ECONOMICS AND GOVERNANCE: DELINEATING THE FAULT LINES*

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Abstract

The study of intervention of State in economic affairs of a society has long occupied the works of noted economists. It again resurged in the form of New Political Economy with a little variation in its context. But, in recent years, the word governance gets prominently mentioned in economics literature in the wake of prescription of good governance for development by multilateral organizations in the late twentieth century. Three-four decades ago when success stories of Asian tigers were discussed, most people attributed success to their governance styles. When Asian Crisis raged in these same tiger economies in the late 1990s, again reference was made to governance failure, besides external factors. When India is compared with China, one of the most important differences cited by most scholars is the difference in their governance complexion and style. Recent and not-so resent researches by multilateral organisations confirm this view. Recognizing importance of governance in matters economic, scholars keep advising governments and people, corporations and boards, councils and authorities what they ought to be doing.

This sudden interest in 'governance' in economics profession owes to the work and assertion by those who explored the area of transaction cost and information asymmetry as well as by those who developed what is known as new institutional economics. Development practitioners, believing more in grounded theory, also covered this area better by collecting data on people's experiences

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and experiments instead of making assertions of plausible or appealing assumptions in tackling problems of externalities. Surely, word governance did not exactly, nor always, mean the intervention or interference by government.

I just intend to develop, in this paper, broadly the fault lines of mainstream economics with respect to governance and try to argue that transaction cost has to be drastically reduced to effectually decentralize governance structures that are being developed in the wake of new ethos and technological possibilities. People constantly keep innovating and improvising technologies and institutions to reduce transaction cost as they keep reducing transformation cost and transportation cost. It is little less appreciated by scholars except deep economic historians.

Keywords: Classical Economics, Neoclassical Economics, Institutional Economics, Transaction Cost, Governance, Vertical Integration, Vertical Separation

I

Economy could never be conceived without governance whatever they could mean even though usage of phrase political economy has been quite out of fashion for pretty long time. Marshall (1920/1890) who preferred, popularized, and argued for use of word economics over the phrase of political economy starts his main text with 'Political Economy or Economics'. In fact, erudite scholars, like Kurien (1992) do not describe economy itself in terms of assemblage of goods, assets, and resources or sectors of production like agriculture, industry, and services or a set of problems like poverty, unemployment, and inflation. They lay emphasis on economic relationships between different participants in economic transactions such as buying-selling, lending-borrowing, and employing, which are a subset of social relationships. Economics should then mean a study of these relationships—their structure, working and transformation of structures. The study of intervention of State in economic affairs of a society has long occupied the works of noted economists. It again resurged in the form of New Political Economy with a little variation in its context. But, in recent years, it is the word governance that gets prominence in economics literature in the wake of multilateral prescription of good governance for accelerating development, in the late twentieth century.

Three-four decades ago when we were discussing about the success of Asian tigers, most people made reference, even reverence, to their governance styles. When Asian Crisis raged in these same tiger economies in the late 1990s, again reference was made to governance failure, besides external factors. When India is compared with China, one of the most important differences cited by most scholars is the difference in governance complexion and style. Recent and not-so resent researches by multilateral organisations confirm this view. For example, one by Mustaq Khan (2007, p.1), prepared for UN/DESA, opens the paper with the sentence that 'Economists agree that governance is one of the critical factors explaining the divergence in performance across developing countries'. Though institutional economists and neo-classical economists differ in details, they recognize the importance of governance in economic affairs of an economy and lay emphasis on the role of State. In an interestingly titled paper viz., *Growth without Governance,* two World Bank economists, namely Kaufman and Kraay (2002), tried to relate per capita incomes of the countries with the quality of governance and found strong positive causal link running from better governance to higher per capita incomes, besides a weak negative feedback in the opposite direction. Recognizing importance of governance in matters economic, scholars keep advising governments and people, corporations and boards, councils and authorities what they ought to be doing in order to improve the performance of organisations, sectors, and economies.

However, mainstream economics did just the opposite till the other day. Williamson (2005) finds that compared to 1977-79 in 1990-2000 articles using word governance sans corporate governance in journals of economics were 1 to 60, in those of business/ management 4 to 76 in sociology/organization 18 to 79 and in political science 25 to 60 where economics journals included *American Economic Review, Journal of Political Economy, Quarterly Journal of Economics,* and *Journal of Economics Policy.* According to Avinash Dixit (2008), the term 'governance' has exploded from obscurity to ubiquity since early 1970s. In a search of the EconLit database it is found that there were 5 occurrences of the word in titles, key words and abstracts, during the 1970s which jumped to 112 in the 1980s and 3825 in the 1990s and were likely to be around 10000 in 2000s and 20000 in 2010s. This sudden interest in economics profession about governance owes to the work and assertion by those who explored the area of transaction cost and by those who developed what is known as new institutional economics. Development practitioners, generally believing in grounded theory, covered this area better by collecting data on people's experiences and experiments instead of making assertions of plausible or appealing assumptions in tackling problems of externalities. Surely, word governance did not exactly, nor always, mean the intervention or interference by governments alone.

I just intend to develop, in this paper, broadly speaking, what can be called fault lines of mainstream economics with respect to governance and try to argue that transaction cost has to be drastically reduced to effectually decentralize governance structures that are being developed in the wake of new ethos and technological possibilities. People constantly keep innovating and improvising technologies and institutions to reduce transaction cost as they keep doing about transformation cost and transportation cost. It is little less appreciated by scholars except deep economic historians.

II

Joan Robinson (1960) was perhaps the first to question long ago the suitability of received wisdom from mainstream economic theory for application in countries like India with respect to addressing their problems of development. She verily questioned its universality and one can also add its eternality. In my view, economics singular did not do much justice with economics plural of a society in its attempt to mimic natural sciences like physics. Economic Science, one tends to agree, was mostly developed in terms of logical deductions and, as a consequence, it was emasculated of its social context and content. Eric Roll (1953) justifies the adjective classical as in 'classical economics', as it basically dealt with a political economy in which classes—landlords, bourgeoisie and labour—were essential part of analytical apparatus, besides it invariably addressed the State for its intervention or withdrawal in economic affairs.

Neoclassical economics, as we know it today, converted actors into factors, that is, intangible relationships between actors into invisible forces of production, and economic transactions into mathematical functions. Marshall could call them agents in the Book IV of his Volume; but it was only in the context of substitution of one by another in order to making supply price smaller that the phrase 'factors of production' was used. Later, economists who sought to elaborate and extend this neoclassical framework invariably picked up factors of production. It is in the same sense we use it today except that a few modern textbook substitute word resources for factors.

As a consequence, labour did not remain a class but became a fact of bodily exertion (physical and mental) and was considered as counterpart of service of a machine which was identified as capital, a gadget. Note that capital changed its character as a machine from one of being corn advanced to labour or raw material in inventory. It is true that, in national accounting, capital formation per force has to include building & infrastructure, machines & equipment, and change in stock—inventory of raw materials and finished products, including livestock. Sraffa (1960) tried to resurrect the classical tradition in the modern idiom, but only to have many admirers—not as many followers.

Smith's references to self-love and invisible hand were over-read as approval of Mandeville's ideas in the satirical *Fables of Bees* where private vices were not found against public benefits, and this case was made out to be an advocacy of non-interventionist minimal government. In fact, he does propose a role for the State in the *Wealth of Nations* (1776) insofar as provision of infrastructure in areas like transport and communication, and education was concerned. His was not a case that private vices promote public good; private virtues are not against public good. He was a Professor of Moral Philosophy and produced *Theory of Moral Sentiments* (1759) two decades prior to the *Wealth of Nations* (1976), wherein he exposes natural inclination in human beings to care for others too.

It ought to be remembered while Smith reacted to Trade Policy of the day, Ricardo and Malthus were concerned with Corn Law and Poor Laws respectively. It is not necessary to agree with their views. The point made here is that they looked at societal economic issues from a close angle of public policy rather than dipped into creating internally consistent models on paper.

Marx, accepted as an institutionalist by a sizeable number of economists, did point out to the problem of adjustment between productive forces which is about technology and production relations which is about institutional arrangement with regard to duties and rights. The only point he makes is that the two do not move with the same pace while they both keep moving. John Stuart Mill explores interface between economics and politics on quite a few occasions. But mainstream economics at the hands of neoclassicals went ahead unheeded. They went on refining tools and perfecting models of competition and firm though acknowledged the real-world existence of imperfectly competitive markets and what was termed as monopolistic competition. They include theoreticians from India like JK Mehta (1943) who would, for example, explore logical definition of market in economic theory. There are very few like Joan Robinson who tried to explain exploitation of labour through this very neo-classical framework.

III

But mainstream economics did not sit well in many instances. Take the case of labour. In mainstream economics, any societal norm is an anathema as its intervention causes unemployment. Labour was treated as a perishable commodity like fish. Labour economists were mostly at unease. They almost discarded its use in the analysis of their problems. Slavery and bonded labour were always analyzed in terms of institutions but labour under capitalist system was perceived in mainstream economics just any other commodity. Solow otherwise known for his contribution to neoclassical growth theory delivered a set of Royer lectures in 1990 under the rubric of *Labor Market as a Social Institution* where he not only highlights the fact of employer-employee relationship and insider-outsider issues but also points out that a labourer has some control over his productivity and reacts to the price paid for his service whereas as capital (machine) or land do not. Therefore, labour cannot be treated at par with any other commodity. The long practice of efficiency wage in quite a few sectors (in corporate world by Henry Ford in 1914) was recognized in economics by like Joseph Stiglitz (1974) and Akerlof and Yellen (1986),

Sociology matters a lot in the case of employment of labour. People are status conscious, willing to take up certain jobs in another place but not in their place of residence. Employers in certain industries seek trust more than labour. Principal-agent issues are relevant in the case of labour, which is absent in other factor markets. Thus, labour market is different from goods market. Communication among workers plays a lot of importance. Labour can unionise. Machines do nothing of the sort as they cannot communicate among themselves nor can they unionise!. Today, machines can perhaps communicate but only when man wants them to do so. This goes all against the arguments of similarities between physical capital and human capital so assiduously built by scholars specializing in economics of education, for example, Schultz (1961). Wages thus could never be reduced to the status of interest or rental, which are defined as the factor prices. Further, much of race and gender discrimination is institutional.

Datta-Chaudhury (1994) has studied labour markets in India as social institutions where traditions, reciprocity, government intervention, trade unions, and politics play a great role in shaping the outcomes in different labour markets occupying agriculture, informal sector, and organized sector—public sector and private corporate world. Although his focus remains on the role of State in labour laws, which favours job security to the existing employees but end up in neither growth of employment nor raising productivity, nor attracting foreign direct investment.

The whole issue is that mainstream theory is not able to explain why there is no active competition among sellers of labour even in the face of unemployment. Rather, they tend to unionise. Employers in many cases do not cut wages but fire the employees should they feel like slashing wage bill. Unemployment is a problem world over. It seeks stabilization role from the government.

Yet, it should be admitted to the credit of neoclassicals that concurrent development of modern public utilities alongside the development of free market analytics made the latter recognize the conditions under which State could/should intervene in the market (Bator, 1958). Even Coase (1960), despite arguing for private negotiations in exchange of commodities (including rights) in the presence of externalities, suggests that the State ought to work towards minimization of transaction cost. But the fact remains that municipalities across the world practice regulations of utilities in order to protect the interests of consumers, producers and investors. Marginal cost pricing, cross subsidization, discriminatory pricing, demand separation, peak load pricing for differing inter-temporal demand, regulation and taxation were devised in the wake of factual situation.

Neoclassical model has been characterized by institutional economists as one 'premised on the belief that market oriented rational bahaviour by free trade agents can serve as the normative guideline for defining the role of government' (Trebing, p.1708). The charge is that neoclassical analysis has not adequately addressed residual power, social costs and economic dislocations and, therefore, its claim to be value neutral science is flawed. It actually works to perpetuate prevailing structure of political and economic power even if it provides rationale and mechanism for government intervention to ameliorate market imperfection, market failure and maldistribution of resources.

It is interesting to see that growth models which laid emphasis on supply side considerations started out with well-behaved production function. Both growth theorists and those who tried to explain long run growth through growth accounting method attributed whatever residual they obtained after accounting for capital and labour to education, productivity or technology (or even to economists' ignorance!) but never to institutions and governance. Endogenous growth models sought to incorporate technology, R/D, and education as endogenized by the system even in the period when new institutional economics was in vogue and good governance had become a buzz word. It may be mentioned here that many scholars working on Indian agriculture found that growth rate in the post-green revolution period was the same that in the pre-green revolution period but after Independence, though distinctly higher that in the pre-Independence period. Most of us interpreted that during 1950s it was change in the curvature whereas after 1960s it was shift in the curve but not change in the curvature. First is believed to be caused by institutional changes brought in through land reform and the latter from technological change.

IV

On the role of economist, an old-time institutionalist economist Richard Theodore Ely wrote more than a century ago in his *Outlines of Economics* (1893, p.10):

> The peculiar and distractive office of the economic scientist is to emphasize the less tangible truths, the remoter consequences, the deeper and consequently less obvious forces of economic society. The impulses of the moment, the immediate demand of the hour, the present fact that stares us in the face (and sometimes blind us), are not likely to lack vigorous champions; to preserve balance there is need of a craft of thinkers far enough removed from the battle to preserve the wider outlook, mindful of the lessons of the past, jealous for the rights of the future, insistent upon less obvious truths. That is why, economics so frequently appears to the practical man, strange and academic. This impression arises from a difference of emphasis which in the main is that the solution is presented as it is inevitable. The academic quality of the economists' work arises sometimes from ignorance, sometimes form pedantry but more frequently from the courageous insistence upon the importance of the less tangible truths and the concerns for distant consequences of present action.

It seems that economics profession, in the publish-or-perish environment, tweaked existing models for quick publication. They preferred mathematical convenience and ignored social relevance or search for truth. As a result, for Nelson (1987), economics became excessively abstract and institutionally naïve. Fogel (1994) finds that many model makers do not realise that their generalisations are based on transient circumstances and therefore advises such theoreticians to delve deeper into history. Thanks to Bator (1958), the only concession the neoclassical economists made was to accept the role of State and government in the market in the face of market failure due to existence of externalities, public goods and natural monopolies—though these issues were already discussed by Pigou and Samuelson, among others, before his succinct articulation. Subsequently the facts of information asymmetry, particularly in the risk market, came to be scrutinized and analyzed.

Answering as to why the field of development has failed to develop, North (1993, p.1) says,

> Neoclassical theory is simply an inappropriate tool to analyze and prescribe policies that will induce development. It is concerned with the operation of markets, not with how markets develop. The very methods employed by neoclassical economists have dictated the subject matter and militated against such a development [in the realm of theory building]. The theory in the pristine form that gave it mathematical precision and elegance modeled a *frictionless* and static world. When applied to economic history and development, it focused on technological development and more recently human capital investment, but ignored the incentive structure embodied in institutions that determined the extent of societal investment in those factors. (Parentheses and emphasis, ours)

And, I seek permission to add that nobody can move, as we all know, on a frictionless surface whatever force is applied!

V

Two basic elements in the decision-making process through choice viz., rationality of actor and methodological individualism have been repeatedly challenged. First, man is only partly rational; he is quite emotional (or irrational) in many actions. Rationality of individuals is limited by the information in their possession, cognitive limitations of their minds, and finite amount of time they have to make a decision. As Simon (1957) articulates, (bounded rational) agent's experience limits his decisions for 'formulating and solving complex problems' (p. 198) and Williamson (1981, p.553) adds that limitation 'in processing (receiving, staring and transmitting) information'. They suggest ways to make classical models of rationality more realistic as well as to replace optimization by heuristics. But economics profession has only appended footnotes to the fact of what is called bounded rationality.

Neoclassical influence was so pervasive that theorists who developed what came to be known as public choice insisted, much to the chagrin of social and political analysts, that individuals are guided by the same motive of self-interest even when they are making political decisions of electing representatives or selecting budget allocations. The only concession Arthur Seldon (2002, p. x) is willing to make is that Abraham Lincoln cannot now be claimed as the father of our 20th-21st century form of democracy while describing it as the government 'of the Busy (political activists), by the Bossy (government managers) and for the Bully (lobbying activists)'. Let us be sure that he is speaking of the present day US where current presidential debate does not make reference to inequality. The author of *Price of Inequality* Joseph Stiglitz's in an interview with Shobham Saxena in the Times of India (22 October 2012) explains how US presidential candidates can speak against the interest of the people from whom they collect money for their election. Further, Gordon Tullock (2002, p. 3) quotes McChesney and Shughart as saying:

> Homo politicus and homo economicus are the same. The critical implication of this assumption of universal self-interest is that the observed differences between public choices and private choices emerge not because individuals different behavioral objectives in the two settings, but rather because the constraints on behaviors are different. Different outcomes emerge not because public choices are guided by motives different from those public choices are guided by motives different from those guiding private choices, guiding private choices, but rather because in private markets self-interested voters and politicians make choices that mainly affect themselves, while in political markets, self-interested voters and politicians make choices that mainly affect others.

The problem is that social collectivities such as states, associations, business concerns and foundations in disciplines like economics are treated as if they were individual persons. [Pick any standard textbook on microeconomics the buyer is always an individual, never a business.] So much so that demand by power industry for coal is treated as if it is made by an individual for using it at home. This goes by the name of methodological individualism. Holding that the usage is only methodological it really ignores the complexity of internal working of (contracts within) organizations as well as the relationships among the players within the organizations and which is not costless.

Ronald Harry Coase got the Sveriges Bank Prize in Economic Sciences in Memory of Alfred Nobel in 1991 at the age of 81 for an idea which he conceived at the age 21. It was the idea of transaction cost—distinct and different from what may be called transformation cost and transportation cost. Under zero transaction cost, market will work fine; otherwise an institution or organization like firm would emerge. Neoclassical theory of firm is not a theory about origin of firm like theory of marriage, family, or state but just about its operation for a given objective. In fact, the neoclassical theory treated the firm as a black box transforming inputs into outputs according to the laws of technology; and, according to Demsetz (1983), its chief mission was to explain how the price system coordinates the use of resources, not the inner working of real firms. That is why Liebenstein (1966) had to invent the idea of x-inefficiency. There is something that does not allow technology to work out fully. For Coase (1937), firm and market are alternative methods of coordinating production and he tried to explain the basis on which, in reality, this choice between alternatives is made. According to Williamson (2005), the standard assumption of zero transaction costs presented neoclassical economics with a logical lapse.

Publication of Coase's paper *The Nature of the Firm* (1937) was ill-timed as that whole economics profession at that time was in the awe of Keynes' *General Theory*. It was taken due notice of along with his most celebrated and oft-quoted paper on *The Problem of Social Cost* (1960), which was a new response to the developments in the market failure literature where confusion prevailed over nature of externalities and how to tackle them. Only theoretical support available by 1960 was 'Pigou's polluter pays principle'—articulated in 1920. Recognition of existence of positive transaction cost leads to alternative solutions to the problem of negative externality. Recently, the idea of internality has also been promoted for types of behaviour that impose costs on a person in the future that are not taken into consideration while the person makes a decision in the present. So far passive smoking was part of economics but now, for self-smoking, paternalistic rights are extended to the State besides sin taxation of demerit goods.

A few years after, Arrow (1969) gave a fillip to transaction cost framework and a new orientation. In his paper *The Organization of Economic Activity: Issues Pertinent to the Choice of Market versus Non-Market Allocation*, Arrow held that 'transaction costs in general impede and in particular cases completely block the formation of markets' (p.48). In a subsequent paper (Arrow, 1970, p.2), he further held 'an incentive for vertical integration is replacement of costs of buying and selling on the market by the costs of intra-firm transfers;

existence of vertical integration suggests that costs of operating (even) competitive markets are not zero, as is usually assumed by theoretical analysis'. However, it can be deduced from the above that if transaction costs could be reduced, vertical integration could give way to vertical separation. Some of the vertical integrations were technological and guided by economies of scope and some could arise because of uncertainty about availability of essential intermediate products but some could also arise simply because of fiscal incentive structure that taxes outsourced inputs while in-sourced ones are not easily amenable to taxation. It is another matter that transfer pricing has its own set of administrative problems. In recent years, a lot of unbundling of services took place—whether it is a sector of electricity or telecom, railways or aviation as transaction costs of monolith structures were presumably high. A lot of information could be easily hidden than revealed.

VI

Epitomizing the developments till mid-twentieth century, in her Nobel Lecture, Elinor Ostrom (2009) says that the dominant scholarly effort was to try to fit the world into two simple models of market and government, and to criticize other institutional arrangements that did not fit into them. Looking into early development economics literature, one discovers that many an institution and many a cultural trait, abounding in specific societies, were said to be draggers to development, which was conceived as rise in per capita income and structural change that took place in last two hundred years in the west..

The two institutions that fit nicely with economic modelling were the market and the government. The market was seen as the optimal institution for production and exchange of private goods. For non-private goods, the government was needed to impose rules and/or taxes to force self-interested individuals to contribute necessary resources and refrain from self-seeking activities. This dichotomous view of the world explained patterns of interaction and outcomes related to markets for the production and exchange of strictly private goods but it did not adequately account for internal dynamics within private firms. Nor did it adequately deal with the wide diversity of institutional arrangements that humans crafted to govern, provide and manage public goods. Ostrom added, to this dichotomy, the category of common pool resources—which has been her area of particular attention in research. Finally, she draws the attention towards one model of the individual that makes all individuals—timid, docile, disciplined, eccentric and extremist—to be fully rational. And this is accepted in mainstream economics as well as in game theory which throws methodological challenges to the former. She thinks that this model has fruitfully generated useful and empirically validated predictions about the results of exchange transactions related to goods with specific attributes in a competitive market but not in a diversity of dilemmas which abound in matters of public affairs. In fact, we have all seen that there are several ways through which small groups, ad hoc or long-surviving, have been solving the issues involving public affairs, or say inter-personal affairs.

Writing on economic governance and economics of governance, Dixit and Williamson are willing to accept the definition of eunomics, proposed by legal scholar Lon Fuller in 1954, as the science, theory or study of good order and workable arrangements. However, a fact pointed out by Dixit (2009) himself is that the European colonizers established institutions of slavery and inequality (hierarchy) to facilitate the exploitation of labour on a large scale. It cannot be accepted as a good order. For our purpose, therefore we accept that what government does is governance but governance is not only that which government does. It is a complex of institutions and instruments through which issues of 'public' nature are resolved—corporate affairs being accepted here as public affairs. Thus, it encompasses all levels and types of governments— including ministries, departments, branches and wings but also all community based organizations, all non-government organizations and user groups as well as the rules, regulations, norms, customs and traditions. Human civilizations have been moving from informal arrangements to formal laws, from traditions and customs to rules and regulations. Still we need to write out new code of conduct or guidelines.

VII

Twentieth century and particularly second half has witnessed a tendency towards centralization of power. In a way, there was a move towards vertical integration of sort at various levels in governance structure in economic world as well as in political world, technology being partly responsible for such a development. Closing decades of twentieth century were, however, also marked by efforts towards further decentralization—leading to strengthening of local governments, using non-state agencies, including market, for variety of tasks and unbundling of activities within government departments and outsourcing of services. This could all be seen as vertical separation.

As against two modes of allocation of resources viz., market and state, scholars learning from ground and field experiments that there exists a diversity of settings in which people are found solving their problems on their own without mediation by government agencies or market. Of course their focus was on common pool resources such as fisheries, irrigation, forests and lakes. Accepting that all settings in all situations are not equally successful, they hold that there exists a considerable agreement. For justification, Elinor Ostrom refers to Amartya Sen that there exists no single normative theory of justice that can unambiguously be applied to all settings. Yet, she favours what she calls *polycentric governance* of complex systems.

What comes out well is that humans have a more complex motivational structure and better capability to solve social dilemma than pointed out in the earlier choice theory. Williamson calls the new understanding as the lens of contract construction which is a contrast to the lens of choice employed by the orthodox economics. Contracts abound in our life. Agreements and undertakings, written or unwritten, long term or short term, between persons or associations, are all contracts. Cheating on contract is possible. According to Dixit, if discounted pay-off in a long term contract is less than one-time pay-off by cheating, a player may opt to break the contract. Therefore, there may be need for enforcement through institutions which may come out from legal setups or from social sanctions. There is some transaction cost involved in ensuring rightful conduct of contract. However, power equation may result in asymmetric contract. So there can be a case with incomplete or asymmetric information. In fact, North (1993, p.3) aptly cautions,

> Institutions are not necessarily or even usually created to be socially efficient: rather they, at least formal rules, are created to serve the interests of those with the bargaining power to create new rules. In a world of zero transaction costs, bargaining strength does not affect the efficiency of outcomes; but in a world of positive transaction costs it does.

We observe a very similar situation in international affairs, in giant corporations, and in social situations. Slavery and bonded labour were obvious candidates in this category. However, we note the words ‘at least formal rules’ in North’s caution. But then, in many local situations, there are found a variety of local solutions to resolve issues arising out of externalities. They need to be encouraged. If cooperatives in India had problems they had not because of just because of quality of membership but more because of rigidly framed rules and a lot of interference by the government. Self-help groups, if they are doing better, are doing so because they are voluntarily formed without government being a partner. If local governments are not doing too well, it may partly be because the State departments wield too much power and turn them into agencies—raising principal-agent problems. If vertical separations have yielded better results in certain sectors because a lot of transparency has come in. In other words, costs of operating transactions do matter.

Choice may then lie in many areas of governance between internal coordination and external cooperation. In case of an integrated system, one needs coordination within the hierarchy and for a set of dispersed structures one needs cooperation and collaboration. To use scientist Yashpal's phrase, time has come to experiment with paralleling and networking. Cost of networking is all that matters. Technology permits low costs. Let institutions also permit so.

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