

Markets in Society

The Theory



Artwork commissioned from Bizana artist A. Msongelwa

1. From the classics to Keynes

A key theme in this thesis is the role of markets, how they impact on enterprise on the margins, and what this means for enterprise development as a strategy for reducing poverty. These debates will be addressed mainly at the micro level of enterprise development strategy, but the assumptions that inform that debate are rooted in macro policy debates that draw from theories of political economy. While there have been huge movements and changes in human history since the emergence of capitalism, there is in fact a remarkable level of continuity in the key themes of the debate, which revolve now, as they have since the 18th century, around how economic and social relations interact and the role of politics in mediating the outcomes in societies. These 'meta-narratives' are manifest in the debates around the relationship between the state and markets, between social and economic policy; between economic efficiency and social equity. These are also all

issues that have been at the core of politics and power in South Africa's transition, and that play out at the level of enterprise development on the margins also.

This section will therefore provide an introductory overview of the key themes in this debate, from Adam Smith to the present. It will focus on those elements of a complex set of debates that have relevance to arguments in the chapters to come, where this theory will also be built on further in more applied contexts. This will be the case in particular in relation to theoretical debates specific to co-op development, to the emergence of the market development paradigm, and to its elaboration as an approach called 'Making Markets Work Better for the Poor'.

To start the discussion, here is a remarkable early ode to capitalism and globalisation:

The need for a constantly changing market for its products chases the bourgeoisie over the whole surface of the globe. It must nestle everywhere, settle everywhere, establish connections everywhere.

The bourgeoisie has through its exploitation of its world market given a cosmopolitan character to production and consumption in every country. To the great chagrin of Reactionists, it has drawn from under the feet of industry the national ground on which it stood. All established national industries have been destroyed or are daily being destroyed. They are dislodged by new industries, whose introduction becomes a life and death question for all civilized nations, by industries that no longer work up indigenous raw material, but raw material from the remotest zones; industries whose products are consumed not only at home, but in every quarter of the globe. In place of old wants, satisfied by the production of the country, we find new wants, requiring for their satisfaction the products of distant lands and climes. In place of old national and local seclusion and self-sufficiency, we have intercourse in every direction, universal independence of nations. And as in material, so also in intellectual production. The intellectual creation of individual nations become common property. National one-sidedness and narrow mindedness become more and more impossible, and from the numerous national and local literatures, there arises a world literature. (The Communist Manifesto, Marx and Engels: 1848).

This quote captures a key contradiction at the heart of capitalism. Not, in this instance, the contradiction between capital and labour, but rather, the contradiction between capitalism's immense powers of destruction, alongside its immense power to create wealth – and in the process, to destroy old forms of social organisation, and to create new ones.

That power has impacted in differential and contradictory ways on human history and human lives ever since, as a result of struggles to contain or resist its destructive power, as well as to harness its potential to create wealth and reduce poverty. These struggles have taken many forms, as the spread of capitalism and of global markets has taken place, with highly differential outcomes within and between nations and interest groups across the globe.

The growth and spread of capitalism has always been inextricably bound up with changes in the form and content of political power, formal and informal, where, in the end, the rules of the game are both made and enforced; and the history of political economy is about how this has happened.

Understanding the global economy and how markets work in today's world requires an understanding of the ways in which societies have been incorporated into the global market economy. For many countries, this trajectory is very different from the way capitalism developed in Western Europe, but it is nevertheless necessary to start there, where the roots of global capitalism lie. This means going back to that patriarch of economics, Adam Smith, whose *Enquiry into the Nature and Causes of the Wealth of Nations* came out in 1776, before the Industrial Revolution had taken place, in the 'Age of Commerce' that created the market conditions for it to do so.

For Smith, the key defining feature of the Age of Commerce was the establishment of the right to private property and the right of private individuals to enter contracts – including contracts over their own labour power. Liberty was defined as security from the arbitrary power of the king or feudal lord, within a framework of the rule of law. (Desai 2004: 17) This definition of 'liberty' is central to the future of liberalism. It was also to have some perhaps unintended consequences:

Classic liberalism championed freedom, but was wary of democracy. This is why Marx's unfinished critique of Hegel was so radical for its time. To admit the propertyless (proletariat) into the Elective estates was beyond the imagination of Locke or Mill. For classic liberalism, freedom was freedom to hold and enjoy the fruits of property. This included, of course, property in your own labour-power.... The creation of the proletariat had profound, unintended consequences. Once the freedom to contract, to sell labour-power, had been granted, the parity of status in the sphere of contracts could not but lead to a demand for status equality everywhere else.' (Desai 2004: 307)

As Smith conceded at the time, the right to private property led to heightened economic inequality. The linked right to contract, however, created status equality, laying the basis for modern democracy and setting the terms on which the social impacts of the market economy would be managed.

In the West, liberty, liberalism, the emergence of capitalism, relative freedom from monarchy, the rights of individuals over their own labour power, the creation of the proletariat, the birth of democracy, and the creation of associated social and political institutions are all inextricably linked in this set of historical moments. It isn't possible to understand neo-classical economics, let alone neo-liberalism, or the implicit identification of capitalism, liberty and democracy in the Western psyche without understanding these roots; nor to understand that the institutions to which they gave rise are specific to a history which is not universal.

In South Africa, this is well illustrated by the entirely different processes through which an African working class was formed. In Britain, a propertyless proletariat arose as a result of the enclosure of land and the removal of people's rights of access to the commons. They streamed into towns and cities. In South Africa, by contrast, while people were also forced off land, they were denied access to urban areas, and forced into limited communal areas - or 'the commons' - even where they had prior rights on freehold land. The creation of an African working class was therefore directly associated with the removal of rights to hold private property and with the re-enforcement of feudal relations on communal land. This went hand in hand with processes that entrenched status inequality on racial grounds – all as key features of the development of a wider market economy.

The point here is that the linkages and assumptions that underpin neo-classical economics and liberalism, and their associated institutions, are based on a set of historical processes that are quite simply absent from the story of the development of capitalism in much of the rest of the world: issues that will be revisited in the discussion of Douglass North's work later in this Chapter.

One more element of Adam Smith's work will be highlighted here, and that is his focus on the emergence of what he termed 'anonymous exchange' as a consequence of growing specialization and division of labour within society. This required the

emergence of new forms of contract and new institutions to ensure that transactions could be enforced.

Those who disliked the Age of Commerce contrasted it with a happier past when workers had permanent masters who looked after their welfare, what was made locally was consumed locally, and exchange was not just an anonymous act but a rich social ritual with extra-economic resonance...Smith argued that these earlier societies were based on dependant relationships especially for the labouring majority. They also had arbitrary laws which made property insecure. The powerful were above the law, and thus confiscated the fruits of other people's work on unnatural and unreasonable grounds. Liberty meant independence from these myriad social oppressions.(Quoted in Desai: 22)

Britain at this time was what would today be termed a 'transition economy'; some of the tensions and transitions described above still resonate today in areas where analogous transitions are still in process, as later Chapters will describe.

The Age of Commerce is followed by the Industrial Revolution; Marx's analysis of the productive forces this unleashed, of class formation and struggle, of the raw economic effects of competitive market pressures and the concentration of capital that results from this remains key to the analysis of capitalism. This holds true not only within a Marxist tradition, but beyond it also - whether as core to the analysis or as a form of theoretical 'counterfactual'.

One of the enigmas of Karl Polanyi's 1944 work on the emergence of market economies, titled 'The Great Transformation', is therefore the extent to which he simply ignores Marx's analysis of the rise of capitalism altogether, leaving readers to construct both the resonances and dissonances for themselves, in a context in which Polanyi provides his own scathing critique of economic liberalism.

Polanyi provides a detailed critique of the concept of self-regulating markets, a concept that he argues became a matter of 'veritable faith' for economic liberalism in this period, based on three classical tenets:

(T)hat labor should find its price on the market; that the creation of money should be subject to an automatic mechanism; that goods should be free to flow from country to country without hindrance or preference; in short, for a labor market, the gold standard and free trade. (Polanyi 2001: 135)

This goes along with the assumption that there should be no interference in markets by the state, and that neither price nor supply nor demand should be regulated,

creating conditions which make the market the only organizing power in the economic sphere. At the core of Polanyi's critique of neo-classical economics and economic liberalism is his argument that no market economy can or has developed in this way:

(T)he road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism. To make Adam Smith's 'simple and natural liberty' compatible with the needs of a human society was a most complicated affair....the introduction of free markets, far from doing away with the need for control, regulation, and intervention, enormously increased their range. (Polanyi 2001: 140)

Polanyi argued that economic liberalism is utopian, and that the concept of self-regulating markets implies the separation of society into distinct economic and social spheres, when in practice, no such separation is possible. Despite the fact that he 'glimpses' the idea rather than naming it or elaborating it (Block: 2001: 1), he is credited with the argument that the economic sphere is 'embedded' in society, and cannot be 'disembedded' (Fred Block, in the Introduction to Polanyi 2001: xxiii, and also Block 2001).

His work foregrounds the extent to which market economies have relied from their inception on the ongoing and direct intervention of the state, rather than on self-regulating mechanisms. This is particularly the case in relation to markets in land, labour and money, and Polanyi argues that rather than these being commodities produced in order to be bought or sold, these are instead 'fictional commodities':

Undoubtedly, labor, land and money markets are essential to a market economy. But no society could stand the effects of such a system of crude fictions even for the shortest stretch of time unless its human and natural substance as well as its business organization was protected against the ravages of this satanic mill. (Polanyi 2001: 71-73)

The heart of Polanyi's argument is that the concept of self-regulating markets is a fiction, and that in practice, societies have protected themselves against the ravages of the market economy in what he describes as a 'double movement':

Social history in the 19th century was thus the result of a double movement: the extension of the market organization in respect to genuine commodities was accompanied by its restriction in respect to fictitious ones. While on the one hand markets spread all over the face of the globe and the amount of goods involved grew to unbelievable proportions, on the other hand a network of measures and policies was integrated into powerful institutions designed to check the action of the

market relative to labor, land and money. ...Society protected itself against the perils inherent in a self-regulating market system – this was the one comprehensive feature in the history of the age. (Polanyi 2001: 76)

The origins of the concept of social protection lie here: not as a welfare net, but as a set of mechanisms through which society protects itself from the negative impacts of the market economy on society – including on its monetary policy. Given the role and social impact of international financial crises, and the social impacts of monetary policies in the 20th century, the scope of Polanyi's concept of social protection has proved prescient.

Polanyi's sweeping exploration of this 'double movement' provides a march through history from the mercantile era in England to the end of the second World War, when Polanyi has his own 'end of history' moment, and declares the notion of the self-regulating market to have been defeated. With fascism newly vanquished, Keynesian economics on the ascendance, the New Deal part of recent modern history, the UN newly formed and the Marshall Plan unfolding in Europe, Polanyi could be forgiven for this if it weren't that the 'double movement' was his own trademark theory. This should have alerted him to the certainty of a counter-movement, which when it came, was in the form of a raw and aggressive neo-liberalism.

Before then, however, the 'Golden Age' of Keynesian economics lasted some forty years, with its essential architecture becoming so institutionalized in Western societies that the entitlements it created remain embedded still, albeit in embattled and truncated forms.

Keynes, too, rejected the concept of self-regulated markets, with a key part of his critique focused on the classical economic theory of general equilibrium, in particular as it relates to the labour markets. This theory assumes that if markets are left to themselves, and if labour is left to 'find its price' on the market, the laws of supply and demand will lead to full employment. The theory of general equilibrium has relevance here because of its implicit presence in contemporary debates about the role of the informal sector and as part of calls for labour market flexibility, in which context unemployment is blamed on the regulatory constraints imposed on the

market mechanisms through which labour is expected to find its price. A particular level of ire is reserved for the impact of trade union negotiation on this process.

By contrast, Keynes argued that fluctuations in employment should be an expected part of the cycles in any economy, and that in addressing these cycles, it was necessary to make an analytical distinction between macro- and micro-economics – a distinction that Keynes is credited with being the first to make. He argued that mass unemployment is not a problem that can be solved at the level of micro-economics, namely by simply reducing the cost of labour until it finds its price on the market; it is instead a problem of aggregate demand in the economy as a whole, which requires intervention at the macro-economic level. For Keynes, macro-economic policy was part of the planning required to create a 'socially viable economy', in which government 'could not disclaim responsibility for shaping demand and the structure of the market system itself.' (Townsend 2002: 1-2)

Keynes' argument for the provision of unemployment benefits and government investment in jobs had two dimensions. Firstly, Keynes argues this was necessary to stimulate consumption in the economy in order to stimulate demand, which would in turn lead to the creation of jobs. This would then reduce the reliance on such mechanisms. In addition, however, Keynes argued that because the risks of unemployment are societal-level risks, society needs to share that risk through compulsory social insurance provided to the unemployed as a right.

In the post-war years in the West, unemployment was contained, economies grew, inequality and poverty were much reduced, and a wide set of public goods and social entitlements were institutionalized. However, the seeds of the destruction of Keynesian economics were busy germinating, with the oil price shock and rising inflation, taking place against the wider global backdrop of decolonisation and a continued Cold War.

While anti-colonial struggles across the 'third world' all had their own forms of anti-imperialist or national liberation content, in practice, the Cold War's hot wars were also fought vicariously through many of these struggles. It is in this context that 'aid' and 'development' were also born, as post-colonial phenomena that created new forms of dependency as part of securing a global balance of power.

But in this period, both aid and development were explicitly de-linked from politics, and particularly from democracy. This was not a context of governance conditionalities: far from it. Such linkages would have limited the flexibility to follow coups in the Belgian Congo or Chile with the 'aid' needed to keep the allegiance of Mobuto Sese Seko or Augustus Pinochet. It was not just aid that flowed freely in this period, but loans also, laying the seeds of the debt crisis and the justification for the neo-liberal policies that were to follow.

2. Neo-liberalism

In the 1980's, the rise of neo-liberalism and its expansionist global reach through the International Monetary Fund (IMF) and the World Bank soon reduced Keynes to a hazy memory. The 1990's brought the end of the Soviet Union, the deconstruction of the Berlin Wall and of 'actually existing socialism,' leading Fukuyama to declare 'the end of history' - the antithesis of Polanyi's earlier declaration. This time, however, it was the market economy that was the victor, with free market fundamentalism seemingly unfettered by any remaining geo-political niceties.

It was an era of resurgent economic liberalism, with a focus on trade liberalisation for developing countries (as opposed to at home); capital account liberalisation, and deflationary monetary policies, in which social spending had to be cut in the interests of stabilization, public enterprises were privatised, and the state was emasculated. While the macro-economics of Keynes had been oriented to social planning and a close integration of social and economic policy, neo-liberalism instigated a bitter divorce.

It was a long dark night, especially for Africa, where these policies were particularly assertively promoted by the International Monetary Fund. However, neo-liberal triumphalism did not last, tempered finally by the growing evidence that these policies were failing on their own terms, with a growing number of text-book case studies of how unfettered markets can lead societies to self-destruct. James Putzel uses Polanyi to illustrate a contradiction at the heart of the liberalisation agenda:

The formula for development proposed by the advocates of economic liberalism has been based on giving free reign to market forces and rolling

back the state, but historically the consolidation of markets has been achieved only through significant state intervention. (Putzel 2002: 2)

By rolling back the state, 'the neoliberal reformers of our age undermine the vehicle for social protection so essential to the development of capitalism historically.' (Putzel 2001: 3)

The 'rediscovery of poverty' in the multi-lateral institutions, the focus on sustainable development, the adoption of the Millennium Development Goals and the shift from structural adjustment to Poverty Reduction Strategies and then growth can in some senses be seen as part of Polanyi's 'double movement' being played out on a global scale – despite the absence of global mechanisms through which such a double movement can be effectively expressed or secured.

While a substantive paradigm shift has taken place, core aspects of neo-liberal thinking nevertheless remain remarkably resilient and embedded. This includes the continued separation of the social and the economic in policy praxis – with implications for how markets are understood, and the scope to change how they work.

3. From Neo-liberalism to New Institutional Economics

By the 1990's, mainstream economics had discovered institutions, and the 1993 Nobel prize winning economic historian credited with achieving this was Douglass North. Three key themes in his work are particularly relevant to the issues that follow in later Chapters. Firstly, his definition of institutions is widely used in the 'making markets work' debates to provide the framework within which markets are specified as institutions. Secondly, his work on the determinants of change in economic history will be drawn upon to explore how systemic change happens within markets and market systems. Finally, elements of his work on the institutional and incentive frameworks required for growth have a direct bearing on issues of market development.

North concedes that the importance of institutions has a long pedigree on the left, if not in neo-classical economics. In reflecting on rapid changes in economic history and the increasing role of econometrics, North comments:

But even while the new breed was destroying one traditional explanation after another, the traditional historian, even in retreat, kept muttering over and over, 'But you are destroying the existing myths without replacing them. Soon there will be no economic history – just an immense heap of numbers.' And sometimes, plaintively, from the left flank of retreating historians, there would come the cry, 'But institutions ARE important!' (North 1971: 118)

North's focus on institutions does not place him on the left flank, but it did shake up mainstream economics, leading to New Institutional Economics, which is credited with the sudden centrality of 'governance' in the development discourse in the post Washington Consensus period - and with what Mushtaq Khan would call the rise of the service delivery state to replace the slim (or emaciated) state of the 1990's.

North defines institutions as follows:

Institutions form the incentive structure of a society, and the political and economic institutions, in consequence, are the underlying determinants of economic performance. (North 1994: 359)

Institutions are the humanly devised constraints that structure human interactions. They are made up of formal constraints (e.g. rules, laws, constitutions), informal constraints (e.g. norms of behaviour, conventions, self-imposed codes of conduct), and their enforcement characteristics. Together they define the incentive structure of societies and specifically economies. (North 1994: 360)

It is the interaction between institutions and organisations that shapes the institutional evolution of an economy. If institutions are the rules of the game, organisations and their entrepreneurs are the players. (North 1994: 361)

North critiques the view that incentive frameworks can develop without the active intervention of government, and in an argument strongly reminiscent of Polanyi, he argues that the evolution of the legal framework for market economies in the West 'was a long incremental process stretching from the medieval law merchant to the gradual integration of those rules into common and Roman law.' (North: n.d. (1): 12)

The institutional features that facilitated growth in developed economies include an increased role for government.

(T)he economic restructuring itself entails a still more fundamental restructuring of the entire society in order to create efficient economic

markets. This technology and accompanying scale economies entail specialization, minute division of labour, impersonal exchange and urban societies. Uprooted are all the old informal constraints built around the family, personal relationships, and repetitive individual exchanges. Indeed, the basic traditional functions of the family – education, employment (the family enterprise), and insurance – are either eliminated or severely circumscribed. New formal rules and organisations and an increased role of government replace them... (North 1990)

For North, this is a sign of the 'adaptive flexibility' that characterizes the relative success of the developed world in altering their institutions to respond to (and create the conditions for) economic change, and argues that in less developed countries, such institutional change has proved intractable – to be made all the more intractable by the slim state that was still to follow. Although North doesn't argue this, elements within his notion of adaptive flexibility have synergies with Polanyi's double movement, with North's examples illustrating ways in which society adapts and innovates institutionally to mitigate the social effects of the market, with government playing a key role in the process.

North argues that economic history is overwhelmingly a story of economies that failed to produce a set of economic rules of the game that induce sustained growth. 'The central issue of economic history and economic development is to account for the evolution of political and economic institutions that create an economic environment that induces increased productivity.' (North 1991: 98).

North argues that neo-classical economics and contemporary growth theory are unhelpful in understanding what incentivises the process of growth:

In fact, to put it bluntly, the growth theory stemming from neo-classical economics, old or new, suggests not only ignorance of the empirical evidence, historical or contemporary, but a failure to recognise that incentives matter; surely a remarkable position for economists whose theory is built around incentives. It is the incentive structure imbedded in the institutional/ organisational structure of economics that has to be a key. (North n.d. (2): 1)

While some incentive structures develop in ways that facilitate exchange, encourage technological change and human capital development, others develop in ways that support monopolies, thwart technological change, and raise the costs of transacting.

Why then not simply replace 'good' institutions with 'bad' ones? North argues that institutional frameworks cannot simply be transplanted from one context to another

and develop and change incrementally, through the interaction of institutions and organisations, negotiated by formal and informal social compacts and trade-offs in a given context:

(Institutions) evolve incrementally, connecting the past with the present and the future; history in consequence is largely a story of institutional evolution in which the historical performance of economies can only be understood as part of a sequential story. Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation or decline. (North 1991; 97)

Or, to paraphrase Marx, people make history, but not under the circumstances of their own choosing. It is in this context that North uses the concept of 'path dependency,' and argues that it is why revolutions are never as revolutionary as they intend to be, because 'while the rules may be changed overnight, the informal norms usually change only gradually', and it is these norms that provide legitimacy to the formal rules. This is another reason why institutions can't be implanted from one context to another.

Nor can it be assumed that societies will adapt in ways that lead to growth. North argues that in this respect, 'the rationalist assumption' underlying economic theory is 'patently false,' because it assumes that choices are made under conditions of certainty and complete information:

The rationalist assumption of neo-classical economics assumes that the players know what is in their self-interest and act accordingly; ten millennia of human economic history say that is a wildly erroneous assumption. (North n.d. (2): 12)

In his analysis of the types of institutions that support economic growth, North places particular emphasis on secure property rights, on institutions that reduce uncertainty in exchange and facilitate anonymous exchange, and institutions that reduce transaction costs. These are all key issues for enterprise development at an applied level, as well as key themes in New Institutional Economics (NIE).

In relation to property rights, North is at times at risk of elevating a particular form of tenure security to the status of a universal institution, despite his own strong emphasis on the fact that institutional frameworks cannot be transplanted and are historically specific.

Institutions that reduce uncertainty in exchange, that facilitate Smith's anonymous exchange, and that reduce transaction costs are all key to the development of the services sector, to how markets do and don't work, and to the terms on which enterprise on the margins are able to participate in them. According to North, with a growing division of labour and increased specialization in society:

... societies need effective, impersonal contract enforcement, because personal ties, voluntaristic constraints and ostracism are no longer effective as more complex and impersonal forms of exchange emerge. It is not that these personal and social alternatives are unimportant; they are still significant even in today's interdependent world. But in the absence of effective impersonal contracting, the gains from 'defection' are great enough to forestall the development of complex exchange. (North 1991: 101)

The greater the division of labour and of specialization, the more complex the forms of transaction, and the more important the issue of transaction costs. Without contract enforcement mechanisms, the transaction costs will reflect the associated risk that the other party will defect on the contract. North argues that throughout history, the size of this risk premium has acted to limit the development of complex exchange, and therefore the possibilities of economic growth. (North 1990: 33)

North cites empirical work that shows that 45% of US GNP in 1970 was devoted to the transaction sector. He describes the stage of development of modern western societies as follows:

In the final stage, specialization requires increasing percentages of the resources of society to be engaged in transacting, so that the transaction sector rises to be a large percentage of gross national product. This is so because specialization of trade, finance, banking, insurance as well as the simple co-ordination of economic activity, involves an increasing proportion of the labor force. Of necessity, therefore, highly specialised forms of transaction organisations emerge. International specialization and division of labour requires institutions and organisations to safeguard property rights across international boundaries so that capital markets (as well as other kinds of exchange) can take place with credible commitment on the part of the players. (North 1991: 102)

North criticises neoclassical economic theory for failing to take transaction costs into account in the theory of market efficiency:

The neoclassical result of efficient markets only obtains when it is costless to transact... When it is costly to transact, institutions matter. And it is costly to transact. (North 1994: 360)

Perfect competition is presented as politically neutral in economic theory; but institutions are social constructs. Issues of power and influence are intrinsic to the terms on which they are constructed, and they differ in different societies.

While North is cited as the intellectual catalyst for New Institutional Economics, a significant literature has developed in the area since then; and while the footprints of North's arguments are everywhere, the body of the arguments often seems to be missing, and NIE seems to fall often into precisely the traps he warns against: in particular, reducing the 'correct' institutions to a set of pre-determined Western (or Washington) ones. By contrast, North argues the case for the historical, political and cultural specificity of institutional development, the role of organisations and of political processes in shaping institutions, and the need for these to reflect key forces in the society, in order to create the legitimacy required for the enforcement of the rules of the game.

4. NIE, Governance and the Service Delivery State

In a critique of New Institutional Economics (Chang 2005), Ha-Joon Chang comments on the explosion of academic literature on institutions and development, and on governance reform, including the World Bank's 2002 World Development Report: 'Building Institutions for Markets' (Oxford University Press, NY).

WDR 2002 argues that efficient and inclusive markets are critical to poverty reduction and growth, and identifies the need for institutions to enhance market development. Such institutions need to perform three key functions: they need to reduce information asymmetries, reduce transaction costs such as dispute resolution and contract enforcement, and they need to enhance competition in markets. Chang argues that the focus on institutions has provided a new lease of life for neo-liberal economics:

So, now the orthodox economists use institutions to explain why 'good' economic policies based on 'correct' economic theories have so consistently failed. By talking about deficient institutions, they can argue that their policies and theories were never wrong, and did not work only because the countries that implemented them did not have the right institutions for the 'right' policies to work. In other words, the institutional argument is being mobilised as a means to protect the core tenets of

orthodox economics in the face of its inability to explain what is happening in the real world. (Chang 2005: 2)

Chang cites Rodrik in accusing NIE of 'property rights reductionism,' critiques the glorification of private property rights as against any other form of secure rights in property, and calls into question the assumption in the literature that strong protection of existing property rights is always optimal for economic growth - because this assumes that the status quo is always optimal for growth. He highlights the extent to which existing rights and endowments are politically constructed:

To begin with, the establishment and distribution of property rights and other entitlements that define the 'endowments' of market participants, which neoliberal economists take as given, is a highly political exercise. The most extreme examples are the various episodes of 'original accumulation' in which property rights were redistributed through the most naked forms of politics, involving corruption, theft and even violence, such as the Great Plunder or the Enclosure in the early days of British capitalism, or the shady deals that dominate the privatization process in many developing and ex-communist countries these days. (Chang 2001:12).

These key issues are addressed by Mushtaq Khan in his analysis of failed states – and of successful states in the developing context. He distinguishes between two concepts of the state: the 'service delivery state' and the 'social transformation state'. The governance debate has led to a 'liberal-market consensus' that in order to generate growth,

.....states have to protect private property rights, defined by strong contract enforcement, low expropriation risk, and low corruption; they have to ensure undistorted markets defined by low rents; and they have to achieve democratic accountability and civil society participation to keep the state in check. The key service delivery capacities of the state are to provide protection for property rights, and to deliver democratically decided-upon public goods efficiently. (Khan 2002: 1).

These are the key features of the current governance agenda, and what Khan defines as the service delivery state (or reconstituted developmental state), in which calls for privatisation are now largely muted, public goods are good again, and the service delivery role of the state is increasingly centre stage – a position perhaps partly exemplified by emergent post-GEAR policy in South Africa from 2005 – and certainly by Britain's 2006 White Paper on Development, entitled 'Making Governance Work for the Poor'.

Khan argues that many of the elements in this agenda are important as ends in themselves, but that it is necessary to distinguish between means and ends, and the fact that these may be desirable ends does not mean that they are *instruments* for achieving 'economic take-off'. He argues that 'the reform package which aims to push institutions in developing countries in the direction of a generalized advanced country model is not actually relevant for assisting developing countries in carrying out the *transition* from essentially pre-capitalist societies to dynamic capitalist ones.' (Khan 2002: 2). He argues:

This social and economic transformation happened in advanced countries over centuries. A shock of similar magnitude has hit developing countries telescoped over a period of decades and (perhaps partly as a result), the transition to capitalism has been much more patchy. Old production systems have collapsed often well before new ones can take over, social conflicts are intense, and stable and productive political constituencies on which viable democracies can be based are often absent. At the same time, political and economic expectations are higher than at any time in the past. The real question facing developing countries is whether these processes are likely to lead to a viable and dynamic capitalism as it appears to have done in a few high-growth economies, or whether it will lead only to the theft of resources by unproductive classes and a descent into anarchy...The consequences of yet another round of multilateral-led reform in developing countries running out of steam do not need to be spelt out. (Khan 2002: 2)

Khan argues that states in developing countries play a much more critical role in economic development than the service delivery model suggests; and that in contexts where the capitalist sector is not dominant, state success or failure in the transition is not related 'in any simple way to the state's neutrality in upholding pre-existing property rights, or its abstention from intervening in the economy or in social conflict.' (Khan 2002: 9)

We have seen that the liberal-market consensus argues that the institutional structure for maximising growth is one which ensures that there are no rents in markets, where the state maintains stable property rights, and limits the transfers it carries out. The main task for the state is to concentrate on the delivery of democratically agreed upon public goods and to have a tax system that is efficient in raising resources for these tasks. While public good delivery is very important, evidence from developing countries casts doubt on the adequacy of these positions. The state's ability to carry out relatively massive interventions in property rights systems has been critical in dynamic social transformations in many high-growth economies, as has been the creation and management of growth-generating rents. States have also carried out significant transfers which contributed to political stability and thereby made the emerging institution structure politically viable. (Khan 2002: 9)

Khan argues that far from stable property rights being a necessary condition for growth, high-growth transitions have by contrast often been characterized by a rupture in existing property relations, with such ruptures creating new conditions for growth. According to Khan, stability in institutions such as property rights follows, rather than precedes, such transitions. Khan argues further that 'the most persistent types of state failure occur when institutions fail because of an inappropriate match between internal political settlements and the institutions and interventions through which states attempt to accelerate transformation and growth'. (Khan 2002: 3).

5. The Social Construction of Markets

In a complementary critique, Chang argues that in the debate over the role of the state and markets, there is a tendency not to give the concept of markets much institutional specificity, and that the terms of the debate are often rooted in a flawed set of assumptions. As a result, many of the critics of neo-liberalism have responded to it with models that justify state intervention in markets – as with the 'service delivery state'.

Chang takes the debate back to basics by arguing that both these models take as given both the concept of the market, as well as a set of assumptions about what constitutes 'intervention'.

Chang argues that implicit in the debate about how much or how far the state should intervene in markets is the neo-classical assumption of market primacy – that markets develop best left without interference. He refers back to Polanyi to make the point, and in an argument complementary to Khan's above, Chang argues that

whether or not we accord institutional primacy to the market makes a critical difference to how we design development policies for countries that have yet to set up a fully developed market system.... the developmental crises that many development countries have gone through ..shows how dangerous it is to assume the primacy of the market and believe it will naturally develop as far as the state does not interfere with its evolution. (Chang 2001: 11)

Chang uses examples from both the UK and the USA to illustrate the key role of state intervention in establishing private property, markets, and in promoting industrialization, pointing to the USA as the home of infant industry protection. In his book, *Kicking away the Ladder*, Chang elaborates on the many ways in which the

forms of state intervention declared out of bounds for developing countries today formed the backbone of the successful development policy in countries that now no longer need the protection such policies afforded.

Once we accept that even the United Kingdom and the United States, the two supposed models of market-based development, did not develop through spontaneous emergence of markets, it is much easier to see that virtually no country achieved the status of an industrialized country without at least some periods of heavy state involvement. (Chang 2001: 10)

Chang also argues that what defines a market as 'free' and what is seen to constitute 'intervention' are both context specific, and based on an underlying set of assumptions about the rights framework.

He uses the example of child labour, arguing that few people in the advanced countries would at present consider the ban on child labour as a state 'intervention' artificially restricting entry into the labour market, whereas many Third World capitalists currently regard it as just that. In the advanced countries, the right of children not to work is seen as having precedence over the right of producers to employ them. This is so widely accepted that it is not considered a legitimate subject of policy debate – let alone a form of 'state intervention'. Yet in many developing countries, it is indeed still considered a state intervention that impacts on economic efficiency. The same applies to the issue of slavery. This is no longer considered an 'intervention' that limits labour market flexibility, yet it was over a hundred years into the development of capitalism, and only following significant struggles and a civil war in the US, that the ban on slavery stopped being considered an unjustified intrusion of the state into the market. Markets are constantly shaped by social and political factors – they are socially constructed:

People usually assume that what goes on in the market belongs to the economic sphere and the rest in the social sphere. However, a market can be defined only with reference to the rights and the obligations of its (legitimate) participants, which in turn are products of various (conscious and unconscious) political decisions, and not some 'scientific' law of economics. In other words, as Polanyi (1957) has so clearly shown, the market itself is a political (and social) construct, and therefore there cannot be any such thing as a neatly separable domain of 'market' that is free from 'politics' or 'social' concerns. (Chang 2001: 3)

Chang argues that the notion of political economy is generally applied to analysis of the role of the state; but that there is a need for a 'political economy' of markets

also, that specifies in more analytical depth the ways in which they are socially and politically constructed.

6. Employment and enterprise development: straddling social and economic policy

This Chapter has so far focused on elements within the overarching debates on political economy, the relationship between the social and the economic, the state and the market, and the role of social protection and the 'double movement' in market economies. It has looked at the increasing attention paid to the role of institutions in political economy, and has explored the analysis of markets as institutions that are socially constructed.

These issues provide key conceptual reference points that will be drawn on and built upon in the Chapters to come. First, however, there is an interim level of analysis required to locate the debates on the role of small enterprise in development within the context of wider labour market and employment concerns, as well as in relation to social policy and social protection. This is because policy to promote small enterprise development straddles all these areas - in often uneasy ways.

The presence of small enterprise development as part of both social and economic policy is because of the role ascribed to it in employment creation. Yet Judith Tendler (2002) argues that in fact, the level of focus on small business development as the vehicle for job creation in developing countries reflects the extent to which employment concerns have been marginalised from core trade and industrial policy. While in the past, policy concerns about employment were wedded to economic policy, this is no longer the case:

Today, concerns about employment have no such home. No longer considered 'serious' economic development, they are now relegated to the realm of social policy, safety nets, and small-enterprise and informal-sector specific programs - a realm that has become marginal to the central project of economic growth. (Tendler 2002: 4)

In post-apartheid South Africa, the Reconstruction and Development Programme (RDP) was soon replaced with a more neo-liberal framework called Growth, Employment and Redistribution (GEAR). Despite the intents of its title, jobs

haemorrhaged from the economy in this period (Altman 2005). Trade and industrial policy were accused of abdicating their roles in relation to employment protection or creation, with the role of the small enterprise sector in employment creation providing a form of policy proxy for this instead.

However, the inexorable rise of unemployment levels from a broadly defined 26.5% in 1995 to 41.8% by 2004 (Altman 2005: 425) has brought employment creation and employment-related policy squarely onto centre stage and back into debate on trade and industrial policy in South Africa. This increased policy focus on employment creation has had the perhaps perverse effect of also bringing small enterprise promotion into increased prominence as part of the core growth and employment creation agenda.

With this sector arguably punching way outside its weight in the employment debate, the constraints facing small business growth have been given high priority within wider policy – and in particular, within debates about labour market policy. This is in part because the notion that small enterprise is good at creating jobs has become a truism rarely subjected to critical analysis.

This is compounded by the extent to which, in the South African debate, the definition of small enterprise routinely lumps together a continuum of economic activity that spans formal-sector light industry and high-value-adding small enterprises that may be at the cutting edge of technological advance along with formal and informal micro-enterprise and survivalist income generating activity.

As a consequence, 'small, medium and micro enterprises' (SMMEs) and 'the informal sector' are often used almost interchangeably, with inflated expectations of the sector's job creation potential arising as a consequence (Isandla 1999). The informal sector, or the 'informal economy' as the ILO now calls it, is in turn defined as including both informal enterprise, and also the informally employed. This conflation of distinct trends has not been helpful to policy clarity.

In practice, while different definitions of informality have been used ever since the term was coined on an ILO mission to Kenya in 1973, the defining parameters of the concept have proved elusive (Chen 2004; Hart 2004; Trebilcock 2004; Devey,

Skinner and Valodia 2006). Alice Sindzingre lists just some of the descriptions typical in the literature:

(N)on-observed, irregular, unofficial, second, hidden, shadow, parallel, subterranean, informal, cash economy, black market, unmeasured, unrecorded, untaxed, non-structured, petty production, unorganised, to name just a few. There is no common understanding as to whether they refer to the same phenomena and if not, what the relationships are between them. (Sindzingre 2004: 10).

In the face of such conceptual fungibility, Hans Singer's definition has a certain appeal: '(T)he informal sector is like a giraffe: it is difficult to describe but easy to recognize.' (Sindzingre 2004: 4)

Despite the attractions of this definition, it is not actually useful, because while people do assume that they recognise the informal sector when they see it, they're often actually wrong. For example, the Lesotho stone cutters discussed in Chapter Seven would seem obvious candidates for the 'giraffe'-based definition: most group members are illiterate; they are working with hand tools in the mountains of Lesotho, at a site to which no formal road exists, without shelter, electricity or running water. Any casual observer would assume they represent a clear-cut example of informal enterprise. Yet in practice, they are a registered co-op, with a quarrying license, a bank account, and carefully kept books; they are also part of a supply chain exporting to Gauteng and the Seychelles.

In practice, there is a highly diverse continuum of relationships within the economy, within which relations between formal and informal, core and periphery, empowered and disempowered are woven in complex ways, without even a clear continuum of standardised relationships, and with participants as much 'negatively incorporated' as socially excluded or marginalised.

This illustrates a key point relevant to the current South African debate on the dual economy, which is that while the South African and regional economies are certainly highly unequal, this inequality derives from and is reproduced by a myriad of interdependencies and relationships that mean there is no clear dividing line between first and second economies, or formal and informal ones. This is the case whether an economic or a social lens is used, and is reflected within local economies, within supply chains, within markets, and within households and communities too.

The 'labour elite', much derided by the private sector and its champions, goes home to households straining under the growing burdens of unemployment and HIV and Aids. Statistics indicate that households in which at least one member is employed are that much more likely to include others that are self-employed or involved in enterprise activity (Devey, Skinner and Valodia 2006: 241). Similarly, recipients of predictable social transfers are more likely to invest in economic activity than those without. (Sampson 2006). Redistributive flows take place within households in multiple crucial ways across these conceptual divides, in relation to both capitals and consumption. Understanding this is vital for policy and praxis.

With the limits of the concept of the informal sector noted, further compounded by the variances in South African statistics in this area, it is nevertheless relevant that the informal sector remains a small part of the South African economy by international standards, comprising about a quarter of the total workforce (Altman 2005: 448) compared to half to three quarters in many developing contexts. This is the case even taking into account that the extent of its current growth is contested. (Altman 2005: 449; Poswell 2002).

In this context, and in order to clarify the focus in this thesis, it is necessary to note some relevant distinctions within the sector. The most important of these is that within the informal sector, it is the informally employed who constitute by far the largest sector. Cross-country statistics compiled for the International Labour Organisation and based on national statistics show that in South Africa, self-employment represents only 25% of non-agricultural informal employment, compared to wage employment at 75% of non-agricultural informal employment (Chen 2004: 18, citing ILO 2002).

These figures are significant for two reasons. Firstly, this ratio is the inverse of the dominant trends in Africa, Latin America and Asia reflected in the same report, and based on statistics drawing from 24 other countries (Chen 2004: 18, citing International Labour Organisation 2002). It highlights the extent to which South Africa is primarily a wage economy – not only in its formal sector but in the informal sector also – where even those classified as 'self-employed' are often there as an option of last resort for unemployed people who have been ejected or excluded from

the labour market. In rural areas in particular, 'necessity entrepreneurs' far exceed the numbers of 'opportunity entrepreneurs'. (Rogerson 2004; Global Entrepreneurship Monitor 2006)

These features distinguish South Africa from many other developing countries, and it means that changes to labour market policy will have particularly significant transmission effects on poverty. These figures also highlight the need to differentiate between different types of growth in the sector, and to recognise that 'new' jobs in this sector may reflect the displacement of jobs from the formal sector, as a result of processes of casualisation and informalisation of work. While such processes may make manufacturing companies more competitive and may even contribute to growth, such job displacement from the formal to the informal sector is not job creation.

These processes are also associated with a decline in conditions of work and in living standards. In South Africa, where the wage share of GDP has declined in relation to that of profit (Altman 2005), growth underpinned by such processes can go hand in hand with an increase in levels of poverty. Not surprisingly, it is a growth path that organised labour has bitterly opposed. Changes in labour market policy aimed at facilitating an increase in these kinds of informal sector jobs may expand these poverty-creating effects – in the name of job creation.

At the same time, however, there are forms of enterprise and self-employment which, although often survivalist, nevertheless do represent additional economic activity that is making a net contribution to livelihoods on the margins. While both of these trends in the informal economy share marginality, vulnerability and a lack of social protection in common, there is a clear need to differentiate at a policy level between the ways in which those displaced from the formal sector and those engaged in informal, marginal enterprise activities relate to the formal sector and to markets of different kinds, and to recognise also that much of the polemic about labour market reform made in the name of creating jobs in this sector is as much about facilitating the further casualisation and displacement of existing jobs as it is about unlocking the supposed job creation potential of SME's.

This latter expectation also has to be qualified. While there may well be opportunities for small and medium enterprises in South Africa's core economy, the expectation that any meaningful growth in South Africa will come from the informal sector is highly implausible. Cross-country studies by the ILO show that 'no economy has successfully industrialised or boosted its productive employment primarily or largely through a massive expansion of informal own-account or petty activities.' (quoted in Isandla 1999: 6).

Yet the expectation that the informal sector can absorb the unemployed drives what Judith Tendler refers to as 'the devil's deal'. In the South American context, where the informal sector is far larger, she characterises the devil's deal as an implicit agreement by governments to overlook regulatory compliance issues in return for political support. While the devil's deal takes a different form in the South African context, the focus on deregulation and exemptions for small enterprise is familiar. Tendler argues:

Focusing on the difficulties small and informal firms face in meeting the costs of environmental and labor standards distracts our attention from pursuing opportunities for firms to, indeed, rise to the occasion and meet these standards, rather than be exempt from them. Though we are used to thinking that SFs [small firms] need protection from these 'excessively' burdensome costs, there are many cases in which SFs have actually met those costs and, contrary to the burden-relieving scenario, have been better off for it. They became more efficient, produced higher quality goods, and gained new access to more demanding markets. (Tendler 2002: 12)

While of course there is value in reducing unnecessary compliance costs or red tape, there is a distinction between this and waiving regulations altogether. Tendler argues that the focus on exemptions and deregulation also has the inadvertent effect of undermining other important elements within strategies for reducing poverty and increasing employment:

The waiving of tax, labor, and environmental regulations that results from sympathy for the 'plight' of small firms may hinder rather than help local economies if it condemns them to low-level economic stagnation, degradation of the environment, and violation of worker rights. The latter all clearly increase unemployment and poverty, as well as burdening unnecessarily the task of poverty-reducing social policy. (Tendler 2002: 15)

In South Africa, social policy has also promoted enterprise development as a solution to poverty, with 'developmental social welfare' attempting to promote a 'go fish' approach to poverty reduction:

The DSW (Department of Social Welfare) approach emphasises that social development cannot take place without economic development. It also stresses that economic development is meaningless unless it is accompanied by improvements in social welfare (Midgley, 1996). DSW is seen as promoting a preventive rather than a curative approach. It is concerned with long-term, sustainable development. It is understood to be implementing the expression that it is better to teach a person (usually stated as a 'man') to fish rather than giving them a fish. In practical terms this means involving poor people in economic development projects rather than giving them grants. (Mullagee and Nyman 2001)

Some of the impacts and outcomes of this approach will be explored in later Chapters.

In conclusion, in the current phase of South Africa's history, the formal labour market is the preferred point of entry into the market economy. This is an irony, a tragedy, and a victory all at once.

It is an irony that this should be the case because of the long history of resistance to incorporation into the labour market in South Africa. It is a tragedy because in the process of coercing black South Africans into the labour market, apartheid laws systematically limited their access to land, capital, or the 'right' to engage in many forms of business. This created the current high level of dependence on wage labour, and now that the labour market can no longer absorb all those seeking work, these potential alternatives have been eroded. There is, for example, no easy return to the land for mineworkers. The victory resides in the fact that despite a history of exploitation and abuse, struggles within the South African labour market and as part of the political transition in SA mean that the formal labour market now provides relatively high levels of rights and protection – certainly compared to the alternatives.

In this context, it is flawed to present a romanticised vision of an entrepreneurial informal sector and of micro-enterprise as a preferred solution to unemployment. Instead, it needs to be recognised that these are options of last resort for many of those currently excluded from the formal labour market, who are left with little alternative but to claw their way into the market economy through what is essentially the back door.

The questions explored here include whether it is possible to improve the terms on which those excluded enter through this back door, in a context in which the mainstream economy is failing to provide alternatives, and whether it is possible to do so on terms that create decent work and decent returns that reduce poverty. Whether this is making markets work for the poor, or simply making the poor work for markets is certainly an important part of the question.