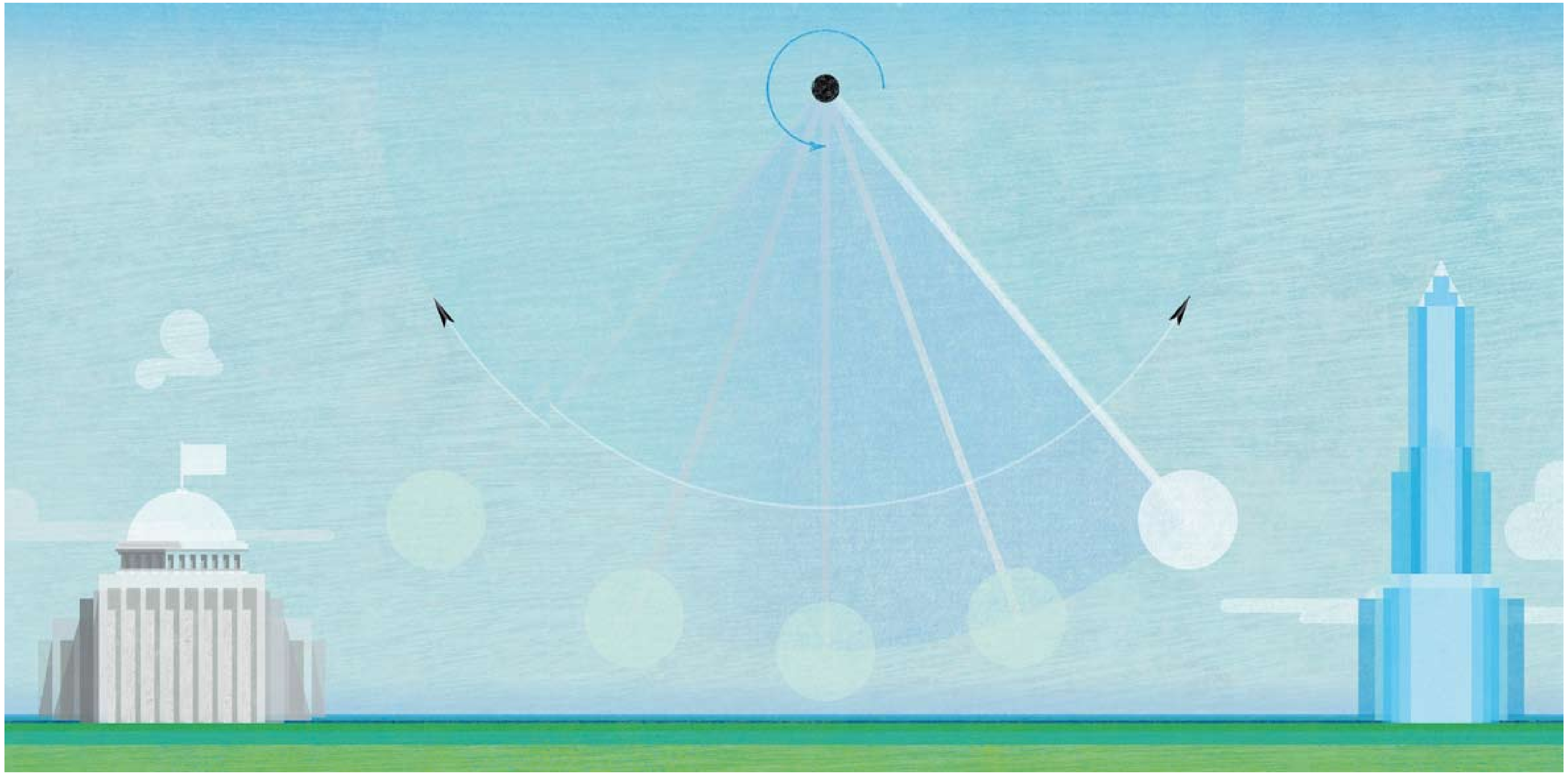

Beyond boom and bust

Swinging between the regulations of government and the excesses of the market has proven flaws, says **Michael Thompson**. Here he outlines how cultural theory can offer a new economic paradigm

"It's déja vu all over again," Yogi Berra once declared, and many of those who have now experienced the credit crunch and its subsequent financial and economic turmoil will be inclined to agree with him.

In the 1980s, Arthur Seldon, the founder of Britain's staunchly (some might say rabidly) pro-market Institute of Economic Affairs, conceded that there was one worthwhile task to which its rival and newly opened think tank – the left-of-centre Institute for Public Policy Research – should address itself. Privatisation, he said (in a letter to *The Independent*), had been the great and unqualified triumph of the preceding decade but even he had to admit that, when everything that could successfully be privatised had been privatised, a limit would have been reached. If the new think tank could determine where that limit lay, then that, he conceded, would be something well worth knowing.

Arthur Seldon died in 2005 and so did not live to see the enormous wave of collapses and nationalisations that has swept away so much of the privatisation he had championed (and, indeed, the demise of a fair few outfits that were firmly in the 'private goods' category before he even set out on his crusade).

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All of this suggests that the idea of a 'natural line' between the private and the public is too simple-minded. Hence the more dynamic notion of some sort of endless cycling: the natural line is still there, but various mechanisms – the unavoidably time-lagged feedback of information about the level of demand, for instance – ensure that, rather than settling down around that natural line, we get a never-ending pendulum effect. Things were swinging so strongly in the market direction in the 1980s that the natural line was overshot by some distance, which has led to the recent institutional carnage around the globe as the pendulum has done its thing and started to swing back the other way. Policy, of course, can dampen (and, often enough, amplify) those swings, but the fond hope that the cycle itself can be tamed has been largely abandoned. Few people nowadays are eager to align themselves with the hapless president of the New York Stock Exchange who, in September 1929, said: "It is obvious that we are through with business cycles as we have known them."

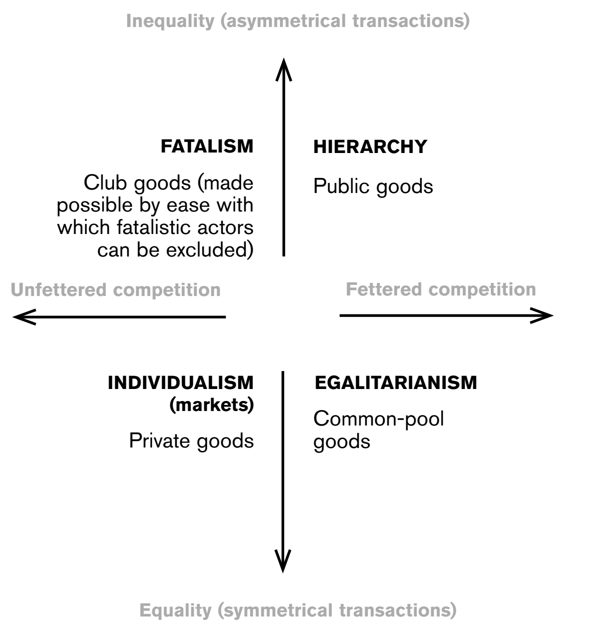
Coming back to Yogi Berra's "all over again", it is worth pointing out that Arthur Seldon's 'challenge' was not particularly new. Indeed, it is essentially a rerun of the titanic struggle, back in the 1940s, between Hayek and Keynes. Both agreed that if it wasn't the market that was allocating goods and services, it was the hierarchy (government for the most part). They disagreed only over where the line between those transactional realms should be drawn. Keynes wanted a major role for hierarchy; Hayek saw that as *The Road to Serfdom* and, like Arthur Seldon 40 years later, wanted the line pushed back as far as it would go. Either way, as Keynes observed, thereby winning on points as it were, a line had to be drawn. Hayek was all for letting nature draw the line; Keynes favoured a judicious and man-made drawing of it, some considerable distance short of where the 'natural limit' is located.

But what if there is more than just markets and hierarchies: more, that is, than the pendulum swinging back and forth between light-touch and heavy-handed regulation? Things then would be very different, rather in the way the payoff matrix for Pascal's wager (about whether to believe in God's existence) alters dramatically once we entertain the possibility of there being more than one God.

Neither Hayek nor Keynes considered that possibility (more than markets and hierarchies, that is, not more than one God) but that is what the theory of plural rationality, also called cultural theory, does. After all, why should there be just two ways of organising if, as economists and political scientists have long argued, there are four kinds of goods: private, public, common-pool and club (see Figure 1).

Briefly, markets institutionalise equality (of opportunity, that is, not outcome) and promote competition; hierarchies institutionalise inequality (eg upper echelons/lower orders, Brahmins/Dalits) and set all sorts of limits on competition. The theory of plural rationality simply completes the typology by making explicit the other two ways of organising: equality with fettered competition (which is called egalitarianism) and inequality with unfettered competition (which is called fatalism). And, for good measure, it specifies the various social constructions of nature that justify and render rational each of these four fundamental arrangements for the promotion of social transactions. An instance of these social constructions is the aforementioned four kinds of goods, category membership being demonstrably under-determined by a good's physical properties. Even lighthouses (often seen as epitomising public goods) can be privatised, and private goods soon cease to exist in a social setting where everyone has become convinced that all property is theft. And Coca-Cola's recent troubles in India, it is claimed, stemmed from making a private good of something – the groundwater – that the local villagers had long shaped into a common-pool good.

FIGURE 1
Four ways of organising competition



Take, for example, the Brent Spar oil storage structure, the deep ocean disposal of which was proposed by the market actor – Shell – and approved by the hierarchical actor – the British government's regulatory agency. Had there been only markets and hierarchies, the Brent Spar would now be mouldering in its watery grave. But of course it isn't. Another actor – Greenpeace – from a third way of organising (egalitarianism), forced its way in by audaciously, and very publicly, landing a helicopter on the structure as it was being towed out into the Atlantic. The disposal plans were abruptly abandoned by Shell (motorists, particularly in Germany, having stopped buying its petrol) and the British government was left with egg all over its face (John Major, the prime minister at the time, called Shell's senior managers "wimps"). Shell then entered into lengthy discussions with Greenpeace and the Brent Spar has been cut up into cylindrical sections to form a ferry terminal in Norway. Those British citizens who managed to remain ignorant of the whole affair (and there were many) or who found themselves convinced by whomever they happened to have last seen arguing their case on television, were evidently bound into none of these 'active' ways of organising – individualism, hierarchy or egalitarianism – and constituted a fourth and rather inactive way – fatalism – assuring one another either that ignorance is bliss or that "nothing we could do would make any difference anyway".

So the theory of plural rationality, by doubling-up from two to four ways of organising, is able to make sense – predictive sense – of something that must always remain beyond the explanatory reach of those who have equipped themselves with the conventional social science wisdom. In other words, returning to the credit crunch and the various diagnoses and prescriptions that have been advanced, we can see that the pendulum model is seriously inadequate and misleading if what we have is four ways of organising, each of which is striving to chew bits off the other three.

"What if there is more than the swing between markets and hierarchies?"

"The economic system is no longer deterministic and predictable"

True, the failure of a market is still the success of something else, but now, instead of that something else being hierarchy, it can be either hierarchy, egalitarianism or fatalism. And the eventual failure of whichever of these three was successful will be the success of one of the other three, ad infinitum. The system, in other words, is no longer deterministic and predictable; pendulums can't swing back and forth between more than two extremes.

We can visualise this sort of dynamical system as a 'transactional sphere', the surface of which is covered by four patches of differently coloured algae – the four ways of organising – each of which is all the time endeavouring to expand itself at the expense of the others. I have found it helpful to actually draw these algal patches onto table tennis balls, and if you do this you will find that each patch can have a 'frontier' with each of the other three. But some of these frontiers can disappear if one or two of the patches tend towards hegemony: spreading themselves around the equatorial regions, as it were, and pushing the others out towards the poles. And, in extremis (and here you can think of Alan Greenspan's 'self-interest ideology' that, he still believes, served him so well for 40 years), one or two or even three patches may shrink to points, thereby reducing the number of colours to three or two or even just one.

The theory of plural rationality's requisite variety condition – that each way of organising ultimately needs the others, so as (among other vital things) to have something to organise itself against – tells us that, though it is certainly possible to get to these three-colour, two-colour and one-colour states of affairs, it is not possible to then stay like that. It is hardly surprising, therefore, that, having managed to get the world's financial system pretty well to the one-colour markets-can-do-it-all state of affairs, we found ourselves hit by what Alan Greenspan has called a "once-in-a-century credit tsunami".

So, are there any practical guidelines that we can draw, once we've detached ourselves from the inadequate and misleading pendulum model and embraced this indeterminate and disequilibrating table tennis ball? Yes there are, and I'll mention just two of them. First, Ashby's law of requisite variety tells us that a control system must always contain a variety equal to that which exists within that which it aspires to control. In other words, if one or more of our coloured patches are being reduced to points (as they likely will be if the control system we are applying lacks the requisite variety), watch out! And this principle, slightly more elaborated and tied-in with the classic theory of pluralist democracy, leads us towards the somewhat counterintuitive notion of 'clumsiness'. Clumsiness is where each voice (each of the policy stories that are generated by the four ways of organising) is (a) able to make itself heard and (b) is then responsive to the others (see Figure 2).

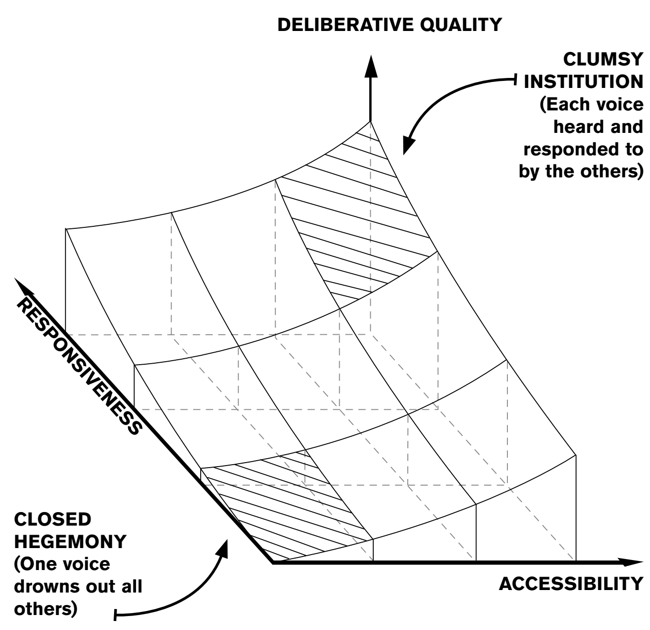
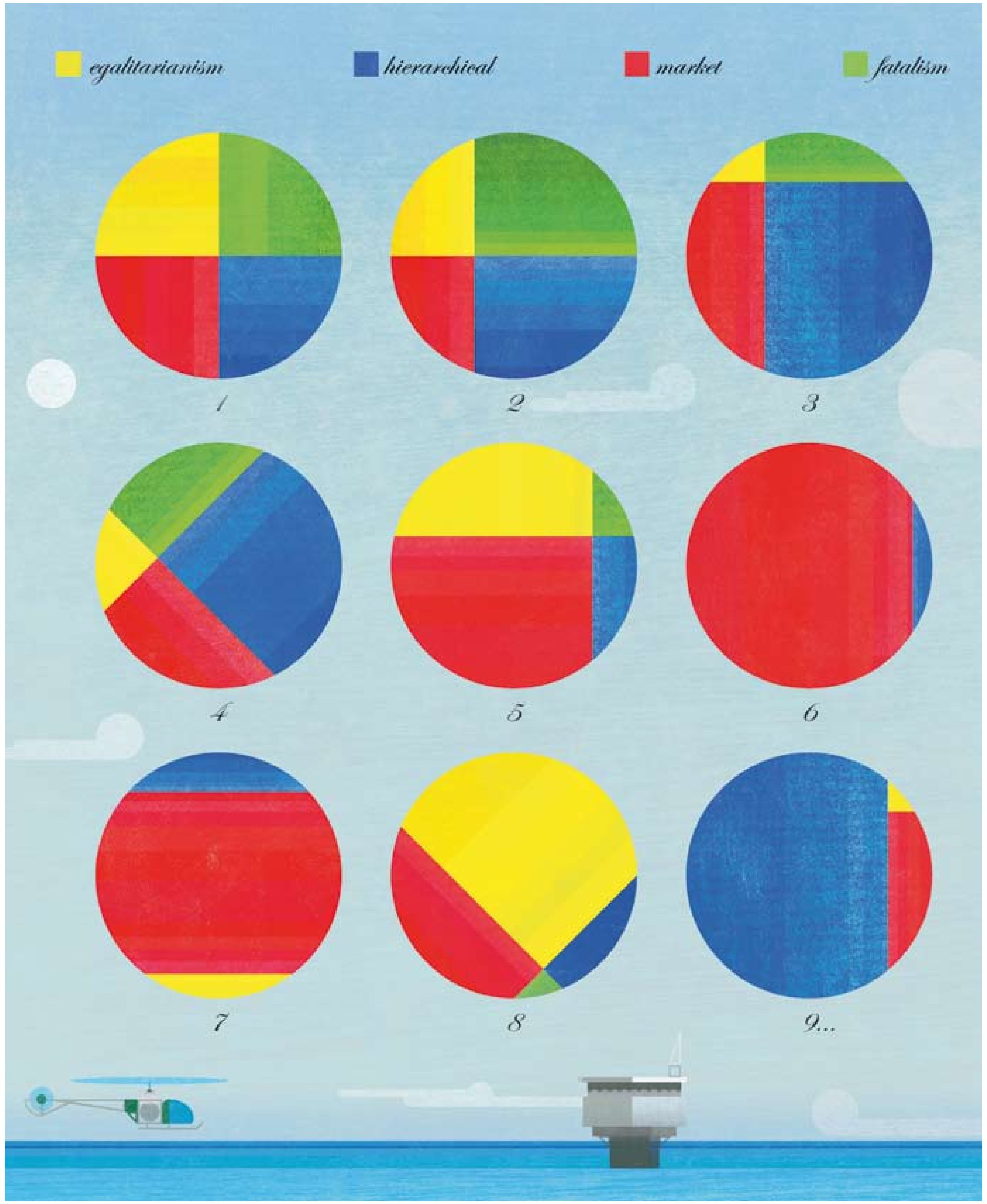


FIGURE 2
The classic theory of pluralist democracy refurbished
Note: In the classic theory, there is no typology of voices and, therefore, just a dualistic distinction between closed hegemony and pluralist democracy. Steven Ney has refurbished this scheme by placing three calibrations on each axis: one voice, two voices, all three. The fatalist way of organising has been omitted from the two axes (because it tends not to have a voice). Deliberative quality – the third dimension – increases as accessibility goes from one to three (because we get more 'nodes') and also as responsiveness goes from one to three (because we get more 'arrowheads' between those nodes).

The proper application of this diagram calls for some painstaking discourse analyses, and for equally demanding network analyses so as to identify the relevant 'policy sub-systems' (the



"We have created agent-based computer models in which all four ways of organising are present"

networks of policy actors who, between them, are shaping the decisions), but here are a couple of quick-and-dirty versions.

In the case of the Brent Spar, two voices made themselves heard, and each was then responsive to the other. In other words, the policy sub-system was in, or close to, the central province on this curvy surface. Once Greenpeace forced its way in, however, the policy sub-system moved sharply uphill into, or close to, clumsy institution (in the process uncovering rather robust options and pointing the way towards new and less objectionable technological paths that had until then remained hidden).

By the time of the credit crunch, however, the relevant policy subsystem (exemplified by the Paulson Plan, with its Wall Street/Washington architects united in an individualistic consensus) was in, or very close to, closed hegemony. Invoking the pendulum model and then instituting some fairly heavy-handed regulation will, at best, get us back up into the central province. But it will never get us to where we need to be: right up there in clumsy institution. Main Street, of course, having recently forced its way in and prevailed on Congress to throw out the Paulson Plan, might manage to stay there, but if we were to shift ourselves across to the table tennis ball model we could (a) ensure its continued presence and (b) see to it that it and the other two voices were then responsive to one another.

Secondly, we can open up a whole new area of economic thinking (and, with luck, close down a few existing ones) by actually building 'artificial life' table tennis balls – agent-based computer models, that is, in which all four ways of organising are present – and then playing around with them to see what happens. One such model, which Paul Tayler and I built more than 20 years ago, is a 'world' comprising just 30 firms, each of which has to survive (and, if possible, prosper) in its environment, which of course is nothing more than the other 29 firms.

The 'bottom-up' rules are that each firm or automaton must latch on to one of the four strategies that accompany the four ways of organising (thereby becoming an agent: hence agent-based modelling). But it must abandon that strategy and embrace one of the others if it suffers a surprise (a mismatch between expectation and result) in three consecutive rounds of the 'game'. To our delight, this stylised 'world' with its few and simple micro-level rules, once set in motion gave rise to some remarkable, and remarkably 'life-like', whole system behaviour. None of the strategies ever went into permanent extinction, it never settled down around some equilibrium, it never settled into a repetitive sequence of changes; in other words, there was nothing pendulum-like about it. Yet it did exhibit a definite cyclical pattern: optimistic upturns accompanied by some firms growing to super-size, leading eventually to a turning point and then to a downturn that was accompanied by waves of bankruptcies, after which the individualistic strategy seeped back in and a new upturn began. On and on, but with no cycle ever repeating – firm-by-firm and strategy-by-strategy – what had happened in previous cycles. "History," as Mark Twain observed, "does not repeat itself; at best it rhymes."

We tried playing the game without this or that of the four strategies and found that the 'life-like' behaviour did not emerge (which gives some experimental support to our theory's requisite variety condition). We also noticed that, although we were doing nothing to influence the complex dynamics of our interacting agents, the peaks and the troughs, though they came with impressive regularity, were (in marked contrast to what you get with a pendulum) tremendously varied in their amplitude. Occasionally, for instance, there would be a downturn so emphatic that every single firm went bust. But, in the often long interims, the cycles were sufficiently muted for the claim "No more boom and bust" to appear perfectly credible. If staff at the UK Treasury and the US Federal Reserve, in their idle moments, had had this little game running on their laptops, they might have found it a little less easy to assure themselves, when the tsunami hit them, that "nobody could have seen it coming". ■

Michael Thompson's book Organising and Disorganising: A Dynamic and Non-Linear Theory of Institutional Emergence and its Implications *(Triarchy Press, Oct 2008) is now available from the RSA Bookshop: www.RSABookshop.co.uk. A further reading list can be found in the online version of this article at www.theRSA.org/Journal*

Interactive

Watch Michael Thompson in interview with Matthew Taylor, as they explore further this dynamic approach to organisational theory: www.theRSA.org/Journal