact and cannot tell if they have met before. In such circumstances, it pays the single actor (or player) to violate unilaterally the prevailing rule or agreement. In the words of Buchanan

"As more parties are added to the initial contractual agreement, in which an assignment of rights is settled, the influence of any one person's behavior on that of others becomes less and less. As an element inhibiting individual defections on an initial contract, this influence tends to disappear completely after some critical group size is reached. In large-number groups, each individual ... has a rational incentive to default; hence, many persons can be predicted to default and the whole agreement becomes void unless the conditions of individual choice are somehow modified" [Buchanan, 1975 : 66; see also Olson, 1965, 1982].

To the above difficulty, one must add the risk (strongly emphasized by moral philosophers of the eighteenth-century Scottish Enlightenment) of corruption among state administrators, that is,

20 For a detailed discussion of Hobbes' ideas, see Taylor, 1987 : 126-150.

the risk that they approach political affairs with a view to advancing their own private interests, reflecting the infiltration of the principle of profit-seeking into the body politic.

Under the assumptions of rational selfish actors and informational asymmetries, the conclusion thus emerges that no state would be viable "since enforcement costs of the rules would be, if not infinite, at least so large as to make the system unworkable" [North, 1981 : 45]. For the political order ruling over a market economy to be viable, two conditions must be satisfied. For one thing, the domain of public power must be restricted, implying that many aspects of social intercourse which create opportunities for conflict ought to be organized by the individuals themselves, according to certain informal standards or fundamental rules for mutual tolerance. As noted by Buchanan : "Life in society, as we know it, would probably be intolerable if formal rules should be required for each and every area where interpersonal conflict might arise" [Buchanan, 1975 : 118; see also Shott, 1979, 1329]. For another thing, to the extent that formal rules are needed to resolve conflicts, the costs of operating law-enforcing agencies must not be too high, a condition that is likely to be fulfilled if individuals place a high value on obedience to law. Indeed, "If individual preference functions embody this principle, it is the announcement and enactment of the rule or regulation that imposes limits to behavior that matters; enforcement and punishment institutions assume secondary importance" [ibidem : 119]. Note that, since people's civic spirit depends upon the perceived legitimacy of the existing system, which in turn is influenced by the prevailing dominant ideology, the costs of maintenance of an existing order is inversely related to the success of the ideological superstructure in legitimizing market arrangements among which the rule of contract and private property stand foremost [see, for example, North, 1981 : 53].

When the above two conditions are poorly met, a state intent on modernizing its economy through the market is under the strong temptation to resort to coercion or persuasion to ensure rule compliance. Resulting costs tend to be high since considerable resources must be devoted either to repression or to investments in legitimacy. True, a totalitarian state could alternatively use the more subtle and less (directly or immediately) costly strategy that consists of enhancing and exploiting the agents' mutual distrust

[Gambetta, 1988 : 220], for example by inviting people to denounce any person who disobeys the rules. This strategy, known as *divide ut impera*, has been and still is widely practised by totalitarian regimes eager to economize on the central power's resources. Nonetheless, it is bound to entail formidable indirect costs, at least in the long run, if only because the distrust thereby created unavoidably gives rise to severe excesses or injustices (all the more so as many dictators have paranoid personalities prompt to fabricate imaginary enemies) and spills over into all spheres of human interaction. Fear and suspicion infiltrate the whole society as a result of which individuals tend to withdraw from as many social intercourses (including economic transactions) as possible, to shun away from all risky ventures, and to take refuge in private life.

Clearly, to have men and women evolving, and abiding by, implicit rules as well as complying with the indispensable formal rules, what is needed is mutual trust instead of distrust. In game-theoretic terms, this would mean that the *one-shot* PD game (it is one-shot because individuals play the game against one another repeatedly but anonymously) is actually *transformed* in such a way as to yield a cooperative outcome if (1°) actors have a predisposition towards cooperation in the sense that they derive a positive utility from cooperation, and (2°) each one has reasonably good expectations that others would also like to cooperate. In the literature, the new game is known as the Assurance Game [Sen, 1967, 1973, 1985; Runge, 1981, 1984, 1986; Dasgupta, 1988; see also Ullmann - Margalit, 1977 : 41; Collard, 1978 : 12-13, 36-44, 80-89; Field, 1984 : 699-700; Taylor, 1987 : 18-20, 38-39, 139-140; Levi, 1988 : chap. 3]. In the AG, like in the PD game, no altruistic motive is ascribed to the actors. What distinguishes the former from the latter is that there is no more a dominant (free rider) strategy because the particular outcome "depends crucially both on prior expectations and on a preference for coordinating one's own actions with the actions of others" [Runge, 1984 : 158]. Insofar as the structure of mutual expectations plays a crucial role, multiple equilibria become possible and the Pareto-optimal outcome is one of them. The AG is thus particularly interesting because it provides both a formal way of looking at interdependence and uncertainty associated with nonseparable externalities [see Runge, 1981 : 598-601], and an escape from the counterintuitive result that free riding is the *unique* possible equilibrium in a single-period framework.

To make things clearer, consider the following symmetric one-shot game²¹ :

		Player 2	
		H	C
Player 1	H	20,20	5,15
	C	15,5	10,10

Figure 1 : The Assurance Game

It is assumed that a large group of individuals make up the society and meet pairwise at random in every period to transact. Anonymity therefore prevails. Each actor can choose between two strategies : to be honest (H) or to indulge in some cheating (C), and choice strategies are determined simultaneously. As is evident from the above payoff structure, each player would prefer to transact honestly if the other were to choose to be honest, but he (she) would prefer to cheat if the other were to act dishonestly. In other words, when dealing with honest people, it is nice to be honest, but it is unpleasant to be exploited by dishonest transactors. Moreover, each one prefers both to choose H rather than C : bilateral honesty is deemed preferable to bilateral cheating.

It is immediately apparent that, for each party, the best policy depends on what he (she) thinks the other will do. In fact, optimal choice of one player is H if the probability that the other player will choose the same strategy is assessed by him (her) to be in excess of $1/2$, and his (her) optimal choice is C if this probability is less than $1/2$ ²². Thus, while there is no certainty that the game will equilibrate at the more favourable of the two (Nash) equilibrium points, HH and CC, this can happen if the transactors have enough confidence in each other, the degree of trust being measured by the probability that the other chooses H instead of C. It may be noted

²¹ This game is a slight variation of that used by Dasgupta [1988 : 56-59] and the comments offered in the text are directly inspired from this source.

²² Suppose the probability is denoted by p . Then for each player to be indifferent between H and C, p must satisfy the equation $20p + 5(1-p) = 15p + 10(1-p)$, yielding $p = 1/2$.

that the degree of trust needed to yield cooperation is inversely related to the intensity of the agents' inclination towards honest dealing. Thus, if it is assumed that each player gets a payoff of 30 instead of 20 when both behave honestly, a player will be induced to so behave if his expectation that the other will follow suit is greater than or equal to only 1/4 (instead of 1/2)²³.

Let us now modify the above AG so as to allow for the possible presence in the population of a group of inveterate opportunists who are eager to exploit to their own profit any situation which they encounter. Let us assume the following modified assurance game where type 1 players are given to honest urges while type 2 players are opportunists :

		Player 1			Player 2			Player 2	
		H	C		H	C		H	C
Player 1	H	20,20	5,15		H	20,12		H	12,12
	C	15,5	10,10		C	15,5		C	15,5

Figure 2 : A Modified Assurance Game where opportunists are present

The payoff structure of the game is essentially the same as in Figure 1 except for the fact that when type 2 players deal honestly with cooperating type 1 players, they get only 12 (all what matters is in fact that this payoff be strictly smaller than 15). The three kinds of possible encounters in this modified game are portrayed in Figure 2 above. Note that the first type of encounter (would-be honest agents meet together) is strictly equivalent to the game depicted in Figure 1. Furthermore, it is worth emphasizing that the game embodies an assumption of imperfect information. Indeed, no player knows *ex*

23 There is an interesting analogy between the role played by the players' predisposition towards honesty in the one-shot AG on the one hand and that played by the probability of meeting an opponent again in an extended PD game on the other hand. Let π designate the latter probability and, moreover, let p be the probability assessed by a player that a random opponent will choose a strategy of brave reciprocation. It can then be shown that the higher is π , the lower p needs to be in order to induce a player to follow a strategy of brave reciprocation [see Sugden, 1986 : 116-117].

ante whether he is dealing with an honest or a dishonest transactor; only *ex post* can he know the answer to that question. It is immediately apparent that type 2 players (the opportunists) have a dominant strategy, which is to cheat. As for type 1 players (who are a priori inclined towards cooperation), their strategy will again depend on the state of their expectations regarding others' inclination to make honest dealings. Thus, assuming that P stands for the proportion of type 1 players in the population - and $(1-P)$ for the proportion of type 2 players - type 1 players will choose to behave honestly provided that they expect P to be at least equal to $1/2$. If P is assessed to be less than $1/2$, they will opt for cheating which will be universal practice in the society.

The main conclusion that emerges from the above modified AG is the following : for honest dealings to prevail *on a large scale* in an anonymous society, it is not sufficient that a significant majority of people deem honesty preferable to dishonesty but it must also be the case that these people feel confident that their bent for honesty is shared by many others too. Therefore, if there are many would-be honest agents who however believe that many people around them are not similarly given to honest urges, no honesty equilibrium will arise. In addition, an important result obtained under the simple AG continues to hold : the degree of mutual trust required to cause an actual display of honesty among the agents predisposed towards it is inversely related to the intensity of this predisposition. Finally, it bears emphasis that in the Modified Assurance Game honest behaviour is not necessarily precluded to arise even though P is (significantly) smaller than one. In other words, this model can account for the widely observed fact that there is a certain amount of fraud and economic crime in all successful market economies : regular crookery, *provided that it is kept within tolerable bounds* , does not prevent economies from thriving.

Now, the question is not only how, or more precisely under what conditions, honesty in economic transactions can be established, but also whether it can be sustained over time. The easiest case obtains when everyone in the society has a bent for honesty ($P=1$) and this fact is common knowledge. We then have a stable honesty equilibrium (of course, if $P=0$ and this is commonly known, we have a stable cheating equilibrium : everyone cheats and continues to cheat). The issue becomes much more complex as soon as one

assumes that P is comprised between zero and one. As pointed out by Dasgupta, to know which stationary (or steady-state) equilibrium is going to prevail in the long run (if at all the society gravitates towards a stationary equilibrium), we need more information about the dynamics of expectation formation, which clearly requires the support of detailed historical knowledge [Dasgupta, 1988 : 59]. In a dynamic setting, indeed, decision whether or not to act honestly requires continual reevaluation of the probability that others will also behave honestly based on concrete experiences in past rounds : not only do expectations affect honest behaviour, over time, honest behaviour affects expectations [Runge, 1984 : 170-171]. To illustrate the importance of the dynamic aspects of the (modified) Assurance Problem, let us consider the rather straightforward following scenario. Initially, P is high enough to incite type 1 players to give cooperation a try. The experiences of all agents are common knowledge so that expectations at each period adjust in the direction of the past period's average behaviour. Under these conditions, honest equilibrium behaviour is a stable expectation : a slight departure from honest equilibrium expectation will bring the expectation back to equilibrium [Dasgupta, 1988 : 58]. This is clearly an ideal situation where each agent knows what to expect of others in the relevant future.

Let us now continue to assume that type 1 players start by behaving honestly. However, people's experiences are no more common knowledge - information is imperfect because players are only aware of their own personal experiences (and perhaps also of that of neighbours and relatives) - and people's expectations are vulnerable to bad experiences that prove honesty to be too costly a strategy. In other words, if type 1 players have an uninterrupted run of bad experiences (say, during x consecutive transactions), they turn cheaters²⁴. This will actually be the case for a number of them. Other type 1 players will have mostly good experiences and will therefore remain cooperators. On the other hand, defectors remain defectors. In these circumstances, the proportion of defectors in the population rises, thereby increasing the probability

24 In the words of Hume : "Your example both pushes me forward in this [defection] way by imitation, and also affords me a new reason for any breach of equity, by shewing me, that I should be the cully of my integrity, if I alone should impose on myself a severe restraint amidst the licentiousness of others" [Hume, 1740 : Book III, Part II, Sect. VII, 535].

that cooperators meet defectors and decide to free ride following the disappointment of their expectations. Trust may thus gradually unravel, leaving ultimately no cooperator in the society. In the above example, the kind of trust exhibited by (would-be) honest agents reflects an attitude of initial openness to evidence, these agents acting *as if* they trusted the others, at least until more stable beliefs can be established on the basis of further information [see Gambetta, 1988 : 234]. In other words, trust corresponds to an attitude of initial predisposition to honesty subject to revision over time depending upon the degree of fulfillment of expectations. In this case, there is evidently no a priori assurance that honesty is sustainable in the long term even if a majority of agents are honest to start with.

Fortunately, this scenario is not the only one that can be imagined. Alternative processes of expectation formation can possibly avoid the gradual unravelling of trust. This could happen, for instance, if cheaters feel guilty to continuously cheat amidst a large number of honest dealers, or if would-be honest agents who have turned cheaters after a run of bad experience are ready to start again behaving honestly after a run of good experience (in the latter case, we need to know the precise mechanism of expectation formation to determine whether honest behaviour is a stable equilibrium). On the other hand, additional possibilities for sustaining honesty arise when the payoff structure of the game is allowed to be modified. For example, the unravelling of trust and the erosion of honest practices can be avoided if honest agents feel vengeful enough and are able to punish defectors at low cost to themselves. Protection of trust is still better guaranteed if honest agents punish not only defectors who have harmed them but also those who have been found to harm other people with whom they somehow identify.

1.4.3. The essential role of generalized morality

From the foregoing discussion, it is apparent that honesty is especially likely to be established and sustained on a significant scale if (1°) a large number of people have a preference for honesty; (2°) they also have sufficient trust in others' predisposition towards honesty; (3°) their bent for honesty is strong enough not to be easily discouraged by bad experiences while it is easily reinforced by good

experiences; (4°) cheaters are subject to strong guilt feelings when they are free riders among many honest dealers; and/or (5°) honest people are willing to sanction breaches of honesty conventions even when their *own* interests have not been harmed by the observed breach (and despite the fact that private sanctioning activities will probably not bring them any direct reward in the future). Note incidentally that conditions (4) and (5) imply that the structure of the modified AG depicted in Figure 2 is being altered. What we shall argue now is that the fulfillment of these conditions largely depends on the prevalence of moral (other-regarding) norms in the society.

Norms are expectations about one's own action and/or that of others which express what action is right or what action is wrong [Coleman, 1987 : 135]. The concept suggests a standard of conduct which people believe they ought to follow lest they should expose themselves to some way of sanctioning or unpleasant experience. Obedience of the norm will occur when the sanctions or discomfort are sufficiently great and sufficiently certain to make disobedience less immediately attractive than obedience [Coleman, 1987 : 141-142]. For patterns of behaviour to be sustained by norms, a society (and the underlying social consensus) must therefore exist to impose sanctions on norm violators. This can be done through a central agency acting as an external norm-enforcer (see *supra*), through agents inflicting sanctions upon one another in a decentralized manner, or via a self-policing mechanism. Nonetheless, the first two solutions are fraught with serious problems. As far as the first one is concerned, we need to repeat Buchanan's point that life in society would be extremely costly and difficult if a great many aspects of social intercourse were not organized anarchistically, especially so if people do not have much respect for law (see *supra*). Further, it must be reckoned that without a climate of expectations supportive of cooperation, even the most draconian enforcement measures may fail to produce public goods, including trust [Runge, 1984 : 172]. The practicability of the second solution is obviously much greater in small groups where interactions among individuals are somewhat close and continuous (and where reputation loss is an effective threat) than in many-person settings where relationships are largely anonymous and where private sanctioning activities are certain to bring no future reward to the punishing agent. We are therefore left with the

third solution as a practicable way of solving the problem of honesty in market economies. A self-policing mechanism obtains when external monitoring and sanctioning devices (whether formal or informal) can be actually dispensed with. *Moral* norms, understood as rules that are at least partly internalized by the agents (thereby forming, in Freudian terms, their *superego*) and prompt them to take others' interests into account, provide such a mechanism²⁵.

Internalization of standards may be said to arise when an individual actually conforms because of a personal attitude about the act itself, that is, when conformity becomes a motive of its own because it is *intrinsically* rewarding or because deviation is *intrinsically* costly [Weber, 1971 : 22-23; Opp, 1979 : 777, 792; 1982 : 146; Jones, 1984 : 89; Taylor, 1987 : 13]. Hence "internalization refers to the aspect of the process of socialization through which attitudes, values, and behaviour patterns come to be maintained even in the absence of external rewards or punishments" [Jones, 1984 : 89-90; see also Aronfreed, 1968, 1969, 1970 : 104; Bergsten, 1985 : 115]. As a result, moral norms are followed even when violation would be undetected, and therefore unsanctioned, because the moral act - which appears to be in conflict with the immediate or direct interests of the actor himself - is valued for its own sake [Griffith and Goldfarb, 1988 : 22; Elster, 1989b : 104]²⁶. Now, an important lesson from developmental psychology is that moral behaviour and the ability to empathize emerge hand-in-hand with the maturation of specific emotional competencies²⁷. In this maturation process,

25 A person may be considered to face a moral decision whenever the welfare of one or several other persons potentially depends upon his actions [Schwartz, 1970 : 128].

26 Our approach to moral norms is thus radically different from the rational choice approach adopted by Vanberg. For him, indeed, if moral norms help solve PD problems, they are used strategically by the actors. More precisely, if people stick to such norms, it is only because it is difficult to identify situations in which it would not be detrimental to violate them (which happens when violation is undetected) or because of the risk of misidentifying such situations. Given imperfect information, moral routines are therefore rational and morality can be viewed as an "efficient behavioral technology" [Vanberg, 1988 : 3, 21-30]. Quite revealingly, Vanberg has dismissed the true role of emotions in the process of internalization of moral norms, thereby negating the genuine nature of this process. Thus, he writes that "internal sanctions cannot be considered an autonomous, independent source of moral enforcement. They are a source that ultimately derives from, and ultimately remains dependent on, the direct or indirect experience of external enforcement" [ibidem : 31].

27 In psychology, empathy denotes "an individual's affective experience when it is elicited by social cues which transmit information about the corresponding affective experience of another person"

identification obviously plays a crucial role since a failure to follow the standards set (consciously or not) by reference persons is bound to generate the painful feeling that one is unable to meet their expectations and, thereby, to deserve their love or respect. Thus, the principal claim of Kagan (1984) is that moral norms are actually supported by a limited number of simple, highly uniform emotional capacities. According to him, the main motivating force behind moral behaviour is the desire to avoid feelings of guilt and shame which are themselves the combined outcome of unpleasant emotions (anxiety, empathy, responsibility, fatigue/ennui, uncertainty)²⁸. 'Bad' or unpleasant feelings stirred by violations of the prevailing moral norms are the ingredients of a 'tortured conscience' which tend to deter many people from breaking these norms. Moreover, as found in numerous experiments, subjects induced to commit some transgression (or to believe that they have transgressed) are more likely than nontransgressors to engage in altruistic or compensatory behaviour. This is apparently because they are eager to repair their self-conception or self-presentation so as to convince themselves as well as others of their moral worthiness [see Shott, 1979 : 1327].

Notice that, in the above scheme of analysis, emotions or passions have a positive role to play in society. This is at variance with the position adopted by Adam Smith in *The Theory of Moral Sentiments* : there, we are told that passions (fear and anger on the one hand, and "the love of ease, of pleasure, of applause, and of many other selfish gratifications" on the other hand) are so many drives that are apt to mislead man into mischievous actions while their control enables him "upon all occasions to act according to the dictates of prudence, of justice, and of proper benevolence" [Smith, 1759 : Part VI, Sect. III, 238]. What Smith appears to believe is that, when man

[Aronfreed, 1970 : 107]. It refers to "vicarious emotional experience" [Shott, 1979 : 1328]. As initially pointed out by Adam Smith (1759), empathy (called sympathy) can be of two sorts according to whether one's emotion arises from the emotion one observes in another (it thus consists of feeling the emotion *the other person* feels) or from the emotion one would feel in another's situation [Shott, *ibidem*]. In fact, the concept has been defined for the first time by David Hume (1740). See *infra*, for more precise references.

28 "When a person knows he is responsible for an action that harms others, but no one else knows it, he feels guilt. If others do know, he feels both guilt and shame. If others wrongly believe he has harmed another, he feels only shame" [Frank, 1988 : 153]. The reader will find a good summary account of Kagan's theory in chapter 8 of the book of Robert Frank.

reasons coldly, he can think of the long-term or of the social consequences of his behaviour (at least if he is a 'wise' man) while, on the contrary, when he is given to the urgent drives of passions, he is unable to see beyond his immediate short-term interests and he may thus be sometimes seduced "to violate all the rules which he himself, in all his sober and cool hours, approves of" [ibidem : 237]. What we argue instead, following a line suggested by Frank (1988), is just the opposite : emotions are susceptible of leading people, almost unconsciously, to overcome the temptation to give in to short-term considerations and to therefore act in accordance with their long-term interests.

From the above discussion, it is evident that inculcation of moral norms involves much more than purely cognitive learning. This is particularly true of primary socialization which an individual undergoes in childhood since it takes place under circumstances that are highly charged emotionally [Berger and Luckmann, 1967 : 149-157]. Note carefully that primary socialization (henceforth called PS) creates in the child's consciousness a progressive abstraction from the roles and attitudes of *concrete* significant others (usually the parents) to roles and attitudes *in general*, implying that the child becomes able to identify "with a generality of others, that is, with a society" [ibidem : 152-153]. This is an important aspect insofar as any moral rule includes an element of conceptual generality that involves the capacity to recognize the claims of others and to impose such rules both on oneself and on others similarly situated [Griffith and Goldfarb, 1988 : 22-23].

Moreover, for generalized morality to be a social capital capable of sustaining order in the marketplace, it is essential that concern for others or ability to see things from another's viewpoint be based on identity or loyalty feelings towards a large reference group actually encompassing all the relevant market transactions. This is precisely the condition which Granovetter does not think it possible to satisfy when he contends that norms of limited rather than generalized morality can tame fraud and deceit : in his own words, networks of relations, rather than institutional arrangements or generalized morality, "are the structure that fulfills the function of sustaining order" [Granovetter, 1985 : 491]. However, the ability to recognize the claim of a large generality of others is clearly present in the Christian ethical principle according to which we ought not to do to

other people what we would not like them to do to us; or in the Kantian generalization principle according to which we ought to abstain from any action that would threaten to disrupt social order were everybody to undertake it (an action is morally possible only if it can be universalized without self-contradiction).

The same ability to put the 'other' on a similar footing with oneself seems to have characterized classical republicanism, a doctrine based upon the notion of a well-ordered republic. According to Skinner, the social ethos of Calvinism can be actually seen to constitute a special case of classical republicanism [Skinner, 1974]. If this view is accepted, it might then be maintained that "it was not a specifically Calvinist or Puritan work ethic which encouraged economic take-off in the Protestant cities of the seventeenth century, or Christianity itself in the medieval cities of north and central Italy, but the secular ethic of classical republicanism" [Pagden, 1988 : 139]. The reason why this doctrine was so congenial to market expansion appears to lie in its emphasis on public good over private interest which "enabled men from different kin groups, and hence from different societies, to trust each other", thus making possible the operation of a 'commercial society'. Such a perspective invites us to pay much attention to Weber's little known thesis that "the great achievement of the ethical religions" had been "to shatter the fetters of the kin", an outcome which could not materialize in China where "the fetters of the kinship group were never shattered" owing to the absence of a similar ideology [Weber, 1951 : 237 - quoted from Pagden, 1988 : 139].

There is yet another fine observation by Weber that is worth mentioning here because it also allows us to link up the above conclusion about the achievement of generalized morality in Western Europe in modern times with what we have said earlier about the limited domain of trust in traditional societies. Weber's point is indeed that the universal diffusion of unscrupulousness in the pursuit of self-interest was far more common in precapitalist societies than in their more competitive capitalist counterparts [Weber, 1970 - quoted from Gambetta, 1988 : 215-216]. While normative behaviour based on the principle of reciprocity (I cannot expect others to deal honestly with me unless I am honest with them) was restricted to close networks of kinship and other social relations in the former societies, security of expectation or assurance

has been provided by the pervasive influence of a code of generalized morality in the latter. What deserves to be emphasized is that, when such a code is provided or supported by an universal religion, the generality of others to which it applies is vast. This avoids the major shortcoming of state-driven consensus ideologies which are often based on patriotic identification and on projection of aggression against outsiders, thereby resulting in a restriction of the market size to national boundaries. Societies led by these ideologies tend to be "not merely bureaucratized and heavily internally-policed but also paranoid in their foreign relations and militaristic to a high degree" [Badcock, 1986 : 182]²⁹.

1.4.4. The need for reinforcement processes

We have seen above that PS plays a crucial role in the norm generation process. Nevertheless, moral norms are subject to erosion : they form a 'social capital' [Coleman, 1988] and, as such, they are liable to depreciation. They therefore need more or less continuous reinforcement to be maintained. One such kind of reinforcement consists of what Berger and Luckmann have called secondary socialization (SS). SS is "the acquisition of role-specific knowledge, the roles being directly or indirectly rooted in the division of labour" [Berger and Luckmann, 1966 : 158]. Contrary to PS which cannot take place without an emotionally charged identification of the child with his significant others, most SS "can dispense with this kind of identification and proceed effectively with only the amount of mutual identification that enters into any communication between human beings" (it is necessary to love one's mother, but not one's teacher). In PS, the child does not apprehend his significant others as institutional functionaries, but as mediators of the only conceivable reality : in other words, he internalizes the world of his parents not as one of many possible worlds, not as the world appertaining to a specific institutional context, but as *the world tout court* [ibidem : 154, 161]. This explains why the world internalized in PS is "so much more firmly entrenched in consciousness than worlds internalized in secondary socializations". As a matter of fact, since SS's main function is to

²⁹ It is true that the Third Reich has appealed to religious feelings ('Got mit uns') but this was obviously a perverse manipulation of the Christian doctrine.

transmit specific knowledge (in schools, in factories, etc.), the social interaction between teachers and learners can be formalized and the former are in principle interchangeable [ibidem : 154, 162]. Note that reinforcement of moral norms is particularly effective when church attendance ensures that people are continuously exposed to a moral discourse which repeatedly emphasizes the same values as they were taught by their PS' s agents during their childhood. The church (both catholic and protestant) obviously played a central role in the process of moral norm generation and maintenance throughout modern Western history. Its impact was all the more significant as (1°) it promised a considerable reward (an eternal life of absolute happiness) for all those who were ready to incur personal sacrifices by behaving in other-regarding ways; and (2°) monitoring costs could be brought to a minimum insofar as God was thought to act as an impartial and free monitoring agent. In the words of Frank :

"Teaching moral values was once the nearly exclusive province of organized religion. The church was uniquely well equipped to perform this task because it had a ready answer to the question. 'Why shouldn't I cheat when no one is looking ?' Indeed, for the religious person, this question does not even arise, for God is *always* looking" [Frank, 1988 : 250].

Moral norm reinforcement must also come from the state or the rulers. Arrow, one of the first (modern) economists to have stressed in an articulate way the essential contribution of norms of social behaviour (including ethical principles and moral codes) to the production of trust in the economic life of market societies, has written that :

"... ethical elements enter in some measure into every contract; without them, no market could function. There is an element of trust in every transaction; ... It is not adequate to argue that there are enforcement mechanisms, such as police and the courts; these are themselves services bought and sold, and it has to be asked why they will in fact do what they have contracted to do" [Arrow, 1973 : 24 - quoted from Williamson, 1985 : 405; see also Phelps, 1975].^{30 31}

30 Elsewhere, Arrow furthermore notes : "In the absence of trust, it would become very costly to arrange for alternative sanctions and guarantees, and many opportunities for mutually beneficial cooperation would have to be foregone" [Arrow, 1971 : 22].

The last point made by Arrow is important : it suggests that ethical principles or generalized morality are required to solve the aforementioned problem of honesty and social dedication among those in charge of the enforcement of formal rules prescribed by institutions. When other-regarding norms have a pervasive influence among the social and political elite, social order is indeed more likely to come about and to be maintained in an enlarged sphere of human interactions. Contrary to the New Political Economy of development (NPE) which assumes that people in political positions are exclusively motivated by individual self-interest [see Toye, 1991], history actually abounds in examples showing the incidence of such norms. Thus, just to give one example, during the eighteenth century the Russian nobility was deeply imbued with a high sense of its moral duty vis-a-vis the state, the public in general, and the disadvantaged groups in particular. It is interesting to note that a well-known specialist of Imperial Russia has attributed this moral inclination of the elite to the diffusion of Western education :

"Western education, especially the new teaching methods that gave priority to the moral and cultural responsibility of the individual, helped shape the ideals of the new elite : devotion to the life of the mind and the service of the people ... The decree of February 18, 1762, whereby Peter II freed the nobility from the obligation to serve the state, enabled nobles who had once bestowed their loyalty upon the state to turn instead to the people ... The upshot of these changes was that the cultivated elite, or at any rate its most advanced and liberal members, began to focus their efforts on a new task : that of serving the people as moral guides and spiritual and cultural teachers" [Raeff, 1984 : 108-109].

Morality and a high sense of public purpose among the rulers are important ingredients of a well-functioning market order not only because they ensure that rules will be properly enforced, but also because of the positive demonstration effect exercised by leaders with whom people have perhaps come to strongly identify. When

31 As pointed out by Dasgupta, however, "a minimal non-congruence between individual and moral values is necessary for the problem of trust to *be* a problem". This is because the problem of trust, which involves *expectations* about what others will do, would not arise "if we were all hopelessly moral, always doing what we said we would do in the circumstances in which we said we would do it" [Dasgupta, 1988 : 53].

the public attitude of these leaders exerts a significant impact on people's behaviour, fewer laws are needed and, to the extent that they exist to regulate behaviour, people are more likely to comply; consequently, less repressive or sanctioning resources are required to ensure their enforceability. As a matter of fact, "social perceptions of what are legitimate behaviours are *partly* influenced by the legality of the matter" [Bhatia and Drèze, 1990 : chap. 3]³² and the legal character conferred upon rules is more easily recognized by the people when they can observe a broad consistency between the type of behaviour sanctioned by legal rules and that displayed by the political elite. Thus, for example, it can perhaps be contended (even though this has become quite out of fashion in those days when Maoist China tends to be painted all in black) that one of the most outstanding achievements of the modern Chinese revolution has lain in the ability of the Communist leadership to put an end to corruption and petty politics as well as to diffuse other-regarding norms and new models of social behaviour congenial to public progress (this, unfortunately, ceased to be true when the Cultural Revolution was started) among the population.

1.4.5. Moral norms, civil society and equity

Emphasis on the potential role of the state as a norm-reinforcing agency ought not to deflect our attention from the equally important role that a living and watchful civil society must play to support honest behaviour and to banish economic crime. Quite obviously, the contribution of civil society to norm maintenance is especially significant when the state is wanting in this respect and when its agents are perhaps themselves involved in various sorts of illegal or doubtful practices. In terms of our scheme of analysis, a civil society helps to back trust whenever there is a sufficient number of citizens who feel vengeful enough to work towards exposing publicly the illegal acts or malpractices of both private and state agents, and towards bringing pressure to sanction them even though such actions entail significant costs to themselves (by

32 This proposition can be seen as an extension of the result obtained in social psychology according to which a person's perceptions of what is legitimate behaviour can be altered by the others' report of their perceptions [see Coleman, 1987 : 142].

denouncing economic crimes they produce a public good). Insofar as the state cannot be relied upon to (re)activate norms of honesty, either because it is itself corrupt or because it has no moral clout or ideological persuasive powers, the existence of an active civil society imbued with moral norms appears as an important condition of economic growth.

Our argument, it must be noted, does not imply that, *at every stage of market development*, political democracy is absolutely necessary for honest behaviour to be reasonably well maintained. Nevertheless, to the extent that the ability of the state to act as a norm supplier (through charismatic leadership and/or through organized ideological persuasion) is subject to erosion over time -leaders pass away and ideologies tend to wear themselves out -, the argument implies that *in the long run* market expansion and economic growth must be paralleled by the development of civil society and the associated freedoms of political expression.

There is yet another point that needs to be clarified. The fact that a society has imbibed moral norms (as previously defined) to which its members more or less readily obey does not mean that it is fair or equitable. Two examples suffice to show that generalized morality may well go hand-in-hand with a large extent of inequality. Thus, in a market society, an important role of moral norms is to teach respect for private property rights, even though distribution of assets may be very unequal. Another function of such norms often consists of teaching members of labouring classes to be "good workers", that is, to work hard, to come to work on time, to abstain from drinking, and to avoid all sorts of opportunistic behaviour (illness-faking, labour-shirking, output underreporting and theft, asset mismanagement, etc.). Clearly, these moral messages may be viewed as an ideological weaponry used by the rich to keep the poor in their place and to enhance their own interests. In unequal societies, as it is well-known, dominant ideologies typically conceal the masters' interests under the cover of the 'public good'. Therefore, when they are asked to think and behave in terms of the society's (or nation's) interests, the poor are often manipulated by the powerful which are eager to ensure compliance with the rules and values that best suit their (dominant) class-based interests. That ideological manipulation can be effective is evident from a lot of historical evidence. Thus, just to take one

example from 19th century-England, workers who attended philanthropic religious (protestant) schools known as the Sunday Schools have been found to be more productive and more disciplined than those who did not go through such an experience [Howe, 1984 : 280].

1.4.6. Insights from experimental (social) psychology

That moral norms are at work in modern market societies is evident not only from day-to-day experience and historical evidence but also from carefully framed experiments in social psychology. In a general way, experimental research indicates that individuals do not exploit free riding opportunities in the manner predicted by the PD paradigm, especially because of the interaction between their perception of fairness and their own concern for fairness [see, e.g., Rapoport and Chammah, 1965; Eiser, 1978; Marwell and Ames, 1979, 1980, 1981; Akerlof, 1983; Roth, 1988; Frank, 1988 : chap. 9 and 11]. Particularly relevant to our discussion of generalized morality is the fact that reciprocal altruism (altruistic acts performed in the expectation of a future personal gain) and tit-for-tat cannot explain cooperation in many experiments simulating PD because the games are played only once or defection simply cannot be detected. In some experiments, a significant statistical correlation was actually found to exist between the amount contributed by the subjects to the provision of a public good and the level of contribution expected of others [Marwell and Ames, 1979 : 1356]. When there is near unanimity of thought regarding what is fair behaviour (for instance, a fair contribution to the provision of a public good), implying that people hold common subjective expectations about the behaviour of others, free riding appears to be the exception rather than the rule [Runge, 1984 : 173-175].

With specific reference to the problem of honesty, field experiments conducted by Hornstein and his colleagues are especially illuminating ³³. They indeed revealed that, in what is typically a one-shot game, an astonishingly high 45 percent of 'lost' wallets were returned completely intact to their owner in New York city (during the spring of 1968). Moreover, Horstein et al. were able to

33 See Frank, 1988 : 213-216, for further details and for the references.

show that the return rate was significantly higher when the subjects of the experiments were exposed to a positive attitude of benevolence on the part of a third party. The interpretation offered by the authors is that the third party served as a role model for the subjects. A related lesson is that feelings or sentiments, not reason, motivate human decisions in situations where our own acts have a significant influence on others' wellbeing : exposure to different kinds of persons or acts (benevolent or malevolent) evokes particular emotions which drive people to behave in certain ways [Frank, 1988 : 216]. Another experiment which confirms the important function of role models (or the fact that altruism or morality is encouraged by the observation of it) is that reported by Singer (1973). A helpless-looking woman was standing near a car with a flat tyre along the road. It was found that drivers passing this woman were more likely to come to her rescue when they previously had the opportunity to observe helping behaviours in a similar type of situation.

Such experiments would seem to suggest that role models serve as a signalling device reminding people that there are honest people around. The result would be to enhance people's trust in others' predisposition towards fair dealings. Yet, this is to neglect the emotional dimension rightly emphasized by Frank. It is actually more satisfactory to view role models as privileged agents who reactivate emotional capacities associated with PS processes. Moreover, if one still wants to cling to the rational egoist's model of the economists, one may consider that role models have the effect of increasing - or restoring to previous levels - the values of the payoffs attached by people to the HH outcome. Note carefully, however, that contrary to a well-established tradition in economic theorizing, this latter interpretation assumes that individual preferences are *not* stable. It also enables us to better understand the potential role of political leaders in diffusing or reinforcing norms of honesty (see supra). Political leaders now appear as norm reactivators. When they publicly behave in honest ways, they naturally arouse in people the emotions associated with that type of behaviour provided, of course, that people have sufficiently strong feelings of identification with them. Thus, for example, Chinese leaders appearing in Mao suits and living according to sober fashions both at work and at home motivate people to earn honest incomes. On the contrary, many African leaders who display

considerable amounts of wealth fraudulently acquired tend to drive people to cheat in private dealings, to evade taxes and to embezzle public funds.

1.4.7. Conclusion

It is now the time to sum up the whole argument. We have stated a series of five conditions that tend to make honest behaviour more likely to be established and sustained (especially so if they are all simultaneously satisfied). What has been shown is that the prevalence of moral norms in a society favours the emergence of these five conditions. Thus, when such norms (which are by definition other-regarding and largely internalized) are well-established, people tend (1°) to adopt the others' viewpoint when making decisions that may harm others' interests and to feel internally rewarded when behaving in other-regarding ways; (2°) to be confident that others will abide by the same code of good behaviour as themselves; (3°) to cling to this code even when they had unpleasant experiences in which they were 'suckers'; (4°) to feel guilty after they have (perhaps mistakenly) deviated from the moral rule; (5°) to feel vengeful and willing to punish detectable free riders even when their own interests have not been directly harmed or threatened.

The fact that moral norms are typically inculcated in early childhood when they are strongly associated with the maturation of specific emotional competencies is important with respect to almost all the aforementioned points. In particular, this fact helps resolve the monitoring problem mentioned by Elster and Taylor. Indeed, assuming that dishonesty can be detected at comparatively low cost, there remains the question as to what incentives individuals have to monitor dealings and impose sanctions on defectors. Indeed, monitoring and punishment activities are public goods the production of which involves the well-known free rider problem. In the words of Elster, "Punishment almost invariably is costly to the punisher, while the benefits from punishment are diffusively distributed over the members. It is, in fact, a public good : to provide it, one would need second-order selective incentives which would however run into a third-order free-rider problem" [Elster, 1989a : 41; see also Taylor, 1987 : 30]. The problem may nevertheless disappear as soon as one assumes, in the tradition of Smith's *Theory of the Moral Sentiments* (1759) that rational assessment is merely one

of many inputs into the psychological reward mechanism and "rational calculations often lose out to other, more basic forms of reinforcement" [Frank, 1988 : 197]. Thus, vengefulness is an *emotion* that may easily drive persons to punish defectors even at a significant positive (short term) cost to themselves, particularly so if they are deeply (morally) shocked. Emotions can indeed be viewed as commitment devices which have the effect of breaking the tight link between utility-yielding goals and the choice of action [Sen, 1985; Frank, 1988].

It is also useful to recall that the monitoring problem does not even arise if moral rules are backed by religious beliefs according to which God knows everything about all our actions (and thoughts). Under these circumstances, honesty can be sustained even in the presence of high costs of fraud detection since a free monitoring device is actually available. It may be further noted that, insofar as religious beliefs imply the hope that eternal life (or a better future life) will be accorded to all righteous people, the latter's expectations will be robust. In other words, believers continue to adhere to the moral code even though they have possibly been 'suckers' on repeated occasions (see the third point above). By continuing to behave morally despite unpleasant experiences, they may even be convinced that they deserve special attention from God. When such religious beliefs do not exist or are not shared by a significant majority of people, it is all the more important that moral norms are being regularly reinforced by other agents of SS or by role models (such as political leaders) lest they would gradually erode leading to a vicious circle of unravelling trust.

2. Some dynamic considerations about the emergence and erosion of moral norms

For largely impersonal exchanges to take place on a significant scale, a social consensus must exist in the society that ensures mutuality of agreement on fair behaviour in economic dealings as well as on the structure of basic (property) rights which, as pointed out by Buchanan, actually define the entities who enter negotiations [Buchanan, 1975 : 18]. Such a social consensus or mutuality of agreement must be based, at least partly, on moral norms of a generalized kind. These norms fulfil the function of imposing

"'impartial' constraints on the pursuit of individual interests, constraints which are socially desirable in serving interests that individuals share as members of a social community" [Vanberg, 1988 : 3]. Now, to have a theory of norms, we should know how they arise, how they are maintained, how they change over time (how they vanish and how they are displaced by other norms), and whether and how they can be manipulated, all questions which are essentially unanswered to this date. Clearly, these are questions of considerable complexity and around which there are likely to be enduring debate and heated controversies for a long time to come. Depending on the type of answer provided, different approaches will be suggested to central problems such as the one raised in this paper.

2.1. Emergence of moral norms

2.1.1. Insights from eighteenth-century Scottish philosophy

The enormous stake involved in the choice of approach to the dynamics of norms can be illustrated by considering the issue of norm emergence. Two radically opposite views are possible. The first of these views is profoundly optimistic and is grounded in the well-known evolutionary approach to institutional change. In a pioneer attempt made several centuries ago, David Hume has proposed a remarkably articulate formulation of the evolutionary theory when he tried to explain the process of emergence of social order in a market economy.

Hume actually believed that public good cannot be established unless individuals are driven not only by selfish passions but also by a 'moral sense' (a view inherited from Hutcheson). Yet moral behaviour depends upon rational considerations and, in an age of cultural and scientific progress, individuals cannot fail to see the necessity for private property, law, and government. Far from contributing to corruption and degeneracy, the development of 'commercial society' can be expected to pave the way for morality, justice, and good government insofar as it goes hand in hand with moral and political progress [McNally, 1988 : 167-168]. At this point, Hume's ideas as contained in his *Treatise of Human Nature* (1740) deserve to be detailed more fully. This is done below by

quoting at some length the excellent interpretative analysis recently proposed by McNally :

"In the *Treatise* Hume accepts that self-love is the origin of law and government. Nevertheless, since 'the self-love of one person is naturally contrary to that of another', competing and conflicting self-interested passions must 'adjust themselves after such a manner as to concur in some system of conduct and behaviour'. After individuals discover that unbridled selfishness incapacitates them for society, 'they are naturally induc'd to lay themselves under the restraint of such rules, as may render their commerce more safe and commodious'. As rules of social regulation are developed, they become customary and are passed on to future generations. Eventually people come to cherish the rules which hold society together. They develop a sense of *sympathy* for those who observe social norms. Moreover, they come to model their behaviour in such a way as to be worthy of the sympathy and approval of others. Through custom and education, then, individuals develop a love of praise and a fear of blame. For Hume, moral principles are not innate or providentially inspired. They are practical rules developed in the course of living in society; morality refers to the norms and conventions which prevail there. These norms and conventions can be said to enter into the commonsense view of the world most individuals acquire ... [Sympathy] is a capacity derived from experience and modified as the customary rules of social life change. Sympathy has a rational dimension; it derives from the individual's understanding of the necessity for norms of conduct and behaviour. Thus, although 'self-interest is the original motive to the establishment of justice', as society develops it becomes the case that 'a sympathy with public interest is the source of the moral approbation, which attends that virtue' " [McNally, 1988 : 168-169].

For Hume, property, law, and government are therefore the outcome of the evolution of human society³⁴. Through the experience derived from their mutual interactions in the (nascent)

34 The following excerpt from Hume's *Treatise* shows how much articulate his evolutionary argument was :

"... and when each individual perceives the same sense of interest in all his fellows, he immediately performs his part of any contract, as being assur'd that they will not be wanting in theirs. All of them, by concert, enter into a scheme of actions, calculated for common benefit, and agree to be true to their words; nor is there anything requisite to form this concert or convention, but that every one have a sense of interest in the faithful fulfilling of engagements, and express that sense to other members of the society. This immediately causes that interest to operate upon them; and interest is the *first* obligation to the performance of promises.

Afterwards a sentiment of morals concurs with interest, and becomes a new obligation upon mankind" [Hume, 1740 : Book III, Part II, Sect. V, 522-523].

market economy, individuals come to see the necessity of, and to accept the constraints imposed by, those institutions and conventions which preserve the social order. Men "cannot change their natures. All they can do is to change their situation ..." and "lay themselves under the necessity of observing the laws of justice and equity, notwithstanding their violent propension to prefer contiguous [short-term] to remote [gains]" [Hume, 1740 : Book III, Part II, Sect. VII, 537]. 'Public utility' becomes the basis of moral decision and, as Hume put it in his *Enquiry Concerning the Principles of Morals*, "every-thing which contributes to the happiness of society recommends itself directly to our approbation and good will" [quoted from McNally, 1988 : 169]. The main function of rules or norms is to serve as an assurance device : "this experience assures us still more, that the sense of interest has become common to all our fellows, and gives us a confidence of the future regularity of their conduct : And 'tis only on the expectation of this, that our moderation and abstinence are founded" [Hume, 1740 : Book III, Part II, Sect. II, 490]. It may be further noted that Hume's analysis allows for internalized norms insofar as he holds that social rules are passed on to successive generations through education and customs.

A radically opposed and much less optimistic view than the one expressed by Hume is the view that tends to consider that moral norms of the required kind must pre-exist in the society before a market economy can successfully develop : here, generalized morality appears as a social pre-condition in the strict sense of the term. Thus, for example, Edmund Burke held the opinion that "the expansion of commerce depended itself on the *prior* existence of 'manners' and 'civilization' and on what he called 'natural protecting principles' grounded in the 'spirit of a gentleman' and 'the spirit of religion' [Hirschman, 1987 : 160, referring to Burke, 1790 : 115]. Basically the same stance has been taken up by Talcott Parsons for whom "behind utilitarian markets stand an authentic society, a society that is *prior to* and regulates utilitarian contracts between individuals" [Mayhew, 1984 : 1289 - our emphasis]. If this view is followed, therefore, the market economy may not be expected to gradually and unconsciously generate the social conditions upon which its viable existence rests. These conditions must be present in the society before the market economy can arise. How they are in fact produced is an immensely complex question

that cannot be tackled without the assistance of comprehensive and well-articulate historical knowledge.

That Adam Smith inclined towards the second rather than the first of the above views comes somewhat as a surprise. This is all the more so as, in his *Theory of Moral Sentiments* (1759), Smith laid much stress on the fact that all individuals have a capacity for sympathy with others, that is, they are all able, by an act of imagination, to adopt the others' viewpoint and to understand their reactions [see, in particular, Part III, chap. I; see also Hume, 1740 : Book II, Part II, Sect. VII and Part III, Sect. VI]. For him, "this ability to exchange experiences through an imaginary operation based upon sympathetic identification with others is the fundamental basis of society" : indeed, it enables actors to adopt the standpoint of an *impartial spectator* who observes the situation dispassionately, and to react to their experiences in a way that takes others' interests into account, at least to some degree [McNally, 1988 : 182; Brown, 1988 : 67]. In effect, the standards of an imagined impartial spectator may be said to represent the moral code which prevails within a given society : they supply a system of cultural restraints in which moral checks upon the passion of self-love can be embedded [McNally, 1988 : 183; Brown, 1988 : 61-62].³⁵

Given the operation of these cultural restraints, one would have expected Smith to adopt the same position as his friend Hume concerning the production of the social conditions of the market. This was not so, however. Smith actually entertained the fear that moral norms associated with sympathy, instead of being reinforced in the course of market development, would be seriously attacked by the 'spirit of commerce'. As is evident from *The Wealth of Nations*, he was deeply distrustful of the merchants and manufacturers whom he blamed for being exclusively geared towards advancing their own short term selfish interests in whichever way possible. His conclusion was that "the only guarantee that commercial relations will not shred the moral fabric of society is the creation of an institutional framework which sets bounds upon their self-

³⁵ Smith actually believed that the capacity to sympathize was especially noticeable among those occupying "the inferior and middling stations of life". This is because, being obliged to be prudent, they had to learn that the pursuit of self-interest must be held within socially acceptable bounds [McNally, 1988 : 186].

interested action" [McNally, 1988 : 193]. This political task - the constitution and preservation of the moral basis of society - should be undertaken by a select group of virtuous men capable of following the moral ideals of conscience and embodying the civic habits necessary to political stability [ibidem : 192-208]. For Smith, therefore, the social order of the market must be 'fabricated' within the body politic so as to lay down the rules and set up the institutions susceptible of directing self-centered economic appetites into socially desirable channels. Moreover, the political arena must be insulated from the corrupting influence of the economic sphere since, contrary to what Hume believed, moral behaviour cannot be the outgrowth of the interplay of the utility considerations that dominate the economic life of a commercial society. Also worth noting is the fact that Smith stressed the role of the Church in producing and strengthening morality [Colclough, 1991]. The origin and nature of the rather voluntarist attitude of Adam Smith has been well captured by McNally :

"There can be little doubt that Smith's positive, albeit highly qualified, attitude towards commerce had important roots in the tradition of natural jurisprudence, which emphasized the conditions of the regular administration of justice rather than the achievement of civic virtue. Smith was decidedly pessimistic about the capacity for public virtue in commercial society. But he believed that commercial society could be organized in such a way as to bind men together in a system of sympathetic communication in which they would respect the principles of justice" [McNally, 1988 : 207].

2.1.2. Insights from game theory

Do we find in modern economic theorizing some support for one of the aforescribed views ? The answer is yes. Recent works in game theory and in the New Institutional Economics have indeed adopted the evolutionary approach of which Hume's analysis of the emergence of the social market order is actually a remarkable anticipation. The evolutionary approach, as applied to institutional phenomena, is based on the principle that rules regulating human action can evolve without conscious human design, and can maintain themselves without there being any formal machinery for enforcing them. Hayek, who must be credited for having re-actualized this approach (duly acknowledging his debt to Scottish philosophers of the eighteenth century, and to Hume in particular),

made the point that institutions and moral beliefs of a free society are the unintended consequences of a process of evolution [Hayek, 1960, 1979]. The conventions, or established patterns of behaviour, which create order in a market (free) society are supported by moral beliefs (people believe that they ought to keep to these conventions). Yet "there is no independent principle of justice that provides a rational basis for these beliefs" because "the belief that one ought to follow a convention is the product of the same process of evolution as the convention itself" [Sugden, 1989 : 87].

Two game-theoretical strands based on this approach are worth reviewing here. The first is an above-cited study by Axelrod (1984) in which cooperation in the form of a tit-for-tat strategy is shown to evolve out of the repeated interactions of individuals pursuing their private interests within the framework of a PD-structured situation (with an infinite horizon). In the interpretation offered by Axelrod, the spontaneous evolution of a cooperative equilibrium strategy takes place although in the beginning the players do not know whether they can trust each other : cooperation is seen to emerge because players accumulate knowledge directly relevant to their mutual interests and *learn* by trial-and-error that these interests can be best satisfied through cooperative behaviour. Axelrod's (simulation) experiment thus suggests that

"trust would be better understood as a result rather than a precondition of cooperation. Trust ... would consist in nothing more than trust in the success of previous cooperation. Cooperation could be triggered not by trust, but simply by a set of fortunate practices, random at first, and then selectively retained (with varying degrees of learning and intentionality)" [Gambetta, 1988 : 225].

There are several limitations and problems with Axelrod's view of evolution. First, the frame of reference is that of an infinitely repeated game in which agents closely interact with each other. His results seem therefore to apply better to small-group than to large-group settings. Second, as has been already pointed out, the cooperative solution is only one of the possible solutions of the game : in Gambetta's words, "the spontaneous evolution of a cooperative equilibrium among humans is only just as likely as that of a non-cooperative one, *unless some restriction is imposed on agents' belief* " [ibidem : 227 - our emphasis]. In actual fact, the tit-for-tat

strategy is inconceivable without at least some predisposition to trust :

" ... when the game has no history a cooperative first move is essential to set it on the right track, and *unconditional distrust could never be conceived as conducive to this* ... This problem may be circumvented by assuming the presence of uncertain beliefs and a random distribution which accommodates the probability of the right initial move being made and being 'correctly' interpreted. Yet there is no reason why the appropriate conditional beliefs should typically be the case, and the optimal move may be hard to come upon by accident (while we may not want to have to wait for it to come upon us). If it is true that humans are characterized by a lack of fine-tuning and a tendency to go to extremes, the assumption that trust will emerge naturally is singularly unjustified ... tit-for-tat can be an equilibrium only if both players believe the other will abide by it, otherwise other equilibria are just as possible and self-confirming. To show that trust is really not at stake, Axelrod should have shown that whatever the initial move and the succession of further moves, the game tends to converge on tit-for-tat. What he does do is express a powerful set of reasons why, *under certain conditions, ... a basic predisposition to trust can be perceived and adopted as a rational pursuit even by moderately forward-looking egoists*" [Gambetta, 227-228 - our emphasis].

Third, there is the simplification inherent in an analytical framework based on the assumption that each participant has only one strategy available to him, that is, where each participant in a game *is* a strategy. As a matter of fact, what Axelrod does is to exogenously impose a strategy on the players and then ask whether it is viable. To deal with situations where actors can choose between many strategies would of course be a very complex task.

An important deficiency of this research program is therefore that it leaves unexplained how the equilibrium cooperative strategy itself is selected and learned. To explain the spontaneous emergence of tit-for-tat or any other cooperative strategy, players should be explicitly allowed to *learn* from their experiences, that is, they should be "allowed to use the game as a discovery procedure where they gather information from other players' past moves to understand and possibly influence their own future moves" [Bianchi, 1990 : 16-17]. For this to be possible, "the game must be enlarged to make available a wider space of strategic options and possible solutions to the players"; learning from their errors, these players would then be able to develop a new set of rules involving cooperation "which, though out-of-equilibrium, may become a new

equilibrium once signalled, recognized and adopted" [ibidem : 17]³⁶. This being said, such an enlargement of the class of strategies from which actors can choose makes the problem very difficult to analyze. Hence Dasgupta's conclusion that repeated games need some form of 'friction' to generate predictable outcomes and that a form of 'friction' is precisely provided by moral codes (there are certain things that are 'not done' although they are feasible) [Dasgupta, 1988 : 70-71]. Such moral codes thus remain unexplained.

A second strand of thought concerned with explaining the spontaneous emergence of norms understood as established behavioural patterns deals explicitly with repeated games of the coordination or of the Chicken kinds [Lewis, 1969; Ullmann-Margalit, 1977; Schotter, 1981, 1983, 1986; Sugden, 1989]³⁷. The works involved are less relevant to our purpose than Axelrod's attempt insofar as they do not involve PD-structured situations. They are, however, important because they are especially suited to represent the evolutionary approach to (social) norms (where norms are thought of as noncooperative equilibrium solutions to recurrent coordination problems) and because an assurance game can be considered as a coordination game largely defined. Indeed, coordination games are typically games in which there are several equilibria. Yet, while in pure coordination games (as defined by Lewis), players are more or less indifferent between these various equilibria, in coordination games *sensu lato* one equilibrium is Pareto-superior to the other(s). Now, a convention³⁸ can start to

36 An analytical implication of this more dynamic approach involving learning processes is that a deviant move is not simply a mistake, but may be an experiment made by the players to try out new ways of dealing with the situation. As emphasized by Sugden, in the evolutionary approach the crucial mechanism is "the tendency for deviant play, if successful, to be repeated and imitated", and not the responses of rational players to the possibility of nonrational play as conceived in traditional game theory [Sugden, 1989 : 92].

37 Coordination games describe situations in which the players' main concern is to coordinate their behaviour in some way, and in which their interests coincide but not in an *a priori* obvious way [Bianchi, 1990 : 10]. The important feature of a 2-person Chicken game is that there are two equilibria and in each of these one player cooperates while the other defects. For a description of the Chicken game, see Taylor, 1987 : 35-49; Sugden, 1989 : 85.

38 A convention may be defined as an *evolutionarily stable strategy* (ESS), - that is, "a pattern of behaviour such that, if it is generally followed in the population, any small number of people who deviate from it will do less well than the others" - in a game that has several ESS's [Sugden, 1989 : 91]. Notice that evolutionary stability in this sense is a stronger requirement than Nash equilibrium.

evolve as soon as some people believe that other people are following it, thereby providing a focal or salient point. The crucial question is of course what gives rise to this initial belief. One important possibility is that some forms of coordination are more prominent than others, and people have a prior expectation of finding the most prominent ones. But, as emphasized by Sugden, "prominence is largely a matter of common experience" with the implication that "conventions may spread by analogy from one context to another" and one should expect "to find family relationships among conventions, and not just a chaos of arbitrary and unrelated rules" [Sugden, 1989 : 93-94].

There are two other interesting implications of Sugden's way of posing the coordination problem. First, inasmuch as conventions arise in an evolutionary way through common experience, the culture of the people concerned matters a great deal and it is impossible to understand their rules without knowing their particular history. The focus is no more on universal truths or rationally deduced unique equilibrium institutions (like in classical game theory), but on rules that can *work* in a given cultural setting. Such subtlety is not present in most evolutionary models where conventions or norms are purported to emerge spontaneously from the free interactions of independent non-socialized individuals, thus ignoring the crucial fact that, for an evolutionary game to be played, actors must be in total agreement not only about the rules of the game but also about a way to interpret them unambiguously. While the former condition refers to the existence of a social fabric prior to the unfolding of the game, the latter condition points to the existence of a common cultural patrimony. A second feature of Sugden's analysis that deserves to be stressed is that, since an inefficient convention may be more prominent than an efficient one, rules that emerge are not necessarily Pareto-efficient [ibidem : 94]. Further, if a less than efficient solution prevails, the shift to a more efficient one cannot happen spontaneously because of the presumably great stability of a convention (any violator stands to lose from not abiding by it). As pointed out by Bianchi, some active intervention from an external agency may be needed to effect a shift from a less to a more efficient rule or convention [Bianchi, 1990 : 11; in the same vein, see also Steuer, 1989].

The meaning of the above implications for the problem of trust is rather straightforward. In particular, one vexed issue is the question as to how one can hope trust to arise in a society that has a long experience of distrust (that is, in what eighteenth-century thinkers call a 'corrupt' society). Assuming that many people aspire to honesty-based conventions and just need to be reassured about others' preferences, an active intervention from an external agency (e.g. from the state) could apparently solve the problem as suggested by Bianchi. Things may not be so simple, however. Indeed, to succeed, such a solution requires that people have enough trust in the external agency, and this will in turn depend on the historical experience of their relation with it and the way they have interpreted that experience.

2.1.3. A final remark

Insofar as impersonal factor and product markets cannot conceivably develop if the appropriate kind of moral norms do not exist to assure transactors that they can safely deal with one another, the question as to how such markets arise from old patterns of personalized relationships is closely linked up with that of norm emergence. In fact, if we had available to us a solid explanation for the latter process, we would be in a position to simultaneously account for the rise of the modern market (given the presence of attractive trading opportunities and an eagerness to seize them on the part of a sufficient number of agents). On the other hand, authors like Polanyi, who contends that the state has played a decisive role in the development of such a system³⁹, ought

³⁹ Polanyi's account of the rise of the 'self-regulating market' in Western Europe is articulated around the following idea : extension of the market area from localized spheres of transactions to a national domain has *not* been an endogenous process due to the merchants' fear of losing ground in the face of unknown competitors whose actions were out of their control. According to Polanyi, indeed, it is at the behest of the state that an integrated internal market has been created within the national space of the emerging modern countries of Europe. In other words, national markets were neither the outgrowth of the gradual extension of urban trade centres nor the offspring of long-distance trade. The intervention of the state was necessary because the determined protectionism and particularism of the cities and principalities constituted a formidable obstacle to internal market integration and expansion. Local networks of bourgeois interests, strongly structured around highly codified rules and institutions (such as guilds and corporations), fiercely opposed any step which could jeopardize their economic position and encroach upon their business sphere. It is true that what the European states thus built up (except in Holland) were not *free* national markets but highly regulated (mercantilist) trade systems. Yet they did promote the formation of enlarged spheres of exchange which were, at a later stage, to be increasingly

to be able to explain how the problem of trust has been concomitantly resolved. This is actually a good opportunity to improve our understanding of the dynamics of norms by putting the evolutionary theory to a serious empirical test. As a matter of fact, if there is strong historical evidence in support of the above hypothesis regarding the role of the state in the creation of the modern market, and if it can be shown that the state has actually helped to establish trust in order to allow regular exchanges on a wide scale, the evolutionary approach to trust-making norms would be at least partly disproven.

2.2. Erosion of moral norms

From the above discussion, it is evident that knowledge about emergence of (moral) norms is still in its infancy and that whatever theoretical effort has been produced so far raises difficult questions which are not easy to deal with analytically. It also seems clear that abstract theorizing will not suffice to the task and that economists will have to rely on historical and other social disciplines to improve their understanding of this phenomenon. The same conclusion can be drawn with reference to the problem of norm erosion. The latter is an especially important issue given the fact that, contrary to conventions that solve pure coordination problems, norms that solve assurance problems are likely to be less stable since moral rules or preferences for cooperation (provided that others comply) may be subject to erosion.

In this respect, it is interesting to note that Adam Smith was rather pessimistic. He indeed believed that "the division of labour posed quite serious problems to maintaining shared moral sentiments and opinions" [McNally, 1988 : 188]. According to him, the increasing division of labour is bound to fragment the social space within which sympathetic interaction takes place : being involved in radically different situations and life experiences owing to market specialization, individuals will no longer share a common set of moral norms and the moral fabric of society will therefore be under the threat of disruption [ibidem : 189; Brown, 1988 : 99]. Smith's

freed from mercantilist barriers, restraints and privileges under the mounting pressure of bourgeois interests *now* acting as a national class through the body of a representative assembly [Polanyi, 1957 : chap. 5].

fear has been recently echoed by a number of economists who have pointed out that the social capital that a society of trustful and trustworthy individuals represents can be gradually 'eaten up' [Buchanan, 1975 : 16; Hirsch, 1976; Bergsten, 1985; Mishan, 1986 : chap. 8; Vanberg, 1988 : 33]⁴⁰.

Adopting the same starting point as Smith (the determining role of labour division), it is actually possible to construct an hypothesis that leads to an identical conclusion even though it treads a somewhat different route⁴¹. Thus, with increasing division of labour and specialization of knowledge, the family is more and more confined to the role of a consumption unit [Becker, 1981] and the secondary socialization (SS) that takes place under the auspices of specialized agencies tends to supersede the family with regard to this second phase of socialization [Berger and Luckmann, 1966 : 166]. Moreover, insofar as parents find themselves increasingly less able to devote enough time and energy to teaching moral values to their children - since both parents often work full-time outside their home or many children spend some portion of their childhood in single-parent homes -, the intensity of the parent-child relationship is reduced, thereby making primary socialization (PS) less effective [Frank, 1988 : 250]. Loss of PS's effectiveness may also result (1°) from reduced durability of this relationship (because members of the family are less indispensable to each other or are indispensable for a shorter period of time) and (2°) from restricted family size (it is more difficult to teach other-regarding norms to single children than to children who continuously interact with brothers and sisters in what often turn out to be conflictual situations). Finally, to the extent that SS depends on the depth of PS, it also tends to be affected [Berger and Luckmann, 1966 : 160; Bergsten, 1985 : 128]. All these effects are likely to make the maintenance of moral norms

40 The idea that the market mechanism destroys the social fabric of society is also frequently encountered in sociological writings. Polanyi is probably one of those who went the farthest in denouncing the market as a system causing "acute social dislocation through vice, perversion, crime and starvation" [Polanyi, 1957 : 73]. Unfortunately, he does not offer us any substantial hypothesis about the mechanism which is liable to lead to the demise of the 'self-regulating market'.

41 Note that Bergsten, to whom we are partly indebted for the formulation of this hypothesis, is also making exactly the same point as Smith when he writes that a high degree of division of labour contributes "to reduce the shared experiences from which mutual understanding and tolerance stem" [Bergsten, 1985 : 122].

more and more problematic. It is true that SS agencies (such as the school) might partly take over from the family the role of moral norm supplier. Yet, unless high-powered ideological messages are diffused through their channels on a sustained basis, norm transmission will be considerably less effective than before. Indeed, as Etzioni has observed : "Values that have lost their affective elements become empty shells, fragments of intellectual tracts or phrases to which people pay lip service but do not heed much in their choices" [Etzioni, 1988 : 105].

There is probably a much more powerful reason to expect a gradual erosion of moral norms in market societies. The idea that capitalism's emphasis on self-interest tends to gradually erode the norms without which this system cannot function is not new since it can be found in a few economic writings [Schumpeter, 1942; Hirsch, 1976; Mishan, 1986] as well as in the works of several sociologists. This idea can be elaborated as follows. A central feature of recent evolution in capitalist societies may be seen as the rise of individualism, a phenomenon directly associated with the development of a materialist society based upon mass consumption. This development has been accompanied and promoted by active marketing policies that have largely succeeded in conveying the deceptive message that happiness or removal of pain can be achieved through *individual* consumption of *things* (goods and services). In the process, the problem of death and human suffering has been essentially obliterated by creating the illusion of man's immortality or eternal youth. This is an especially significant evolution for the following reason : when the inescapability of death and suffering is erased from people's conscience through their constant immersion in a ceaseless stream of consumption (market's ingenuity has actually succeeded in supplying powerful means of calming or suppressing pain and even grief), the need for a symbolic universe that legitimizes these painful experiments by explicit reference to an ever-living *community* of beings tends to disappear. In the words of Berger and Luckmann :

"A strategic legitimating function of symbolic universes for individual biography is the 'location' of death... Whether it is done with or without recourse to mythological, religious or metaphysical interpretations of reality is not the essential question here. The modern atheist, for instance, who bestows meaning upon death in terms of a *Weltanschauung* of

progressive evolution or of revolutionary history also does so by integrating death with a reality-spanning symbolic universe. All legitimations of death must carry out the same essential task - they must enable the individual to go on living in society after the death of significant others and to anticipate his own death with, at the very least, terror sufficiently mitigated so as not to paralyse the continued performance of the routines of everyday life... The symbolic universe also orders history. It locates all collective events in a cohesive unity that includes past, present and future ... Thus the symbolic universe links men with their predecessors and their successors in a meaningful totality, *-serving to transcend the finitude of individual existence* and bestowing meaning upon the individual's death. *All the members of a society can now conceive of themselves as belonging to a meaningful universe*, which was there before they were born and will be there after they die" [Berger and Luckmann, 1966 : 118-121 - our emphasis].

Thus, when people are exclusively concerned with enjoying their present life and preoccupied with suppressing any pain or grief that may befall them, they do not feel any more the need to belong to a totality which transcends them and imparts a meaning to their life and sufferings. Now, it is precisely the belief that they belong to such an entity that breeds sympathetic feelings in human beings and drives them to take the situation of others into account when they make their behavioural choices. We may therefore expect morality to gradually fall into decay and the role of religion to be correspondingly reduced as the market proves increasingly able to create the illusion that it can fill up man's deep existential wants (under the deceiving appearances of ever-changing artefacts)⁴². The outcome of this evolution is the pervasive influence of what has been called a "doctrine of self-preoccupation", that is, a doctrine that urges "the individual to search for self-actualization, i.e., to pursue

42 In a recent article, Vaclav Havel, the present president of Czechoslovakia, laments on the pervasive presence of fraud and deceit which has characterized his country since its "freeing" from totalitarianism. To save the country from potential chaos, he calls for a revival of a sense of 'superior responsibility' that would take into account the interests of the community and of the future generations. According to him, this 'superior responsibility' springs from the certainty that nothing ends up with our individual death "because everything survives us somewhere above us", in what he calls the 'memory of the being', that is, "in this part inseparable from the mysterious order of the cosmos, nature and life, which believers call God, and to whose judgement everything is subject". In other words, "authentic conscience and genuine responsibility are always the eventual reflection of the implicit postulate according to which we are observed 'from above' where everything is considered and nothing forgotten" [Havel, 1991]. A possible interpretation of the above solution to the free rider problem is that people obey moral norms when they imagine that sanctions will be inflicted upon them from some transcendental deity were they to violate them [see, for instance, Vanberg, 1988 : 4].

his self interests with little regard for the wishes and opinions of other persons" [Berkowitz, 1970 : 149]. The problem is actually compounded by the fact that mass communication media that are largely responsible for the propagation of individualistic consumption-centered values in contemporary market societies have come to play such an important role in the shaping of people's preferences and aspirations. The function of the family as a supplier of moral norms is therefore eroded on a double ground. On the one hand, the intensity of the parent-child relationship is reduced due to constant interference of media messages : in this case, instead of being reinforced, PS is actually weakened by SS processes. On the other hand, the parents themselves are exposed to the new materialistic values so that PS is itself being transformed in the sense that it increasingly neglects the teaching of other-regarding norms.

To adopt norm-guided behaviour, an individual should first recognize the dependence of others on him by becoming aware that his (potential) action has consequences for them. He must then have knowledge of the relevant moral norms and, finally, he must ascribe some responsibility to himself for the action. At each of these steps moral norms may be prevented from influencing his behaviour [Schwartz, 1970 : 132]⁴³. Unfortunately, the effect of the above-described changes is precisely to make each of these three conditions increasingly hard to meet : individuals are less and less concerned with what happens to their fellow citizens (or the society at large) when they behave in a certain way; they are little interested in norms or standards of behaviour that set constraints on their 'freedom' (the ideology of the 'free' society has worked beyond expectation); and they tend to reject responsibilities on other potential actors, on the system as a whole, on chance factors, etc.

The foregoing discussion thus suggests a working hypothesis that is quite in line with the dialectic approach followed by Marx and Schumpeter (the Schumpeter of *Capitalism, Socialism, and Democracy*

⁴³ Moreover, the deactivation of moral norms may occur spontaneously - the individual may not take note of consequences, he may not know the relevant norms, he may not see himself as a responsible agent - or it may arise from a defensive redefinition of the situation once a moral norm arouses inhibiting emotions [Schwartz, 1970 : 131-132].

) to analyze the evolution of market societies. More specifically, capitalist development being based upon a high degree of division of labour and upon continuous processes of competitive innovation that call for ever avid consumers, it tends to cause a gradual erosion of the moral norms on which the effective functioning of the market rests. As a result, one may fear that growing difficulties will stand in the way of further expansion of the market system and perhaps even give rise to a major crisis. Grand theories that predict the impending self-destruction of capitalism sound quite unconvincing nowadays. After all, social scientists have almost always proven to be poor predictors of social changes, and it may well be that, once more, society will find some ingenious way of resolving the above type of dilemma. Nonetheless, the point remains that the market society has a serious challenge before her and that, in the process of meeting it, she may undergo profound transformations⁴⁴.

3. The risk of transplanting the market into unreceptive soils

44 Basing her argument on a re-reading of Mandeville's *Fable of the Bees* (1713), Bianchi (1990) has recently proposed an optimistic view that is equivalent to denying the problematic character of fraud and deceit. According to this interpretation, fraud is a generic name for all activities whereby agents try to get around the existing rules or norms. These activities are not considered as socially harmful in a long term perspective insofar as they always induce the establishment of new rules to counter the cheating. A constant dialectic process of violation/construction of rules and norms - since new devices are continuously found by shrewd agents to circumvent the laws while more effective rules are sooner or later discovered to block the cheaters (temporarily) - is therefore at work in the commercial society and in it can be actually located an important source of market dynamism. Such would be Mandeville's answer to the question as to how order can arise in the presence of multiple and conflictual interests. Bianchi then draws an analogy between the above process and that of competitive or strategic innovation as it takes place in the business sphere. Adopting the new dynamic perspective allows us to conceive of competition as a discovery procedure used for the purpose of creating differential advantages rather than as a coordination mechanism. In the words of Bianchi, "competition represents that institutional form which evolved to stabilize a situation which is not a game theoretical equilibrium but which is still the most attractive for the one who gains an initial advantage". In normal conditions, we cannot expect this solution to be stable [Bianchi, 1990 : 22].

Bianchi's approach, in spite of the original insights it contains, does not provide a satisfactory solution to the problem of social order in the marketplace. This is so because what she has apparently in mind is not the possibility of a generalized lack of trust, but only that of *limited* deviations or defections that can be remedied through *localized* adjustments in *operational* rules or norms. If, instead, fraud and deceit are taken to mean the constant breaking of *constitutional* rules or norms (those that govern the choice of operational-level rules or norms), it becomes absurd to look at malfeasance as an engine of market development and as "an essential ingredient of flourishing trade" [ibidem : 19]. Moreover, the social cost of constantly creating new rules and the increasing uncertainty that is bound to ensue are strangely ignored in Bianchi's argument.

3.1. General considerations

Section 2 has shown that, to function effectively, the market requires the society to be structured in a way that ensures the widespread prevalence of abstract and impersonal relationships among agents as well as the pervasive influence of norms of generalized morality. It is therefore entirely wrong to assume, as is typically and implicitly done in the standard training of economists, that the market is a socially neutral system of economic coordination, able to deploy its virtuous mechanics in any kind of social terrain. As our discussion of the limitations of the evolutionary approach to rules has shown, the idea that a code of *generalized* morality can spontaneously emerge from the decentralized initiatives of economic agents is fraught with almost insuperable difficulties. Moreover, it is not at all clear how impersonal factor and product markets can spontaneously arise from dense networks of personalized relationships. It must be admitted at the same time that, if an external agency can suddenly establish market-supporting institutions (private property rights, laws of contract, money, etc.), it cannot likewise create the social conditions required to make them work effectively by a simple act of will. This is because "the market is embedded in society rather than conversely" [Bromley, 1989 : 64]. Even a strong ideology of generalized morality diffused by the state has little chance to take root if it falls on a social terrain unable to understand it or unwilling to grant the state the role of a norm supplier.

So far, we have thus contended that the social fabric of a society is not to be thought of as a malleable structure that may easily evolve or adjust to accommodate the market and the rules of the game associated with it. It is possible to go one step further and to make the point that, if the market is grafted on a social matrix too unsuitable for the purpose, the society may actually react by perverting and debasing the market's functioning logic. This situation is likely to yield unintended effects radically different from those expected even on the strict level of economic efficiency. To the extent that, like the market, the parliamentary system is also preconditioned on what Marx has called "abstract universality" of interindividual relations, the same danger exists that its

superimposition on a society dominated by relations of "personal-concrete dependence" will result in the corruption of the parliamentary mechanism.

Now, when a social structure obeys the logic of traditional relations, significant perverse effects will result from the abrupt implanting of market-supporting institutions and the sudden unleashing of free market forces. It can therefore be presumed that the risk of these forces going astray is especially high in today's developing societies which are still largely structured by old patterns of relationships, particularly so in SubSaharan Africa and in some parts of Asia (such as Pakistan, Bangladesh, Afghanistan, etc). In these countries, people tend to remain entangled into all sorts of tightly-knit networks of personalized relationships encompassing the family, the clan, the religious sect, the ethnic group, the locality of birth, etc. As a result, the society remains highly fragmented into numerous factions or groups. These entities, which are based on strong feelings of specific identity, may be quite efficient when it comes to support business ventures of members, to provide them social security or other kinds of assistance, and to solve a variety of problems running from the settling of intra-group conflicts to the defense of the group's interests vis-a-vis the outside. Yet, insofar as they contribute to compartmentalize the social space into rival factions which apply different standards of social conduct to inter- and to intra-group relationships, they prevent the market from producing its (beneficial) allocative effects over a wide enough domain.

The character and the functioning of the state are bound to reflect the profound segmentation of the society over which its rule extends. In this respect, the situation of SubSaharan Africa (SSA) is especially illuminating. In this region, the state is indeed structured by rival networks of political factions articulated around individuals, families, religious, socio-cultural and economic groups, subgroups, sects, castes, etc. These factions are often engaged in merciless struggles for access to power and to the wealth and material privileges which automatically reward the power-holders [Sklar, 1979; Young, 1986; Staniland, 1986; Bienen, 1987; Bayart, 1986, 1989]. In the words of Bayart, "what is at stake in politics is accumulation" and it is therefore at an admittedly frightening human cost that "the rotating shift which ensures a succession in

power of the various competing political entrepreneurs and their cliques tends to legitimate the state framework inherited from the colonial period ... and, in this way, helps reproduce it" [Bayart, 1986 : 123; 1989 : 261, 271]. Moreover, it is precisely because factional struggles are so fierce - in a world of scarcity and rising expectations of Westernized elites, access to power as a source of wealth represents an enormous stake - that state authority "is being imposed in the most elementary sense of the term" [Bayart, 1989 : 300]. In other words, the authoritarian modes of conduct of most African rulers answer the need of social control in a fluid political setup dominated by ethnic and interdistrict competition, factional struggles, personal rivalries, and complicated relations of affection and patronage that cannot be encompassed by class analysis [Hyden, 1986 : 66; Ravenhill, 1986; Bienen, 1987 : 298-300; Bayart, 1989 : 257-315; Herbst, 1990].

From this perspective, the state appears both as a strong and a weak agency. It is strong inasmuch as civil societies in most countries of SSA are very poorly developed, particularly because of the lack of a middle class with a strong interest in limiting bureaucratic power and ensuring some degree of rationality in bureaucratic performance. Yet it is at the same time weak because it has, comparatively speaking, very little autonomy [Booth, 1987 : 27; Moore, 1987 : 14]. As we have seen, this lack of autonomy arises from the fact that African states are "generally uninsulated from the particularistic loyalties and 'role diffuseness' which prevail in African societies, perhaps precisely to the extent that they have not developed as *civil* societies" [Booth, 1987 : 27]. Regarding SSA, it is thus necessary to distinguish between the civil society understood as people organized in opposition to or independently of the state machinery on the one hand, and the family and all its ramifications (including kinship and community ties) on the other hand⁴⁵.

In the aforedescribed context, no universally shared social ethic can exist. Codes of conduct are governed by a 'limited-group morality' which emphasizes the strength of ties to real kith and kin and therefore differs from generalized morality in which more absolute,

⁴⁵ As Bayart has skilfully observed, the problem with the African state is not that it has evolved in continual conflict with civil society (which would have corresponded to a healthy pattern of state-society interactions), but rather that it has been deliberately set up *against* civil society [Bayart, 1986 : 112].

abstract principles are considered equally applicable to all social relations [Shipton, 1988 : 113]. Procedural norms, when they exist, and codes of moral behaviour are particularistic; professional standards are low; reward and sanction mechanisms (including litigation) as well as taxation and subsidies are meted out in a specific way so as to make patronage effective; wealth is currently acquired or redistributed through trafficking, racketeering, plundering, looting, or favouritism, all practices which are almost always accomplished within the purview of the political power structure (at the level of the presidency, the politico-military hierarchy, the top civil servants, the ruling party officials, etc.). It deserves to be noted that in many cases the 'small men' draw their livelihood from participating at the lowest level in the various factions, cliques, or groups fighting for power [Bayart, 1989 : 291-293]⁴⁶.

The case of SSA and of some other developing countries closely resembling her is obviously extreme. Asian societies, for example, differ from African societies partly because, some time during their precolonial histories, they have come to be stratified along an urban-rural divide that brought class differentiations in its wake, and partly because, they have inherited the norms of the Western legal tradition due to more or less prolonged existence of a colonial state. One may thus think of British India in which the Indian Civil Service and western education have been solidly implanted by the colonial power, a significant event given the profound imprint that these two institutions have left on the elites of the postcolonial societies born of the old British Empire. Even today, however, these societies remain under the strong influence of traditional patterns of social relations, in particular the principle of the primacy of family and caste (*jati*) relationships. Under these circumstances, it is not surprising that rights and obligations associated with these patterns still tend to predominate over the rules and norms rooted in the *abstract individual* (as opposed to the *concrete person*) which are the typical products of Western history. In one of his books, the Indian

46 In this respect, it can be confidently said that the situation was more favourable during the colonial period. Indeed, as reminded by Fieldhouse : "Because it was external, the state could and did maintain a more or less impartial supervision over the disparate elements over which it ruled ... The effect for Africans was the security and equality of a Hobbesian state. As in the Austro-Hungarian and Ottoman empires before 1914, most African groups, however disparate, could live and move confidently under the umbrella of the colonial power" [Fieldhouse, 1986 : 55-56].

psychoanalyst Kakar has aptly described the essential nature of social relations in contemporary India. In particular, he has emphasized the persisting lack of a common code of generalized morality in the Indian society. We cannot resist the temptation to quote him at length given the great pertinence of his analysis in the context of this paper :

"Among those Indians closely identified with the process of modernization, the well-educated urban elite who hold positions of power in modern institutions, the psycho-historical fact of the primacy of relationships, of family loyalties, of *jati* connections, is often a source of considerable emotional stress. For although intellectually the Indian professional or bureaucrat may agree with his western counterpart that, for example, the criterion for appointment or promotion to a particular job must be objective, decisions based solely on the demands of the task and 'merits of the case', he cannot root out the cultural conviction that his *relationship* to the individual under consideration is the single most important factor in his decision. This conflict between the rational criteria of specific tasks and institutional goals rooted in western societal values, and his own deeply held belief (however ambivalent) in the importance of honouring family and *jati* bonds is typical among highly educated and prominently employed Indians. And among the vast majority of tradition-minded countrymen - whether it be a *bania* bending the law to facilitate the business transaction of a fellow *jati* member, or a *marwari* industrialist employing an insufficiently qualified but distantly related job applicant as a manager, or the clerk accepting bribes in order to put an orphaned niece through school - dishonesty, nepotism and corruption as they are understood in the West are merely abstract concepts. These negative constructions are irrelevant to Indian psycho-social experience, which, from childhood on, nurtures one standard of responsible adult action, and one only, namely, an individual's lifelong obligation to his kith and kin. Allegiance to impersonal institutions and abstract moral concepts is without precedent in individual developmental experience, an adventitious growth in the Indian inner world. Guilt and its attendant inner anxiety are aroused only when individual actions go against the principle of the primacy of relationships, not when foreign ethical standards of justice and efficiency are breached" [Kakar, 1978 : 125-126].

In Pakistan, to take another example, reciprocal favours are an essential ingredient of bureaucratic practice and they are formalized enough to have a name : *vartan bhanji* . In Baluchistan and the North-West Frontier Province, webs of traditional relationships are still pervasive and run through regional official agencies and municipalities. Thus, in a town like Peshawar, Pathan bureaucrats run their offices like the tribal *jirgas* they have been brought up

with. In Punjab and particularly in Lahore, what we find is the rule of the Civil Service of Pakistan (the successor of the Indian Civil Service) which has become "a self-perpetuating club of the well-born established civil service families" of Punjabi origin [Duncan, 1989 : 242-244].

To an unexpectedly large extent, the above diagnosis seems to also apply to countries of Eastern Europe and the U.S.S.R. In these countries, indeed, the government and the political parties tend to be dominated by personal networks whose members belong to the same family or clan, or have known each other for a long time through the school system, the communist party, etc. These networks fill in the gaps left wide open by the sudden disappearance of discredited communist regimes and, in some cases, they are themselves a continuation or a recombination of some element(s) of the old power establishment. Like in SSA and several Asian countries, the new states that are emerging in Eastern Europe are both strong and weak and this is why they tend to evolve towards authoritarian, centralized structures or to become articulated around a strong charismatic leader (such as Yeltsin in Russia or Gamsakhourdia in Georgia). The patronage networks in power tend to impose their rule (including the economic reforms almost entirely designed by foreign experts) by appointing their own people in key positions, and they are keen to ensure that their particularized interests are promoted even at the expense of public good.

In this context, it is largely delusive to speak about democratization and liberalization since ordinary citizens do not have a genuine say in political matters and since privatization essentially means that state enterprises are handed over to politically powerful people or to their friends and relatives. Allocation of physical assets and financial resources is thus based on personal acquaintances and not on merit criteria. Moreover, there is increasing evidence pointing towards all sorts of fraud, deceit, speculation and manipulation, an unfortunate evolution lamented by Vaclav Havel, the present President of Czechoslovakia⁴⁷. What is especially disquieting is not only that such malpractices are pervasive but also that they take place at a time when market development has to be initiated and

47 See note 41.

generalized trust needs to be quickly built up. Hence there is a serious risk that the abrupt irruption of (pseudo) liberal rules and institutions in the countries of Eastern Europe and the U.S.S.R. leads to the same kind of perverse effects as were denounced by Julius Szekfü in his critique of Hungarian liberalism during the period 1848-1918. In the words of Janos :

"Szekfü's culprit was not liberalism per se, but the transplantation of culturally alien liberal ideas into the ostensibly unreceptive soil of Hungary. The results of this transplantation were not only grotesque, they were outright harmful, because the gap between form and substance could only be closed by corrupting the electoral process in politics and by perverting the market mechanism in economics. In turn, the prevailing methods of corruption - the purchase of votes by the government and the purchase of favors by the entrepreneur - had a deeply corrosive effect on national morale. They undermined the self-respect of the elites and the legitimacy of the nation state, and in this manner paved the way for the revolution of 1918-1919" [Janos, 1982 : 267].

To pursue the analysis at the required level of depth, what is needed is an understanding of the precise mechanisms through which market-supporting institutions are somewhat misused or misdirected when actors are unable to separate institutionalized role relationships from the social matrix of family and community relations. Such a task is clearly beyond the scope of this paper. We will therefore be content with illustrating the kind of perverse effects likely to result from an abrupt introduction of market-supporting institutions in an inhospitable milieu. This is done below with respect to private property rights in land and with special reference to SSA. The example has been chosen in view of the considerable stake that agriculture represents in poor countries where it still constitutes the mainstay of livelihood for the majority of the population; and also in view of the fact that there have been recently many attempts to establish such rights in this region under the auspices of Structural Adjustment Programmes (SAP)⁴⁸.

3.2. Subversion of land market : an illustration

48 The reader will find a more detailed analysis of this issue in Platteau, 1991a and 1991c on which the remainder of this section is largely based.

To begin with, it is assumed that land scarcity prevails. Otherwise, it could be easily argued that private property rights do not correspond to a cost-effective institution compared to customary tenure arrangements in which land is held under a general system of corporate ownership. When demand for land is pressing due to population growth and commercialization of agriculture, private rights in land are strongly advocated by mainstream economists on several grounds : (1°) they allow internalization of external costs and benefits; (2°) they reduce uncertainty about land rights and the resulting disputes and litigation costs; (3°) they increase *incentives* to make efficient cropping choices and long-term investments, also because of reduced uncertainty over ownership or possession; (4°) they enhance the *ability* to undertake such investments since an active rural credit market will develop as soon as land acquires collateral value (which happens when titles are clearly defined, legally protected and freely exchangeable); and (5°) they promote an efficient allocation of land among competing users (under the same three conditions as required for the fourth effect to obtain).

In actual fact, there are strong reasons to doubt that the above effects will take place if a free land market is implanted in SSA countries today. To understand the first reason, it is essential to bear in mind the interdependence that may exist between efficiency and equity. African villagers still adhere strongly to the traditional ethical principle (of limited-group morality) that land ought to belong to the "sons of the village", to the members of the local community (most commonly defined by descent or adoption) whose families have been living on the land for several generations and have therefore developed strongly emotional identity links with it. This is all the more so as the ancestors' cult is still very much alive (ancestors are actually believed to continuously intervene in present-day human affairs) and is deeply rooted in the (corporate) land of the lineage. Under such circumstances, the separation of land ownership from land use and the allocation or transfer of land to strangers are bound to arouse deep-seated feelings of injustice and alienation among the people dispossessed of their customary rights of access⁴⁹. The latter are likely to resist

⁴⁹ Thus, among the Luo (Kenya) the idea still seems to prevail (especially among the elders) that land is a permanent lineage asset the sale of which can only arouse the ancestors' wrath and bring "bitter money" which will cause the seller's ruin and misfortune [Shipton, 1988 : 103-104].

the change perceived as unfair and their resistance can easily create serious incentive problems throughout the rural economy.

This is patent when resistance is active and people do not hesitate to resort to open violence. A striking example is provided by the so-called "Manifest of the Oppressed Negro-Mauritanian" : here, an extremist group belonging to the black community of Mauritania aggressively reacted to the post-1983 introduction of private land rights conferred upon stranger investors (particularly in the fertile area of the Senegal river valley), following a land reform in which the World Bank was actually involved. In this manifest, the Negro-Mauritanians are invited to use any conceivable means to prevent their customary lands from passing into the hands of the *Beydane* elite (of Moorish origin), that is, "to boycott, ban, kill if needed, all those who encourage the sale of land; destroy, burn the possessions of these strangers who come to develop your lands while the land should belong to our villages" [quoted and translated from Bayart, 1989 : 82]. That bitter conflicts, tensions or resentments around the land issue can erupt into violence is evident from other country cases (e.g. Mali, Zaïre, Nigeria) in which local occupants oppose the transfer of traditional village lands (whether as a result of more or less free land sales or of mishandling of land allocations by the state) to absent owners belonging to the urban elite. To defend what they perceive as their legitimate rights, they commit acts of sabotage, looting, burning, and theft on the property and crops of these outsiders.

What needs to be stressed in the present context is that such behaviours have the effect of increasing the transaction costs attaching to private property (which includes rights of exclusive ownership and the free transferability of the land) and, therefore, of reducing the relative *efficiency* of this system of land rights. Efficiency costs may actually take two distinct forms. On the one hand, it is much more costly to establish and protect one's private property rights when such rights are openly or secretly contested than when they are considered legitimate. Note that the additional enforcement costs can be both of a fixed and a recurrent nature : thus, the land property needs to be not only better enclosed but also continuously and effectively guarded. On the other hand, social tension in the countryside can give rise to serious labour market imperfections that may entail considerable efficiency costs at the

level of the whole economy. Indeed, landless agriculturalists will presumably be prompted by a desire to take revenge for the loss of their customary rights of access and they will therefore miss no opportunity of harming the interests of the new private owners, at least when these owners are strangers. As wage labourers, they will be incited to labour-shirking and mismanagement of assets while, as sharecroppers, they will pilfer inputs, underreport output and overreport non-labour factor costs. Since such moral hazard problems can be controlled only through continuous and tight monitoring of the agents' efforts, the effective cost of labour is going to be high. The rational response to these problems of labour control on the part of stranger owners is, whenever feasible, to adopt capital-using input combinations or labour-augmenting innovations so as to ease the problems of controlling hired labour and to avoid sharecropping the lands⁵⁰. From a social viewpoint, the mechanization of agricultural production processes, to the extent that it is conceived as a means of breaking labour supervision constraints, appears as an unfortunate choice. As a matter of fact, it involves the use of input mixes that are ill-suited to the factor endowments of African countries since fixed capital in the form of sophisticated imported machinery will cause a serious drain on their scarce and foreign exchange resources.

Recent developments in Mauritania can again serve to illustrate the above-described possibility. Along the Senegal river, the *Beydane* capitalists have acquired private property rights on many good *waalo* (irrigable) lands on the grounds that they possess the finance capital required to develop them effectively. They have actually succeeded in bringing these lands under intensive (rice) cultivation but they have largely achieved this result through a system of owner cultivation assisted by labour-saving mechanical devices. Such a choice cannot be explained by technological considerations alone. It has also been motivated by the desire to overcome difficult

50 It is interesting to note that these moral hazard problems arising from strained agrarian relationships and the falling into decay of the old sanctions operative in the past have first been mentioned with respect to India [Béteille, 1965 : 127; Sen, 1981; Hayami and Kikuchi, 1981 : 236]. It may also be borne in mind that mechanization of agricultural activities has not only the effect of replacing labour (except when it allows multiple cropping) but also that of disciplining the efforts of the workers actually employed. Indeed, it often implies that "the pace and quality of output are primarily determined by machine specifications rather than by the quality of the operator's effort, thus reducing the importance of labour supervision" [Eswaran and Kotwal, 1985 : 362].

supervisory problems in a social context dominated by tense inter-community relations : as pointed out above, the local (Negro-Mauritanian) communities make a strong claim that the *Beydane's* lands historically belong to them. When the social climate is explosive, big landowners tend to avoid hiring wage workers (or entrusting their lands to tenants) even if the labour market is a buyer's market. Mechanization of the production process thus appears as a reflection of an unequal balance power. In Kenya, where free land market transactions have led to a more skewed distribution of land and the development of a large landless class, thereby creating a situation of considerable explosive potential, we learn that : "Many of the new landless do not appear to be moving into tenant or agricultural wage-labor roles, but leaving agriculture as the remaining farmers employ more labor-efficient methods" based upon mechanization [Bruce, 1988 : 44].

At this stage, the need clearly arises to question the mainline economists' assumption that the creation of formal private land rights has the effect of reducing and even eliminating transaction costs so as to encourage long-term investment and increase efficiency-promoting transfers of land. This may be actually right or wrong depending on the social context or structure in which private land rights are introduced. If such rights are perceived as illegitimate and unfair by the people, new transaction costs may emerge not only in the land but also in the labour market, thereby giving rise to multiple market failures⁵¹. Given the absence of a code of conduct based on the principle of abstract equality among individuals, it is therefore possible that *total* transaction costs will be actually higher after than before the introduction of a free land market and the accompanying institutions.

Additional perverse effects may be expected. As a matter of fact, if it is true that the establishment of private land rights has the effect of removing certain kinds of transaction costs only to replace them by new ones, doubts must also be raised about the validity of the argument according to which the creation of a land market will automatically lead to the development of a (formal) rural credit market. In the case where the land market is highly imperfect, land

51 For a good discussion of the way multiple failures in rural markets affect economic efficiency in agriculture, see Collier, 1983.

does not become a truly mortgagable commodity and credit-givers have no incentive to increase their supply to the agricultural sector. There are in fact two reasons why land may be difficult or costly to foreclose and to transfer. The first reason is directly related to the above discussion in terms of equity-efficiency interdependence. In effect, if the persons threatened with the loss of their land feel unjustly treated, they are likely to resist foreclosure whenever they can rely on the solidarity of a close community to defend their interests. In Kenya, for example, we are told that lending authorities have had great difficulty foreclosing on land mortgages chiefly because "the presence of many kin around mortgaged land makes it politically unfeasible to auction the holdings of defaulters" [Shipton, 1988 : 120]. Further difficulties may arise from sheer malpractices of deceit, manipulations and double deals directed against strangers : for example, in Kenya again, "farmers who have pledged their land titles as security for loans are sometimes tempted into selling their land to strangers without informing them of the charges on the land", which leaves them free to default on their loans if they wish [ibidem : 111].

The second reason is also to be understood against the background of personalized relationships and limited-group morality even though the feeling of being exploited does not need to be present. For land to be easily foreclosed and then disposed of in the case of default, there must exist an effective and independent judicial system. Evidence of the non-fulfilment of this condition in SSA is easy to find, particularly in the case of urban areas where official titles have been issued to private owners of land and buildings. In actual fact, a complaint frequently voiced by institutional credit-givers - not only state finance corporations but also commercial banks and other private agencies - is precisely that foreclosure on property belonging to borrowers personally connected with high-level political authorities cannot be legally enforced because the judicial system is subject to interferences from top executive officials. In Senegal, practices whereby the political establishment (through the machinery of the Socialist Party) brings pressure to bear on the judicial system are known, in everyday parlance, as *agir à la sénégalaise* .

The above are important reasons why the supply side of the credit market may not emerge in the way predicted by mainstream economics. It must now be added that, perhaps paradoxically, demand failure may possibly replace supply failure if land seizure and disposal become rather easy operations. The point is that, inasmuch as they are aware that by borrowing against the mortgage of their land they face a real threat of land loss, smallholders may be reluctant to take land-secured loans even though they need credit and supply is available at an acceptable rate of interest. There is actual evidence of this behaviour in Kenya [Odingo, 1985; Shipton, 1988 : 106,120] where, according to Shipton, it is mainly elders who reject the idea of land mortgage while younger men may be more attracted by the prospect of ready cash (and, to that extent, they are more liable to lose their land through foreclosure). There are thus a number of reasons which may explain the conclusion reached by several empirical studies that, in SSA, registration of title does not necessarily enhance a smallholder's access to credit while, conversely, security of use rights under customary tenure may be sufficient to induce investment, access to credit and commercial production [see, for example, Shipton, 1988 : 120; Land Tenure Center, 1990; Migot-Adholla *et al.* , 1990; Atwood, 1990].

In his critique of the new neo-liberalism in development, Colclough has rightly remarked that, where there are serious market imperfections, liberalizing could actually make matters worse : under these circumstances, the market itself is the problem to be addressed [Colclough, 1991; see also Toye, 1987 : 73-75]. The above analysis concurs with that of Colclough and it even goes one step further by making the point that, under certain conditions, liberalizing could well cause *new* market imperfections to arise.

4. Conclusion : some guidelines for research and policy

Some fifteen years ago, North complained about the lack of any systematic analysis of the preconditions for price-making markets [North, 1977 : 710]. Two years earlier, Buchanan had similarly regretted the economists' neglect of the importance of agreement on the structure of rights without which no social order can properly function [Buchanan, 1975 : 22]. And more recently, Sen has also pointed to a glaring dearth of knowledge among his own profession

when he made the apposite observation that "the success of a free market does not tell us anything at all about what *motivation* lies behind the action of economic agents in such an economy" [Sen, 1987 : 18].

Of late, however, a few economists have eventually started to take interest in the central question as to what can be the ingredients (or some ingredient) of the social order of the market (including the kind of required motivation on the part of the agents), and how they can be expected to come about. In this respect, game-theorists have undeniably raised important questions and provided valuable insights. In this paper, we have essentially tried to tackle the above question from an enlarged perspective that makes use not only of game-theoretic results but also of the contributions made by scholars from other social sciences (sociology, history, anthropology, psychology). This has led us to emphasize two crucial social preconditions of the market : the prevalence of impersonal relations disentangled from kith and kin networks on the one hand, and the pervasive influence of norms of generalized morality to bind (anonymous) agents together in a coherent (abstract) society on the other hand. As sociologists would immediately notice, these conditions are fundamentally equivalent to requiring the passage of the societies concerned from the traditional *Gemeinschaft* to the modern *Gesellschaft* , a theme which runs through the writings of Weber and Mannheim and is at the heart of the so-called (revisionist) modernization theory in development sociology. Moreover, the study of social norms has always been a prime concern among sociologists.

Unfortunately, to our knowledge, sociology has not made significant headway in working out these issues during the last decades. This is probably due, at least in part, to the two following reasons. First, the modernization theory has somewhat fallen into disrepute owing to the sharp critique of alternative analyses which have shifted the focus of the discipline "from national economies, societies, and cultural systems toward larger supranational entities, above all, toward the study of relationships among the 'core', the 'periphery' and 'semiperiphery' of a 'modern world system' " [Janos, 1989 : 325-326; see also Janos, 1986 : chap. 3]. Second, as exemplified in the writings of authors like Homans (1958), Boudon (1979) and Bourdieu (1980), a new strand of thought has developed

in sociology which has succumbed to the apparently irresistible appeal of the self-interest paradigm of the economists. There is no gainsaying that these new approaches have enriched the analytical perspectives of sociology and brought to the fore dimensions of development/underdevelopment processes that were largely ignored before. Yet, the relative regression of the study of the role of social norms and of the modes of inter individual relations in sociology is regrettable in view of the fact that our knowledge on this subject is still in its infancy and that the problems involved are of considerable complexity⁵². Given this situation, we can only hope that the present paper has helped to make our gap in knowledge more apparent as well as to open up new lines of inquiry and, perhaps, to suggest some ways of embarking upon the task lying ahead of us.

Economists and sociologists alike agree that trust is a necessary accompaniment to all economic transactions. The problem is nevertheless that this public good is more easily produced in small communities than in large-group settings while economic dealings need to take place on a vast scale to allow the market to generate its positive dynamic effects under the form of increased division of labour, rising labour productivities, and enhanced standards of living. For norms of trustworthy behaviour to operate in a context where impersonal relations dominate, a code of generalized morality must be in force. Since no state can enforce such norms if they are not at least partly internalized by the people, a society which cannot rely on a well-established moral code seems to be doomed to either repression or anarchy. It is actually not difficult to find illustrations of the latter possibility. Thus, in Pakistan for example, we are told that businessmen tend increasingly to hire gangs of armed men whose job it is to extract payment from other

52 In actual fact, to the extent that sociologists are slowly reviving their interest in the study of norms, they seem to be strongly influenced by the economic model. Thus, one of them observes that "if one hopes to find an alternative to the economic theory of norm formation in the sociological and social psychological literature, one is disappointed ... sociologists and also social psychologists, either explicitly or implicitly, propose that the emergence of norms depends on the costs and benefits which are associated with them" [Opp, 1982 : 141]. This certainly applies to the work of Opp himself who does not hesitate to use the self-interest paradigm in ways that many economists would actually disapprove (there is no room for moral norms in Opp's scheme of thought). On the other hand, despite his willingness to escape the grip of the 'economic model', Etzioni (1988) has not really succeeded in articulating an alternative scheme of analysis.

respectable businessmen : insofar as the courts are not going to convict the debtors, harassment and kidnapping of relations appear as "the only sure way of getting paid" [Duncan, 1989 : 302].

It could of course be argued that, if people have an abiding respect for the laws enacted by the state, the problem of generalized trust could be solved. This is admittedly an important point. Nonetheless, it only pushes the question of trust one step further. In effect, one has then to ask how is it that people come to have an abiding respect for the law, which amounts to asking how they come to recognize the authority of modern law-enacting and enforcing central agencies when they have been traditionally used to obey local authorities and to abide by norms of limited-group morality. Here is clearly a tricky problem of what Lipton has called 'transition of trust' [Lipton, 1985 : 51].

The evolutionary approach to norms, which actually dates back to Hume's very articulate reflections on this subject, suggests an answer to the problem of trust in modern market societies. Janos implicitly adheres to such an approach when he writes that, in the historical experiences of the West, "the market economy served as a school for impersonal modes of conduct that are indispensable for the effective functioning of complex societies and large-scale polities" [Janos, 1982 : 314]. Yet, as we have shown, there are serious problems with this approach. In particular, one must give its due weight to Elster's note of caution concerning evolutionary attempts at explaining the emergence of social norms. According to him, indeed :

"In the absence of a mechanism linking the benefits to the emergence or perpetuation of the norm we cannot know if they obtain by accident. Social scientists should be suspicious of theories of society that deny the possibility of accidental benefits. Moreover, and perhaps more importantly, the beneficial or optimal nature of the norm is often controversial. It is only a slight exaggeration to say that any economist worth his salt could tell a story - produce a model, that is, resting on various simplifying assumptions - which proves the individual or collective benefits derived from the norm. The very ease with which 'just-so stories' can be told suggests that we should be skeptical about them" [Elster, 1989 : 113].

Sugden's hypothesis about the emergence of 'spontaneous order' (1989) largely escapes Elster's criticism because, within his

analytical framework, norms are conceived of as supporting devices for conventions that are themselves defined as solutions to coordination games, and because he insists that conventions are not necessarily optimal (since they are supposed to be born of the historical culture of a society through the mechanism of analogy). In this perspective, when the problem of trust is posed in terms of an assurance game, there is no a priori ground to believe that trust can emerge from a society long accustomed to distrust (such as the south Italian village described by Banfield (1958)). For another thing, it is interesting to note that Janos himself has defended the thesis that the process of evolution of the *Gesellschaft*, which unfolded itself in the advanced countries of the West, has not been really at work in many backward countries, including those of Eastern Europe (at least) during the nineteenth century and the first half of the present century. Reasons for this are complex and, according to him, they cannot be understood if one ignores the *external* influences that emanate from industrialized countries and shape the public attitudes in backward societies (by disseminating distorted images of modern life through the modern educational system and various networks of communication)⁵³. It may be noted incidentally that what Janos suggests here is a fruitful way of bridging the gap between the two main strands of thought in development sociology : the modernization theory and the 'world-system' approach.

Now, in spite of the above qualifications and skepticism, it seems reasonable to reckon that the two social conditions of the market on which our analysis has focused need not be *completely* established before the market can work. In other words, while denying full validity to the evolutionary argument, we may still agree that, in the course of its development, the market contributes to *reinforce* the conditions on which its effective working rests. At least, this appears to be a realistic claim as far as the first condition is concerned : to the extent that market expansion tends to foster labour division, specialization of knowledge, and social differentiation, relations among transactors are likely to become more and more impersonal. Perhaps, the view can also be held that

53 Otherwise, asks Janos, how could one explain that, in a country like Hungary whose culture was embodied "in a political tradition of legalism, and in a religious experience that included, among others, the Protestant reformation", what took place was "a gradual regression to the value orientations of the traditional *Gemeinschaft*" [Janos, 1982 : 322].

these transactors will gradually realize that it is in their long-term interests to abide by some norms of fair conduct provided that such norms are somehow available in the fund of common experiences constituting their specific culture. However, the essential question remains as to how the process gets started and how the common basis for trust is being created. Or again, how can people who have a common experience of trust in close friends and relatives within the purview of small-group settings come to trust generalized others and to respect the laws enacted by a centralized agency? In fewer words: how can generalized morality emerge from limited morality?

Far from being academic, these questions are extremely topical today when there are so much talk about, and so many actual attempts (articulated around structural adjustment programmes or SAP's) at, establishing or reinforcing market institutions in Third World as well as in previously socialist countries. Assuming that these countries really need more market to develop or to develop further, how should it be introduced or strengthened so as to minimize dysfunctionings and efficiency losses arising from inadequate social conditions? It is worth noting that the answer to this question cannot be independent of considerations of equity that have received so much attention - and rightly so - in the current debate about the effects of the SAP's on the countries concerned. As a matter of fact, if the social impact of these programmes is considered too unfair and the new rules and the new structure of rights are deemed illegitimate by the populations affected, significant incentive problems may ensue that are likely to jeopardize the effectiveness of the adjustment measures. As we have illustrated with respect to the land issue, the establishment of private property rights may well produce effects that tend to subvert the land market which this institutional reform was supposed to activate. Such perverse processes may be at least partly the result of the fact that people continue to be imbued with traditional norms of limited morality and to be involved in tight webs of customary relations.

The policy implication of this kind of considerations is apparently that structural adjustment measures should not only be moderate so as to mitigate adverse social effects, but also follow a phased approach so as to allow gradual adjustment to new rules, values

and norms. It could nonetheless be argued that the extent to which one of these two conditions has to be fulfilled is inversely related to the extent to which the other is being fulfilled. More precisely, the point can be made that, when social security problems are solved in a satisfactory way, people tend (at least to *some* degree) to be more willing to accept new rules that entail a reshuffling of entitlements. This is because the perceived legitimacy of the new order is greater when vulnerable sections of the population are (and feel) better protected against the uncertainties created by the transition from the old to the new rules. Interestingly, and contrary to a well-established opinion, the experience of capitalist development in 18-19th century England seems to actually support the above hypothesis. Thus, according to a good specialist in the so-called industrial revolution :

"It might be nearer the truth to say that the development of capitalism in England was conditional upon the existence of an efficient and ubiquitous welfare system than to say that it could only flourish by undermining the old system of welfare provision ... the creation and elaboration of the poor law system from the reign of Elizabeth onwards was an important reason for the development of a capitalist system in England, affording the kind of provision for those in need which gave individuals a degree of protection against the hazards of life that in typical peasant cultures were provided by kin ... such provision ... facilitated the growth of an economy where mobility was high, where contract could supplant custom, where the individual could risk losing intimate contact with kin ... [England thus benefited from] the convenient symbiosis of a capitalist ethos in large tracts of economic life with the provision of the range of welfare services needed to enable the community to accommodate to its rigours without producing intolerable stresses amongst those whom the accidents of life or the imperfections of the system had rendered incapable of fending for themselves" [Wrigley, 1988 : 120-121].

The historical experience of England is all the more worth pondering over as transfer payments were made not through the state but through decentralized bodies operating at a local level (the parishes). In many countries of the Third World, and particularly in SSA, generalized morality has probably the best chance of evolving if small associations largely controlled by rural or urban groups are given legal recognition and support by the state while being forced, in some way or other, to interrelate among themselves to solve common problems. The latter circumstance would ensure that traditional webs of personalized relationships are progressively

loosened. Awareness of the conditions of social viability in an enlarged sphere of interactions would then gradually build up from concrete experiences, and civil society would gradually develop to create a civic conscience as well as a potential for democracy (which also needs to be based on abstract relationships to function effectively). To return to the land issue in SSA, it can thus be argued that, to deal with different kinds of 'insecurity' problems and to minimize incentive problems, a number of short- or medium- term solutions that involve the development or the strengthening of informal arrangements at the community level are probably much more effective than a full-fledged formalization of private, freely transferable, titles [Atwood, 1990; Platteau, 1991a, 1991c].

Clearly, a lot more thinking and research is needed on the issues raised here. We believe that social scientists specializing in the field of development should put them on their agenda and assign them a high priority given that they are a matter of great urgency. Among development economists, adherents to the structuralist tradition - with their emphasis upon the importance of initial conditions, their attention to specific, 'structural' features of developing countries, and the eclectic and non dogmatic character of their intellectual perspective - should be expected to raise to the above challenge much more quickly than economists from the neo-liberal school who are usually in a great hurry to find out quick and sweeping solutions to vastly complex problems [on this, see Toye, 1987; Colclough, 1991]. The challenge will be successfully met only if development scholars become acutely aware that the internal conditions of developing countries are not a malleable structure which can be easily arranged so that any kind of development policies can get a clear run. History matters and present-day realities are largely shaped by past experiences at both the objective and subjective levels (the level of events and that of perceptions of these events by the people). Our knowledge of the social conditions of the market and of the ways to promote a viable market order in the countries willing to embark on such route will not make a significant headway unless history as a science is called on to give some flesh to analytical arguments, to present us with detailed case studies, and to direct our attention to new variables and to new causal relationships.

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