Balancing Competition and Cooperation

Lane Kenworthy

Competition is only the half of it, writes the author. He finds cooperation has played a large role in economic development throughout the advanced world.

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For most of the past two centuries it has been widely believed that national economic success is largely a product of market competition. But the comparative evidence suggests that this view is at best only half right. Markets are clearly a useful mechanism for coordinating much economic activity, and competition has certainly proved a powerful motor for economic progress. But competition is not enough. Economies succeed when their institutional frameworks offer incentives for individuals and organizations to engage consistently in productive economic activity, and this requires cooperation. Market incentives frequently are such that actions that benefit individual actors (companies, workers, investors, unions, government agencies) are not as beneficial for society as a whole. Economies do best when they balance competition and cooperation, and markets alone are insufficient to generate such a balance.

In his recent book, *Trust*, Francis Fukuyama argues that cooperation is critical to explaining differing national economic performance patterns. In Fukuyama's view, cooperative economic behavior is stimulated principally by culture—specifically, by a culture of trust. *Trust* is one of several recent works to explore the link between trust and cooperation.[1] It is a fascinating and insightful book. But Fukuyama's argument suffers from several weaknesses.

Fukuyama suggests that trust is important primarily because it enables the formation of large privately owned corporations. This, in turn, is said to be key to understanding differences in the success of national economies. Japan, Germany, and the United States are classified as high-trust societies, whereas France, southern Italy, Hong Kong, Taiwan, and South Korea are low-trust societies. In the latter, bonds between family members are so strong as to preclude trust outside the immediate family, which inhibits the creation of large-scale enterprises.

Fukuyama picks his cases carefully. It is questionable whether the argument would fare as well if tested across a broader set of nations. Yet even among the countries he examines, he overlooks the vital economic contribution made by small and medium-size firms in Japan, Germany, northern Italy, Taiwan, and Hong Kong. Firm size is important, as Alfred Chandler and others have ably demonstrated.[2] But it gets us only so far in understanding national economic success. In addition, Fukuyama notes that such countries as France and South Korea have fared well because government has intervened to create and support large firms. He argues that there are limits to such a remedy, because not every government is as economically competent as Korea's. That is certainly true, but then again not every country with a reasonable complement of large privately owned firms is a model of economic success either—witness Britain.

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How important is trust to the creation of large firms? Probably less so than Fukuyama implies. It matters in that the owner(s) of a growing company must be willing to turn management over to someone outside the immediate family. Such willingness does seem to have been more common in the United States, Japan, and Germany than in France, southern Italy, South Korea, Taiwan, or Hong Kong, and the ability to trust nonfamily members may indeed play a role in promoting it. It is not necessary, however, that the bulk of the work force trust management, or vice versa. One would be hard-pressed to make a compelling case that labor–management relations in many large American companies have been characterized by a high or even moderate degree of trust. People work for large firms because they want a job, and sometimes because such jobs pay well and offer opportunity for advancement. Large firms hire people because they need employees. Trust is no more required to encourage people to work for large privately owned firms, or for such firms to hire them, than is the case for small companies or for large state-run enterprises.

The firm remedies only one of many structural inefficiencies endemic to a market-based economy—and only partially at that. Market capitalism is by nature rife with circumstances in which individually optimum actions yield outcomes that are less than optimum for society. Some of these circumstances are produced by markets themselves; others are associated with institutions, such as the firm, which have supplanted market relations.

Although Fukuyama focuses on firm size, he discusses a variety of other types of cooperative economic behavior, including cooperation between firms and their investors, between purchaser and supplier firms, between competing firms, between labor and management, and among workers. He views these as also important to economic success, and as also largely the product of trust. Again, there can be little doubt that the presence of trust makes such cooperation more likely. But is it the fundamental cause? There is reason to think not. Cooperation is in many cases a product of institutional incentives, which in turn are the (often unintended) results of historical struggles and compromises.

For example, Fukuyama suggests that large Japanese firms offer workers an employment guarantee because management can trust workers to uphold their part of the bargain by working hard. But Japan's lifetime employment system grew out of a compromise solution to a series of bitter labor–management struggles following World War II. Once it was created, the system became self-reinforcing. Management sticks to it because it heightens employee commitment and because a firm that began to lay off employees would quickly develop a bad reputation, making it difficult to attract strong new recruits. Employees work hard for two reasons. They know they will be with the company for a long time, so they have an incentive to improve the company's fortunes. Also, the employment guarantee is not absolute, and there is a strong incentive to avoid starting over with a new firm because pay is based heavily on seniority.

In the same way, cooperation between firms and their investors in Germany, Japan, and a number of other nations stems from the fact that certain investors have a consequential ownership stake in companies and a significant voice in their decision-making process. A large ownership stake makes it more difficult for an investor to exit from the relationship quickly and quietly, and an ability to influence company strategy encourages investors to use their position to help change the firm rather than abandon it when times are bad. As a result, investors tend to be stable sharehold-

Table 1 **Index of Economic Cooperation**

		Macro Level			Meso Level			Micro Level		
	Cooperation Index	Industries	Unions	Gov't & Interest Groups	Investors & Firms	Purchasers & Suppliers	Competing Firms	Labor & Mngmnt.	Workers	Functional Depts.
Japan	8.5	1	0.5	1	1	1	1	1	1	1
Austria	6.5	1	1	1	1	0.5	0.5	1	0.5	0
Germany	6.5	1	1	1	1	0.5	1	0.5	0.5	0
Norway	6.5	1	1	1	1	0.5	0.5	1	0.5	0
Sweden	6.5	1	1	1	1	0.5	0.5	1	0.5	0
Finland	6.5	1	0.5	1	1	0.5	1	1	0.5	0
Denmark	5	0.5	0.5	1	1	0.5	0.5	0.5	0.5	0
Belgium	5	0.5	0.5	1	1	0.5	0.5	0.5	0.5	0
Italy	5	0.5	0.5	0	1	1	1	0.5	0.5	0
Switz.	3.5	0.5	0.5	0.5	1	0.5	0.5	0	0	0
Neth.	3	0.5	0.5	1	0	0	0	0.5	0.5	0
France	2	0	0	1	1	0	0	0	0	0
Australia	0.5	0	0.5	0	0	0	0	0	0	0
N.Z.	0.5	0	0.5	0	0	0	0	0	0	0
U.S.	0	0	0	0	0	0	0	0	0	0
Canada	0	0	0	0	0	0	0	0	0	0
U.K.	0	0	0	0	0	0	0	0	0	0

ers, permitting management a long time horizon. This type of relationship emerged in response to underdeveloped capital markets, which forced companies to rely heavily on large investors. It is also the product of lenient financial regulations, in contrast to the United States where laws strongly discourage financial institutions from holding large equity stakes in nonfinancial companies. Again, because long-term investor–firm relationships have virtuous consequences for both parties, once created they tend to be self-reinforcing. Trust can certainly help to lubricate such relationships, but they can occur even if trust is limited.

Perhaps most telling in this regard, Fukuyama notes that trust has been declining in the United States over the past generation.[3] But if that is so, and if trust is the key to cooperative economic behavior, how can we account for the fact that American firms have only recently begun to experiment with some important types of cooperation, which Fukuyama himself emphasizes, such as R&D alliances, long-term partnerships with suppliers, and employee participation? What is happening is simply that firms are searching for new ways to compete more effectively, and these are among the strategies some have decided to try. To the extent these efforts generate cooperation and improve performance, they may become self-sustaining. In the process they will likely foster trust, but such trust will be largely a consequence, rather than a cause, of cooperation.

COOPERATION AND NATIONAL ECONOMIC SUCCESS

Is there a better way to think about cooperation and economic performance? I think so. Two points are critical. First, cooperation can generate benefits in a wide array of economic relationships. At the macro level, it helps foster more productive relationships among large-scale economic actors—among firms in different industries, among unions, and between government and interest groups. At the meso level, which refers to relationships between firms, it can enhance ties between firms and their investors, between purchaser and supplier firms, and among competing firms. Cooperation can also yield benefits at the micro level—within the firm—by improving relationships between labor and management, among workers, and among functional divisions within firms.

Second, rather than being a product of culture, cooperation is frequently generated by institutional incentives. In particular, it is often a product of nonmarket or extramarket institutions such as long-term, ongoing relationships and formal organization.

Industrialized nations differ considerably in the degree to which their economies balance competition and cooperation. To assess the notion that cooperation contributes to economic health, I have created an index measuring the degree of cooperation along nine dimensions. For each dimension, each nation is scored 1 for highly cooperative, 0.5 for moderately cooperative, or 0 for individualistic. The scores are then summed to form the index, which ranges from 0 to 9. The scoring for the 17 richest industrialized democracies, covering the period since roughly 1960, is shown in Table 1.

In order to understand how the index is computed, consider the scoring for Japan.[4] Japan's economy clearly features the most extensive cooperation. The degree of cooperative behavior at the meso and micro levels in Japan exceeds that in any other industrialized nation. Japanese firms and their investors—especially companies and banks linked through cross-ownership—are typically committed to a long-term partnership and communicate directly with each other when problems or dissatisfactions arise. Japanese purchasers and suppliers in a variety of industries use voice-based relationships, in which the purchaser commits to a long-term relation and the parties engage in close and constant communication. Competing firms in most sectors are organized in strong industry trade associations, which have helped forge rapid agreement on standards and serve as an important source of information flow among companies. R&D collaboration among firms occurs frequently, in some cases via an industry-wide consortium.

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The standard labor–management relationship in large Japanese firms features permanent employment for workers and a substantial amount of team-based employee decision-making on the shop floor. These firms have proved very successful at encouraging employee skill development and in eliciting the sharing of useful knowledge, and labor tends to accommodate the introduction of new technologies. Japan is the only nation whose firms have made substantial use of cross-functional teams to coordinate the transition from research through production, which reduces the time and cost of developing new products.

Cooperation is also high at the macro level. A national business confederation, the central employer federation, the Keidanran, helps moderate rent-seeking by individual firms and industries. Unions in Japan are organizationally fragmented; but wage setting for most industries occurs at the same time each spring, and powerful employer associations work closely together, generally with union cooperation, to assure coordination in the bargaining process. Finally, government policy has contributed to and supported Japanese economic success, aided by a high degree of coordination within the state and a strongly cooperative relationship between government and business.

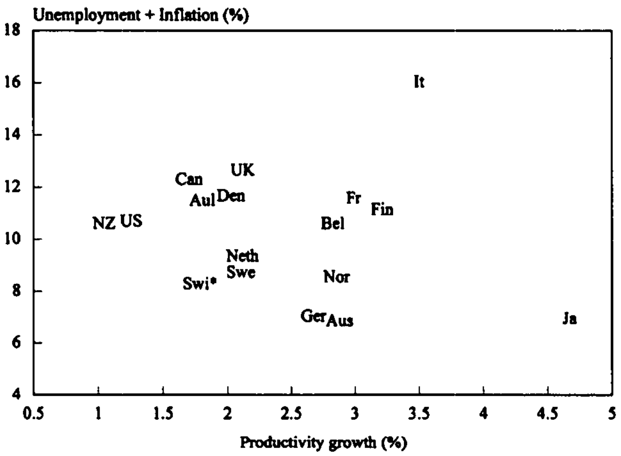
Austria, Germany, and the six small northern European countries—Norway, Sweden, Finland, Denmark, Belgium, and the Netherlands—all feature a rather extensive amount of cooperation, especially at the macro level via their centralized labor and business associations. Denmark, Belgium, and the Netherlands receive an intermediate score for macro-level industry and union cooperation because of their somewhat lesser degree of interest-group centralization and coordination. The Netherlands also differs in being characterized by atomistic relationships at the meso level.

Italy is a mixed case: relatively individualistic in several respects but featuring a wide range of cooperative practices—especially at the meso level—within particular regions, industries, and firms. Switzerland faces pressures similar to those of the other small, open European countries, but its economy is less cooperative at the macro and micro levels. France exhibits relatively little cooperation, except in its relations between firms and their investors and between the state and interest groups. Cooperation in these spheres is connected with the activist industrial policy France has pursued since World War II.

The United States, the United Kingdom, Canada, Australia, and New Zealand have been the most individualistic industrialized economies during the post–World War II period. The only notable exception to this pattern is that Australia and New Zealand have traditionally had moderately centralized systems of wage setting (cooperation among unions).

Figure 1 offers a simple, useful means of evaluating comparative economic performance during the past several decades and how it relates to cooperation. On

Figure 1 **Comparative Economic Performance 1960–94**



*Swiss unemployment rate is estimated.

the horizontal axis is (real) productivity growth, the best measure of how rapidly an economy is growing. On the vertical axis is a sum of the unemployment and inflation rates, commonly referred to as the "misery index." The correspondence between cooperation and national economic success is rather striking. (More sophisticated statistical analysis yields the same conclusion.) There are exceptions, such as Denmark and France. But overall, the comparative evidence strongly supports the notion that cooperation is a key to economic success. The nations with the best performance records—Japan, Austria, Germany, the small northern European countries, and (northern) Italy—have been those most committed to balancing competition and cooperation. Those faring worst—the United States, Britain, Canada, Australia, and New Zealand—have relied predominantly on atomistic, individualistic competition.

ECONOMIC INSTITUTIONS AND COOPERATION

Table 2 summarizes the nine types of cooperation used in the index. For each, the table details the actors cooperating, the institution that promotes cooperative behavior, and the resulting economic benefits. Some of these forms of cooperation, such as cooperation among unions in corporatist-style wage bargaining, cooperation between firms and stable shareholders, and cooperation between labor and management in the form of an employment guarantee, will be familiar to many readers. Let me briefly discuss three of the others.[5]

Cooperation Among Firms in Different Industries

Governments are vulnerable to lobbying by "rent-seeking" special interest groups, whose gains sometimes come at the expense of the rest of society. Business firms have perhaps the strongest interest, and the greatest capacity, to engage in such activity. Companies and industries can benefit handsomely from government provision of subsidies, favorable tax treatment, protection from imports, and so on. Of course, business lobbyists do not always get what they want, and it is by no means always the case that government support for particular industries is inimical to the general interest. But the more fragmented the business community is (i.e., the less cooperation across industry lines) the less productive its lobbying efforts are likely to be for society. As economist Mancur Olson cogently argued in his book, *The Rise and Decline of Nations*, groups or organizations that constitute only a small portion of society have a strong incentive to direct their efforts toward obtaining redistributive gains rather than enhancing the general welfare.

One way to mitigate this problem is via a centralized business federation that links firms across industries and has the authority to speak and negotiate on behalf of its members. As Olson noted, the more encompassing the organization—the larger the share of society that it represents—the less likely it is to seek redistributive gains. By pursuing a rent-seeking strategy, its members would be taking largely from themselves, so they tend instead to try to increase the size of the social product. A central business federation does not eliminate lobbying by individual industry associations and firms. But it helps reduce the likelihood that specific interests will dominate policy-making, both by moderating the demands of firms and trade associations and by itself lobbying on behalf of the general interest.

National business federations exist in most industrialized countries. But the share of companies they represent and their authority vis-à-vis member firms are much greater in, for instance, Austria and Japan than in the United States or Australia. As a result, corporate rent-seeking is less of a problem in the former nations than in the latter.

Cooperation Between Purchaser and Supplier Firms

Market transactions between firms and their suppliers of parts, equipment, and raw materials tend to be

Table 2 **Key Types of Economic Cooperation**

Actors Cooperating	Institution(s) Promoting Cooperation	Economic Benefits
Macro Level		
1. Firms across industries	Centralized business federation	Reduced rent-seeking
2. Unions	Centralized and/or concentrated labor movement	Wage restraint
3. Government and interest groups	Unified government and centralized interest-group organizations	Coherent, productive government policy
Meso Level		
4. Investors and firms	Long-term commitment by investors—a product of investors having large ownership stakes and a means of effectively influencing company decision-making	Extended time horizons for firms
5. Purchaser and supplier firms	Long-term commitment by purchasers	Heightened communication; greater supplier willingness to invest and raise productivity
6. Competing firms	Industry trade associations or government incentives	Greater investment in R&D and employee training; quicker agreement on standards; assistance with financing, technology diffusion, design, accounting, marketing, etc.
Micro Level		
7. Labor and management	Long-term commitment by employers (employment guarantee)	Greater willingness on the part of workers to share valuable knowledge, accept productivity-enhancing technology, and upgrade skills
8. Workers	Participatory teams	Heightened work effort
9. Functional departments within firms	Cross-functional teams that link departments along the production chain	Quicker, more effective transition from R&D to production

discrete and temporary. Such relationships impose costs on firms. Continuous searching for the best supplier or customer and bargaining over the terms of agreements can be time-consuming and expensive. Each party is vulnerable to opportunism, because neither knows the other well. Most important, since there is no guarantee of future transactions, each has an incentive to maximize short-run payoffs, which may inhibit communication and discourage long-term investments. Some companies opt instead for vertical integration, whereby a firm produces its own supplies itself. But this can require a substantial fixed capital investment, promote bureaucratization and aversion to risk-taking, and reduce or eliminate competition as a spur for efficiency and innovation.

An alternative to markets and hierarchies is a long-term partnership with independent suppliers. Such relationships, used extensively by large Japanese companies and to a lesser degree in some European countries, allow firms to enjoy the benefits of low fixed costs and supplier expertise while encouraging their suppliers to invest in long-term improvements and to communicate extensively both with them and with other suppliers.

Cooperation Among Workers

The standard wage payment used by firms, in which employees are compensated according to the amount of time worked, offers limited inducement for workers to put forth an optimum degree of effort. Individual workers have an incentive to shirk, to "free-ride" on the efforts of their co-workers, because doing so will have little effect on their reward as long as others work hard. The standard remedy for this problem is monitoring by a supervisor. But monitoring can be costly and of limited efficacy. Collective pay arrangements (profit sharing or gain sharing) can also help, but they too are vulnerable to free-riding.

Participatory teams are a useful alternative. Employee decision-making through teams fosters trust and encourages team members to monitor individual performance. As David Levine and Laura Tyson have noted: "By working together, team members recognize their mutual interests and observe how shirking by one can hurt the group. Shirking or free-riding now imposes an observable cost directly on all co-workers, so that social sanctions may be rationally applied against workers who deviate from the cooperative work norm."[6] The effect is to promote effort and cooperation among employees. Shop floor teams have been common in Japan for several decades and in Scandinavia since the mid-1970s. Only recently have firms in countries such as the United States and Britain begun to make use of them.

WHAT, THEN, SHOULD WE DO?

Over the past two years the business press has been rife with stories detailing a U.S. economic resurgence. But our recent economic success relative to other industrialized countries appears to have as much or more to do with business-cycle timing as with a genuine strengthening of the American economy. The United States emerged from recession in 1992 just as Japan and Europe were beginning downturns. True success is best judged over a period of two or three decades rather than two or three years.

Logic and comparative experience suggest that an effective means of improving our long-term economic health would be to cooperate more. Plainly, not all cooperation is economically beneficial, but the types I have emphasized here seem to be. Of course, it is unlikely that the United States will ever have centralized interest groups approximating those of the small northern European nations. For one thing, our labor movement is much too weak. More basically, the United States is probably too large to permit the sort of centralization that is manageable in Austria or Norway, nations with labor forces about 3 percent the size of ours.

Yet there are other areas, at the meso and micro levels, in which a better balance between competition and cooperation is feasible here. To some extent it is already happening. Over the past decade, for instance, U.S. auto manufacturers have begun to shift their relationships with suppliers and employees in a more cooperative direction. Some supplier firms have been given long-term contracts, and exchange of information and direct supplier participation in the design process are now much more common. General Motors, Ford, and Chrysler have also conducted experiments with participatory teamwork, backed in a few cases by employment guarantees. To this point, the changes have been partial and halting, and it is unclear whether the automakers are committed to making a genuine shift. They seem, however, to be headed in the right direction. Similar changes have occurred in other industries such as steel, computers, and transportation. In addition, a number of large U.S. firms now utilize cross-functional teams to oversee the research–design–production process. At the same time, however, many companies have dropped whatever partial commitment they once had to job security for their work force in an effort to keep up with the downsizing trend—this despite the fact that surveys show only a small share of firms that have downsized believe it has improved their productivity or competitiveness.

Cooperative institutions can also be encouraged by government policy. For years, strong antitrust laws in the United States deterred R&D collaboration among competing firms. In 1984 Congress passed the National Cooperative Research Act, which substantially loosened the restrictions on cooperative research. Since then, joint R&D ventures have proliferated. The federal government offers tax incentives to firms that create employee shareholding programs. It could do the same to promote employment guarantees or worker participation. The Clinton administration came into office committed to instituting a play-or-pay training tax, but the plan was shelved due to business opposition. In the area of finance, there are a number of possible ways to reduce investor myopia in the United States. These include changing corporate ownership laws to give investors more control over company decisions, revising regulatory laws to allow banks to have significant equity holdings in nonfinancial companies, altering the tax structure on capital gains so that investments held for longer periods receive more favorable tax treatment, and imposing a transaction tax on the sale of shares held for less than a specified amount of time.

Given the present political climate and congressional balance of power, an expansion of government support for enhancing economic cooperation seems unlikely in the near future—with the possible exception of a repeal of the Glass-Steagall law discouraging banks from taking ownership stakes in nonfinancial companies. Whether American firms will press further in the direction of cooperative relationships is uncertain. If the comparative experience of the past several decades is any guide, their failure to do so will be to our collective detriment.

NOTES

1. See also Diego Gambetta, ed., *Trust: Making and Breaking Cooperative Relations* (New York: Basil Blackwell, 1988); Edward H. Lorenz, "Flexible Production Systems and the Social Construction of Trust," *Politics and Society* (September 1993); Robert D. Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, NJ: Princeton University Press, 1993).

2. See Chandler, *Scale and Scope* (Cambridge, MA: Harvard University Press, 1990).

3. For documentation of this trend and an attempt to explain it, see Robert D. Putnam, "Bowling Alone: America's Declining Social Capital," *Journal of Democracy* (January 1995); "The Strange Disappearance of Civic America," *The American Prospect* (Winter 1996).

4. For more detail on the scoring, see Lane Kenworthy, *In Search of National Economic Success* (Thousand Oaks, CA: Sage, 1995), chap. 6.

5. For a more thorough discussion of the nine types of cooperation, see Kenworthy, *In Search of National Economic Success*, chap. 6.

6. Levine and Tyson, "Participation, Productivity and the Firm's Environment," in *Paying for Productivity*, ed. Alan S. Blinder (Washington, DC: Brookings Institution, 1990), p. 187.