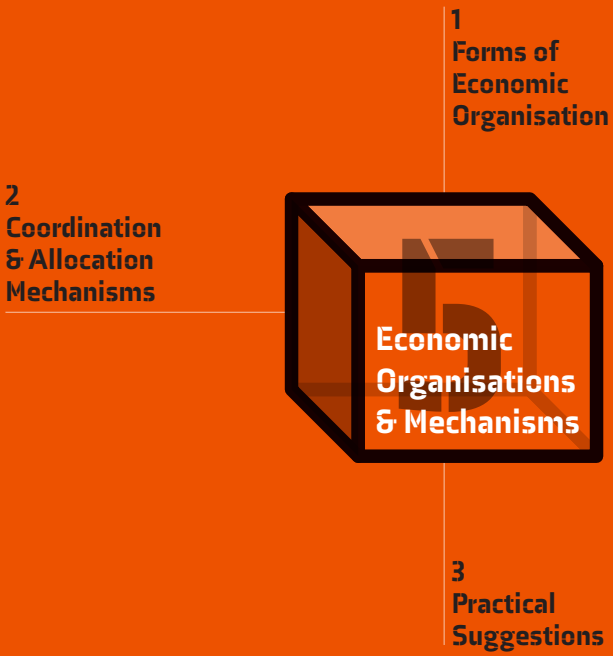




## Building Block 5

# Economic Organisations & Mechanisms

The different economic organisations and mechanisms – how market, hierarchical, communal, associational, familial and cooperative forms together make up the economy.



## What

This building block discusses the different ways in which economic processes can be organised. These are the different ways in which people determine how to allocate the limited time and resources available, how to work together to create economic value and subsequently how to distribute it. The focus of this building block is on making students familiar with the variety of organisational forms and ways of interacting with each other that shape how our economies work.

## Why

Without an understanding of the variety in the organisations and mechanisms that exist it is very difficult to grasp how an economy works and misunderstandings arise easily. A better grasp of the different ways in which economies are organised will also enable students to think openly, accurately and critically about any proposal to reshape economies.

## Contrast with current programmes

Many academic programmes currently focus on markets. Additionally, even when the topic of study is not a market, it is often understood as if it were a market. This causes students to find it hard to think in ways that do not follow market principles. Upon studying a problem, the natural inclination of many economists is to introduce a market or correct a market failure. However, this causes (policy) recommendations to have a *one-size fits all* tendency, and causes many parts of the economy to be unstudied or misunderstood. We therefore encourage introducing and defining a wider range of economic organisations from the start, as well as the different coordination and allocation mechanisms that exist between and within them, examining where they occur, how they differ from each other and how they interrelate.

## “The economy is much bigger than the market.”

Ha-Joon Chang (2014, p. 456)

Economies consist of many different types of organisations, ranging from multinational corporations to groups of volunteers caring for the elderly, and from small cooperatives to state-run infrastructure companies. Within and between these organisational structures, we find different coordination and allocation mechanisms, such as market transactions, hierarchies, commons, networks and reciprocity. These are all different ways in which people organise themselves to create value – whether monetised or not. Differences in both aspects, the organisational forms as well as the different coordination and allocation mechanisms, yield micro and meso level variations in how an economy is structured and functions.

Among all these economic forms, most contemporary economics programmes focus almost exclusively on market mechanisms. We suggest widening the scope, to include the large real-world variety of economic organisations and mechanisms. Without knowledge of how economic activities are organised, it is virtually impossible to understand how economies work or to give good advice for economic decisions. To be sure, we are not suggesting taxonomy or classification for its own sake. We argue for a better understanding of economic processes by conceptualising the wide diversity in forms.

This building block is closely linked to the next, *Building Block 6: Political-Economic Systems*, as they both focus on the different ways in which economies are organised. However, the current building block focuses more on micro and meso patterns, looking at the various ways in which specific processes can be organised, coordinated and allocated. The next building block has a more macro focus on economies as full systems with complex networks of organisations and mechanisms.

# 1 Forms of Economic Organisation

Economic systems, like natural ecosystems, are made up of many different forms. Looking around us, we see a large variety of private businesses, cooperatives, governmental organisations, households and forms of non-profit organisations, most of which also exist in informal varieties. These social constructs vary amongst others on the following aspects, which in turn will vary by country:

- Legal form (as defined by the state);
- Main motive or purpose (profit or non-profit);
- Type and number of owners and transferability of ownership (tradable shares, private owners or state);
- Funding (sales, taxation, donations);
- Power structure (centralised or decentralised);
- Size (individual, small, medium, large);
- Geographic scope (local, national, international).

The universal system of taxonomy that biologists use to identify the different species of the natural world does not have an equally well-structured counterpart in economics. Fortunately, becoming familiar with this diversity does not always require much analysis, but it does require looking with an open perspective. To grasp the different forms of economic organisation that exist, students can simply look at the world around them, perhaps using something like the above list of variables. This list is not an existing theoretical framework; we put it together for this building block, and the relevant variables would differ depending on the purpose of the investigation. We will now briefly review the main categories of economic organisations that can be distinguished.

*Private businesses* are perhaps the most visible type of economic organisations and come in all shapes and forms depending on amongst others ownership (who is the owner and how easily is ownership transferable such as on the stock exchange), their size and whether they act locally, nationally or internationally. *Corporate businesses* for example are large complex legal entities, owned by shareholders (often anonymous underneath a certain threshold and whose shares are freely tradeable) and run by managers. Their employees may be organised through *trade unions* in order to increase their bargaining power and have a voice in how the company is run. In many countries, large corporations are also required by law to have worker representation on corporate boards. Next to corporate businesses, there are various other forms of private businesses. Many companies are privately owned by a *family*, a *partnership* or a *sole proprietor*. It should be noted that family firms are not always small: the ALDI supermarkets, Tata Steel, Koch Industries and Dell are all majority-held by their founding families.

*Cooperatives* are run in a more direct democratic manner: not by shareholders but by their workers, customers, consumers and/or other stakeholders. These too come in many forms and sizes, ranging from small grocery stores to the Basque giant Mondragon. In *worker cooperatives*, such as Mondragon, the people who work at the company determine how it is run. *Consumer cooperatives*, on the other hand, are owned and managed by

customers. These have been especially important in retail and finance such as The UK Co-operative Group and the Swiss Migros. *Producer cooperatives* have been particularly prevalent in agriculture, as they allow relatively small farmers to achieve economies of scale together. Recently, the idea of *multi-stakeholder cooperatives* has become more popular, with the aim to give all relevant groups a voice and seat at the table: from consumers and workers, to producers, investors and members of the local community.

Next to such formal forms of economic organisation exists a large variety of *informal organisations*, which together are generally referred to as the 'informal economy'. This includes all economic activity that is not fully grounded in the legal structures of the state. In the western world, this is relatively limited to particular sectors such as unregistered housekeepers and illegal drug trade networks. In many developing countries, on the other hand, the informal economy covers vast parts of economies. There are various myths surrounding the term, as it is often associated with 'black' markets and 'underground' activities. One should, however, realise that the majority of workers in the world, 61% in 2018, earn their living in the informal economy (ILO). It is not some backwater shadow world, but rather says something about how far the formal systems of state reach.

Most textbooks discuss government mainly as a rule maker, an arbiter and a mechanism of redistribution. While the formal regulations of the state cover only a relatively limited part of the economy in much of the developing world, states are in virtually every country highly important economic producers themselves. The public sector often contributes around half of GDP and *government agencies* conduct massive amounts of economic activity themselves: running hospitals and clinics, schools and universities, the military and police, infrastructure, energy and water systems, and state-owned enterprises in many other sectors.

Another core form of economic organisation is the *household*. While individually, households are fairly small, in sum they are an enormous part of economies. Think of all the unpaid labour, such as care work and housekeeping, that is coordinated and performed inside households. Estimates suggest that household activity may even amount to about half of all economic activities (OECD, 2018). Students should note that the structures and functions of households are different from place to place and from time to time, from the stereotypical *nuclear family* to *single-parent* but also *extended families*. A look at the current situation in terms of household structures in the country can be useful and interesting for students.

Finally, there are also various *civic non-profit organisations*, such as *charities*, *foundations*, *community groups*, and *voluntary associations*, which receive donations to work on some cause and/or function on the basis of voluntary unpaid work. Recently, the line between non-profit and for-profit has become more complicated with the rise of *social enterprises*, which in varying complex ways combine social and commercial goals. There are also many *civil society organisations*, or *non-governmental organisations* (NGOs), trying to influence governmental policies. Commercial corporations are again key here, as private business through employers' and trade associations are the most powerful interest groups in many countries.

All the above descriptions refer to very large categories and there are many differences within them. Letting students choose more than one case of each category to look at or analyse can therefore be very useful, as it will show them how companies can be legally very similar yet function very differently in practice. Useful materials to teach about economic organisations in an accessible way are: *Introducing a New Economics*, *Economics: The User's Guide* and *Organisations: A Very Short Introduction*.

The study of these different organisational forms is not merely an intellectual pastime. The same product or service can be produced by very different types of economic organisations, and this often has far-reaching consequences for all stakeholders, from workers and investors to suppliers and consumers, as well as broader society and the natural environment. A concrete example from the Netherlands: when private equity started buying up child care organisations and transforming their internal organisation, from their services, labour arrangements and scheduling practices to their real estate ownership and lease structuring, this had serious consequences for the way they functioned, sparking societal and academic debate (Dutch Government, 2020; Dutch Parliament, 2019; Roosenboom, 2020; Van Bussel, 2020; Van de Weijenberg, 2018).

## 2 Coordination & Allocation Mechanisms

The previous section discussed fairly straightforward typologies of economic organisations: forms into which people organise themselves. This section focuses on the more complex underlying coordination and allocation mechanisms between and inside these organisation forms, which decide how people and organisations allocate their time and resources. The two most known of these are market transactions and hierarchical redistribution. There are, however, multiple other mechanisms that, despite their importance in real-world economies, have received less



academic and popular attention. These include commons, networks and reciprocity. Students should become familiar with these different ways in which people interact economically with each other in order to understand how economies work.

## Markets and Hierarchies

Markets are currently at the core of economics education, and for a good reason, as markets are highly important for how economies operate today. However, due to an abstract theoretical and mathematical approach, relatively little attention is paid to the exact forms that markets take in the real world. Not every market is the same, as markets are made out of social rules and practices that vary from place to place and from time to time. The economic sociology of markets and game theoretical field of mechanism design, in particular, have focused on the concrete ways in which markets are and can be structured. Markets allocate time and resources based on price, money, competition and individual gain. We suggest letting students study examples of different real-world markets in different contexts, identifying the actors, how they are organised and how they interact, so that they can better understand how markets function.

Hierarchical distribution allocates time and resources based on fixed roles and formalised lines of command. It is typically associated with public sector and state entities, but it is also the way in which many organisations within the private sector are organised internally. Although the number of self-employed people has increased over the last decades, most economic activity in the private sector still takes place within hierarchical organisations: private bureaucracies. This form is not restricted to large organisations. Small organisations can also function on the basis of hierarchical distribution. The key differentiating factor from the market is that decisions within such an organisation are made between people based on hierarchical interactions and not based on the price mechanism.

Similarly, entrepreneurship exists both within the private and public sector and small and big organisations. Change and innovation do not only come from small private start-ups. Big organisations, public and private, often play key roles in creatively developing new products and processes, and changing economic structures.

The interactions between markets and hierarchies are many and complex, as we already noted that many market actors, such as private businesses, are internally organised as hierarchies. Indeed there are various combinations and variations between hierarchical bureaucracies and markets which make the study of organisations so fascinating and important. Simplistic dichotomic notions of *public versus private* and *big*

versus small are not likely to improve our understanding of how these dynamics play out in reality. Therefore, we suggest exposing students to this wide variety of hierarchies and how they can function.

### Other Mechanisms: Commons and More

Besides the mechanisms of the market and hierarchy, there are various others that often get less attention than they deserve, given their importance in real-world economies. There are multiple theoretical conceptualisations of these other coordination and allocation mechanisms amongst which commons, reciprocity, gift economies, associations, networks and householding. The coordination and allocation may be done based on social relationships, trust, group identity, norms or shared practices. Compared to markets and hierarchy, these mechanisms are often somewhat more symmetrical and norm- or culture-driven. *Contemporary Capitalism: The Embeddedness of Institutions* gives a useful overview and introduction into a wide variety of economic mechanisms, from markets and public and private hierarchies, to communities, associations and networks.

How do these coordination and allocation mechanisms function? Here we take one example: the *commons*. In the online resources we provide a brief literature overview of other mechanisms, such as reciprocity, gift economies, associations, networks and householding, accompanied with suggestions and teaching materials for more in-depth courses on economic mechanisms.

Over the last decade the commons have received increasing attention. The term describes situations where resources are held in common by a community which governs them through informal norms and social practices. Traditionally, the concept has been associated with natural resources such as grasslands, fisheries, forests and irrigation systems. Recently, the concepts of the digital, urban, cultural and knowledge commons have gained prominence.

There are two main academic approaches to the commons. First, commons are analysed to determine why and how they can fail, centred on the idea of *The Tragedy of the Commons* popularised by Garrett Hardin in a paper in 1968. A second strand focuses on how they can succeed, centred on Elinor Ostrom's empirical body of work. Ostrom (1990) found that institutional arrangements largely determine the success of shared resource management resources, requiring the following:

- 1 Clear boundaries regarding users and non-users and which resources are concerned
- 2 Appropriation and provision rules are adapted to local conditions
- 3 Most people affected by the arrangements are able to participate in creating and changing its rules
- 4 The appropriation and provisioning, as well as the conditions of the resources, are monitored
- 5 Sanctions for rule violations start very low but become stronger if a user repeatedly violates a rule
- 6 Mechanisms allow conflicts among users or with officials to be quickly and locally resolved at low costs
- 7 Higher-level authorities recognize the rights of local users to make their own rules
- 8 When connected to a larger economic system, governance is organised in multiple nested layers

Going beyond the notion that resources necessarily need to be managed by either the state or the market, Ostrom points out multiple other possible solutions that rely on voluntary self-governing. The point here is not that markets and states are not important, it simply means they are both part of larger governance structures, which she calls *polycentric*, in which commons also play important roles.

Rather than debating which mechanism in general is superior, she argues we should be more open-minded and consider the diversity in ways in which decisions about time and resources are made. We should look at specific cases with their own characteristics and contexts and analyse which (combinations of) mechanisms, and especially which design rules, lead to successes. In other words, rather than trying to simplify the world, we should recognise its complexity and learn about the many ways in which economies can be (more and less successfully) organised.

*Coordination & Allocation Mechanisms* elaborates upon this overview of the commons as well as the other mechanisms of coordination and allocation by examining them from three perspectives: economic anthropology, social systems of production and new institutional economics. We show how these three are connected, how their focus differs and offer suggestions on how to use them in teaching this material. [economy.st/backgroundbb5](http://economy.st/backgroundbb5)



### 3 Practical Suggestions

Below we describe four suggestions to consider when teaching economic organisations and mechanisms. First, treat forms both as analytical concepts and in their real-world expressions: always use examples. Second, start with basic explanations of individual static forms and move towards discussions of dynamic and interacting forms. Third, in specialised courses, showcase the different ways of organising surrounding that topic, such as different labour, financial or tax systems. Fourth, distinguish analytical description from normative evaluation of forms.

First, treat economic organisations and mechanisms both as concepts and as real-world phenomena. Forms of economic organisation (companies, non-profits, etc.) are easily spotted in the real world, and this can make for interesting student assignments. As for the different coordination and allocation mechanisms (hierarchy, the commons, market mechanisms, etc.), they can be quite difficult to grasp. So it might be useful to first discuss the concepts with the help of some clear examples of different mechanisms with students. Nevertheless, it is also important for students to learn how to see these forms in the complex real world around them.

An exercise for this could be to let students record the different mechanisms they themselves engage in on a day. A student might wake up and first make breakfast for him- or herself, an example of householding. Subsequently, they might go on public transport to university which is organised through hierarchical organisations of the state, partially funded by taxation. On their way, they might look up the topic of today's class on Wikipedia, a commons. In class, they might help out a friend by lending him or her a pen – reciprocity. For lunch, they buy a meal at a local cafeteria, a market transaction with a formal private business. In the end of the afternoon, they might go to the student sports club, a voluntary association. As a side job, in the evenings they tutor their neighbour's son in mathematics, an informal private business.

A more extreme exercise to make students understand the roles of these mechanisms in economies, would be to give them the assignment to avoid using one mechanism for a day. This could be done once, or multiple times to let students experience it with different mechanisms. How would a day look without being able to buy or sell anything? Not following any instructions from a superior or giving them yourself (please, only on the weekend). Or without being able to reciprocally receive and return favours (not for too long, or everyone will hate you)? And perhaps most impossible of all, without doing any householding and self-care activities? The goal here is not that students strictly adhere to the exercise, but that they realise the prevalence of each of these different economic mechanisms.

For a less extreme exercise, let students describe what life would look like if they were to avoid one particular type of economic coordination mechanism. Different groups could be assigned different mechanisms, and afterwards, groups could debate what mechanisms are most vital to our economic organisation.

Our second suggestion: start simple and move to more complexity. To help students get an idea of the different organisations and mechanisms, it might be useful to start with isolated and static descriptions: *“This is the concept of a multinational, and here is an example. This is the concept of a commons, and here is an example.”*

Reality is, however, of course more complex. In the real world, organisations and mechanisms do not exist in isolation from each other but do interact in various complex ways. They might strengthen each other but they might as well undermine each other. Furthermore, things change over time. For example, elderly care might first be organised through households and religious organisations, but later through various state organisations and, after that, privatised to for-profit companies.

Understanding how some economic activities and resources move from one form to another is at the core of understanding economic change. Our advice is to start with isolated static mechanisms and, when possible, move to more complex discussions about how they interact with each other and change over time.

Our third suggestion: when teaching a specific topic, such as finance, labour or fiscal policy, use the same logic. Showcase different ways of structuring economic life. Say you are teaching a course on financial economics. This could include an overview of the highly different kinds of financial *organisations*: such as commercial and investment banks, public investment banks, credit unions, hedge funds and green banks. It could also include an overview of various *mechanisms*. For instance, the different financial systems such as a gold standard, fiat money, the international Bretton Woods system and, recently getting more attention, crypto-currencies, full reserve banking and central bank digital currency. The same could be done for various labour arrangements in labour economics courses, or for tax and government systems in public economics, etc.

Fourth and finally, it is important to distinguish normative evaluation as much as possible from the analytical description of organisations and mechanisms. Both are relevant for students to learn about, but mixing them can be very dangerous, so we suggest being explicit to students about

whether the focus is on description or normative evaluation. Furthermore, we think it is helpful to start by giving students an analytical and real-world understanding of the different ways of organising, before going into the normative judgements about them (which is at the core of the final building block of this book, *Building Block 10: Economics for a Better World*).

This approach is somewhat opposite from the currently prevalent approach, which starts from a normative assumption and subsequently goes into analytical descriptions. How so? Many current programmes start by explaining to students that markets, if they are ‘perfect’, lead to *optimal* outcomes. Much of the subsequent programme then consists of learning analytically how these optimal outcomes, sometimes also referred to as ‘competitive equilibria’, do or do not come about, with the help of neoclassical models. Later, the state often comes in as a possible solution for market imperfections, although students are also taught to look out for government failures in such cases.

While this approach teaches students many valuable lessons, it can give students the impression that markets (sometimes accompanied by an interventionist state) are a priori desirable and superior compared to other mechanisms. We firmly believe that learning to think independently and critically is at the core of academic education. Therefore, we think it is important that programmes expose students to a wide variety of positions and analytical ideas, as opposed to teaching a single main perspective or starting point, with the danger of (unintentionally) instilling normative beliefs into students.

The point is not that the neoclassical answers to questions about economic mechanisms are false. It is rather that they are only one set of possible answers to complex normative and analytical questions. We therefore advise to expose students to these different sets of answers and help them to critically scrutinize the philosophical arguments and empirical evidence that underline them.

Furthermore, we think it is important to pay attention to the complex and often nuanced nature of arguments and positions. We would not suggest assigning students to write an essay or debate about which mechanism they think is superior. Rather, students might be given specific cases to analyse and argue about how they can best be tackled. This could require students to suggest combinations of mechanisms and organisational forms to address the real-world problem. The degree of nuance and complexity of such an assignment would depend on the level of the student or class.

# Teaching Materials

- *Introducing a New Economics* by Jack Reardon, Molly S. Cato, Maria A. C. Madi, from 2018, chapters 10, 11 & 12. Three accessible and brief chapters, with accompanying classroom activities and questions, introducing students to what public goods, commons and firms are and how they can be governed, for example as a corporation owned by shareholders or as a cooperative owned by its workers or consumers.
- *Economics: The User's Guide* by Ha-Joon Chang, from 2014, chapter 5. A short well-written chapter on different economic actors and organisational forms, from multinational corporations, cooperatives, and labour unions, to governments and a variety of international organisations.
- *Organisations: A Very Short Introduction* by Mary Jo Hatch, from 2011. A brief, accessible and yet highly informative book full with scientific theories and ideas on what organisations are, how they can be structured, how they change, and their internal dynamics and interaction with markets and society.
- *Governing the Commons: The Evolution of Institutions for Collective Action* by Elinor Ostrom, most recent edition from 2015, chapters 1, 2 & 3. A sharp and rigorous discussion of commons, how they are different from markets and hierarchies, how we should theorize them and real-world examples that help us better understand how they can be successful.
- *Contemporary Capitalism: The Embeddedness of Institutions* by J. Rogers Hollingsworth and Robert Boyer, most recent edition from 2012, chapter 1. An instructive analytical introduction and overview of different coordination and allocation mechanisms, such as markets, public and private hierarchies, networks, communities and associations.

Visit the website for a wider range of teaching materials, to provide feedback, and to exchange ideas and ask support from colleagues worldwide.  
[economy.st/bb5](http://economy.st/bb5)

