Lessons from the Past

Stories about World-class Collaboration

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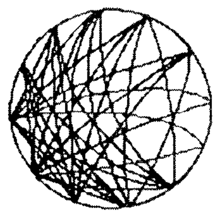

Two Paths, Two Societies

Emilia-Romanga

Italy is in shambles as the curtain lifts on Europe's aptly named Dark Ages. Throughout the peninsula, imperial rule has crumbled. Banditry is rampant. Restoring social order is the government imperative of the time. With the dawning of the 12th century, two radically different approaches emerge:

- Steep vertical hierarchies rise up in the south.
- Horizontal networks spread out in the north.

Hundreds of years later, these two paths reverberate still, not as faint echoes of the past but as powerful, pulsing shapers of the two disparate regions' cultures, institutions, and economies.

Beginning in the early 1100s, Italy's southern region falls under the organizing talents of Norman mercenaries. They superbly blend relatively enlightened feudal rule with Byzantine-style, complicated bureaucracy for the next few centuries. Then, following the deaths of a line of great kings, prosperity starts to wane. The steep hierarchy passes to the landed autocrats.

This vertical, client-patron power structure remains intact for the next 800 years and is still spectacularly evident in the 1990s. The collapse of the central government to corruption, a mega-scandal known as "Kickback City" (in Italian, *Tangentopoli),* was nearly a millennium in the making. Meanwhile Italy's central and northern towns are remarkable forerunners of 21st-century organizational design.

Inventing Credit

Not since the rise of Athens and the other early Greek city-states had the West witnessed such a brilliant light of self-governance as shined in Florence, Venice, Bologna, Genoa, Milan, and other cities and towns in the north of Italy. From the 1100s, decentralized centers of communal republicanism rise and prosper. At their core are voluntary mutual-aid associations of neighbors for protection from marauding violence and cooperation for economic prosperity.

From the twelfth to the sixteenth century the feature which most distinguished Italian society from that in other regions in Europe was the extent to which men [sic] were able to take part in determining, largely by persuasion, the laws and decisions governing their lives."[1]

People form myriad mutual-aid groups in many spheres, creating a "rich network of associational life"—in neighborhoods, among parish priests and religious societies, in political parties, and within "tower societies" that provide security. Key among them are craft and trade guilds, formed for social as well as economic purposes. A "vivid sense of equality" courses through the affairs of these communities.

Most remarkable is the economic creativity unleashed by the growing civic communities. The northern Italian republics invent *credit,* adding this fundamental tool to the already known classic economic factors of markets, money, and law.

Before the innovation of credit, private capital can accumulate but cannot travel further in the economy. Credit links savings and investment. It sets up an accumulating feedback loop whereby wealth can be used to create more wealth and economic growth. The prosperity of the communal north flourishes through finance and commerce, different kinds of affluence from the southern Sicilian Kingdom, that roots wealth in the land.

What lies at the heart of the discovery of credit a thousand years ago? Nothing more complex than an essential human quality already old by then—*trust.* Credit (from the word meaning "to believe") is possible only when there is mutual trust. In the *Oxford English Dictionary,* the third definition of credit *is* trust. The more trust exists, the more efficient credit is. The cost of mistrust goes down. With widespread trust in northern Italy:

"(S)avings were activated for productive purposes to a degree inconceivable in previous centuries.... It was the widespread sense of honesty, strengthened by the sense of belonging to an integrated community, quite apart from definite legal obligations, which made possible the participation of all kinds of people with their savings in the productive process."[2]

Northern Italy has maintained a rich, concentrated culture built on extensive intertwined horizontal relationships throughout the centuries, through plagues, foreign occupations, and periodic impositions of client-patron controls.

Emilia Romagna: The Reprise

An unexpected visitor arrives at our office in West Newton, Massachusetts, in late Fall 1991. He has a message that he says we cannot ignore in the book we are then writing, *The TeamNet Factor*.[i] "You must tell the amazing story of what happens when many, many, small businesses form networks," said Jean-Pierre Pellegrin, a French official at the Organization for Economic and Cooperation and Development in Paris. "Emilia Romagna, then Denmark. Write about them." "Them" turns out to be a very big story indeed in north central Italy.[ii] The somewhat mysterious source of Emilia Romagna's rags-to-riches story is the inspiration for the *flexible business network* movement around the world—where little companies become small giants by linking up.

After a century of centralized rule from Rome, Italy finally decides to decentralize its government in the 1970s. At the time that regional governments begin to form, Emilia Romagna ranks 18th in income among Italy's 21 administrative regions

Over the next decade, the economy explodes as hundreds of thousands of small businesses in Emilia Romagna tie together into networks. It becomes the second wealthiest region in Italy, recording the greatest performance jump of any of the 80 European Community regions by the mid-1980s. Unemployment plunges from 20 percent to almost zero. By the late 1980s, there are 325,000 companies in this region of four million—an incredible ratio of one firm to 12 people, 90,000 of them in manufacturing.

Emilia Romagna catches Denmark's attention. By the end of the 1980s, that country of *five* million, about the same size as the commonwealth of Massachusetts, intentionally launches a similar effort. Denmark's success proves that many of the Italian lessons are transferable. In these two countries, government stimulates thousands of networks, positively affecting the national bottom line.[iii]

Italy's experience in moving from centralized to decentralized governance mirrors that of many organizations. Its mandate comes long before its implementation. Italy's 1948 Constitution calls for the nation to decentralize and establish administrative regions. But it takes more than a generation for this to occur. Italy deliberately establishes an entirely new level of government in 1970. With the regions come new governments with fairly equivalent roles, rules, and budgets.

> *This rare event in a developed democracy offers a natural experiment: a set of governmental constants and a wealth of social, cultural, and economic variables encompassing the many extremes represented in Italy.*

Harvard professor of government Robert Putnam and a network of colleagues seize the extraordinary opportunity to do very-large-scale social *science* in the field.

Together they lay a baseline and track the ensuing institutional results. Putnam's book, *Making Democracy Work: Civic Traditions in Modern Italy,* summarizes their extensive findings and draws powerful implications for democracy and economic development in the Network Age.

They measure the performance of the new governments in three broad areas with 12 indicators:

- *Processes,* including cabinet stability, budget promptness, and statistical and information services.

- *Law making,* including reform legislation and legislative innovation.

- *Implementation,* including day-care centers,[iv] family clinics, industrial policy instruments, agricultural spending capacity, local health unit expenditures, housing and urban development, and bureaucratic responsiveness.

Perception is at least as important as reality in politics. They test these objective performance measures against citizen and community leaders' opinions gathered by surveys and polls and find them in close agreement.

Amazingly, Emilia Romagna tops the authors' "good government" charts among all the regions. [v] Why?

The Hunt for Civic Community

While some regions thrive, others quagmire. These conclusions leap out of the data—field observations, case studies, quantitative techniques, and statistical analysis—prompting the researchers to keep asking why. They liken their search for clues to a detective mystery.

The usual explanation, that good socio-economics leads to good government, does not square with the data. Both the top performer and the bottom one start in 1970 with similar below-average social and economic indicators. Yet, Emilia Romagna in the north becomes the country's rising star, while Calabria in the toe of Italy turns in the most dismal performance.

The answer, once they see it, reverberates throughout the data:

- Indicators of good government[8] correlate with

- Places where people are joined in thick, overlapping networks, what the researchers termed "civic communities,"[9] that in turn map uncannily closely with the

- Most horizontally organized types of governments of the medieval states as they existed in 1300.[vi]

"Civic communities" come about when people engage in horizontal relationships. They are "bound together by reciprocity and cooperation," according to Putnam, rather than by vertical "authority and dependency." Equality and trust, two basic human values, are at the core of civic culture. Civic societies are lush with social networks and associations of all sorts, an observation Alexis de Tocqueville made regarding the about-to-boom United States in his 1840 study, *Democracy in America.*

Many networks tightly braid people in Emilia Romagna, which has the top measures in both civic culture and institutional performance. Putnam calls it "the site of an unusual concentration of overlapping networks of social solidarity, peopled by citizens with an unusually well developed public spirit—a web of civic communities. Emilia Romagna is not populated by angels, but within its borders (and those of neighboring regions in north-central Italy) collective action of all sorts, including government, is facilitated by norms and networks of civic engagement."

The results are simple and strong:

Governments are better where measures of "civic-ness" are higher.

New Gold

In 1970, Bologna, once the intellectual capital of the medieval communal republics, becomes the new regional capital of Emilia Romagna.

What fuels the unprecedented economic growth there and the creation of excellent government? What resources of capital enable such widespread creation of new wealth? Neither new land, natural resources, nor technology grace this ancient area. Not even human capital, meaning a highly educated and skilled populace, distinguish it.

What Emilia Romagna does have in 1970 is an abundant stock of continuously renewing *social capital.*[vii] Its spring of wealth has three tributaries:

- Trust,
- Reciprocity, and
- Dense social networks.

In the communal republics, extraordinary trust develops among myriad mutual-aid associations and allows the civic regions of Italy to invent credit. The lesson of the past millennium applies immediately to today's business networks.

"At the core of the mutual aid societies was practical reciprocity: I'll help you if you help me; let's face these problems together that none of us can face alone."[14]

Today these seats of Western civilization again have shown how to spin old relationships into new gold.

Relationships among the players lodge social capital. Unlike financial and human capital, social capital cannot be the property of individuals or corporations. By its very nature, it is jointly owned.

People generate wealth in dense networks of horizontal relationships in two primary ways because they:

- Lower transaction costs.
- Increase opportunities for cooperation.

Transactions are at the heart of business. All transactions, commercial and otherwise, particularly across boundaries and over time, embody trust. Transactions have costs—heaviest when trust is low, lightest where trust is high.

Mistrust is expensive. Informal communication goes down and formality goes up: Endless forms and legalisms, time and effort spent checking other people's work, drawn out negotiations, political games and backstabbing, sticker-shock at the cost of third-party enforcement, corruption, and crime. When trust diminishes, price goes up.

Left un-renewed and unused, social capital depletes, fragments, and disorganizes under the wear-and-tear of transaction costs. Mistrust makes networks hard to form and relationships difficult to maintain, further diminishing trust. Unchecked, this vicious cycle searches for a stable state. In top-down culture held together by vertical controls, the norm to "never cooperate" stiffens in place.

But there is hope. Social capital also grows through *reciprocity* among people in *horizontal networks.* Reciprocity works when people:

- Barter directly in the here-and-now; and
- Bank benefits for the future, the barn-raising principle.

In barter, reciprocity is in equilibrium with an immediate and equivalent exchange, a trade of some kind. In barn-raising, you do something today believing that it will come around to you in the future.

Future-oriented, barn-raising, cooperative behavior is the most productive type of reciprocity. It enables economic development.

"Rotating credit associations," a simple example found in virtually all cultures around the world, show how trust creates new wealth. Revolving loan funds—from villages in Bangladesh where Grameen Bank funds new businesses to the Pine Ridge Reservation in South Dakota where small groups of micro-entrepreneurs pool resources—happen when everyone in a group contributes to a common pot. One member uses the collective pot, perhaps to increase his or her productivity (e.g., to buy seed or a plow). After experiencing the benefit, members, of course, continue to contribute. Why "of course?" Because in dense networks, where people know one another well, the cost of lost opportunities and the threat of ostracism are prohibitive.

Trust lowers the cost of cooperation, depositing money in the bank. Informal communication increases while formalities and paperwork recede. Negotiations are brief and conclusive. The need for "checkers" evaporates as people simply keep their word. No need to spend time supervising because everyone's involved in real work. With trust and relationships that are reciprocal, social capital accumulates. Without trust, it remains scattered and unformed. The more relationships you have, the greater the potential for cross-hatches of trust.

Greed No More

"Greed, mismanagement ravage fisheries," reads the headline.[viii] Near us, both the United States and Canada are invoking drastic measures to curtail the catch on the once-rich Georges Bank fishing grounds off the New England and Newfoundland coasts. Local economies are devastated. A precious resource is in dire danger globally.

Georges Bank is a real-world example of "the tragedy of the commons," whereby people ruin a place that they own in common with overuse. When everyone maximizes their individual gain by exploiting a shared resource, they destroy a natural, common source of wealth. Add continuously improving technology, such as in ocean fishing, and the spiral to exhaustion accelerates.

The field of game theory has a name for this: "The dilemma of collective action" is one of several logical puzzles that speak ill of cooperation. According to the numbers, cooperation is either folly or, at best, rarely a rational choice. Early game theorists make the science of economics more dismal than Malthus had ever managed with such thinking. In closed transactions where games are played in isolation only once, the winning strategy, they find, is for players to get as much for themselves as possible and never cooperate. Selfishness is logical and rational.

In isolated situations where there are no consequences in the future and relationships are top-down, people "never cooperate," a predictable, suspicious, stable state. It's safer and more "rational" to "always defect," to be mistrustful and exploitative.

However, when people play repeat games, the logic changes dramatically. People become more cooperative when their behavior in one transaction carries forward to subsequent ones. In "infinitely repeated games," cooperation suddenly becomes rational and practical, according to later game theory studies.[ix]

Game theory predicts, and Putnam's study demonstrates, that society holds together at two "quite different levels of efficiency and institutional performance." In one case, the informing principle is to "always defect." In the other, the motto is to "reciprocate help."

When the players connect in rich networks, "brave reciprocity" prevails. News about trustworthy and untrustworthy behavior spreads quickly and widely. Here the norm is different:

"Cooperate with people who cooperate with you (or who cooperate with people like you), and don't be the first to defect.'"[x]

These self-reinforcing dynamics, reciprocity-trust and dependence-exploitation, reflect building up and tearing down forces. They are, respectively, "vicious" and "virtuous" loops, amplifying through positive feedback.

Trust, reciprocity, and networks all are mutually reinforcing, whether on the rise or on the wane.

Trust is at the personal core; reciprocity is at the interface; and networks tie it all together.

Networks facilitate communication and extend trust. When success spreads through a network, it stimulates more cooperation, providing models for others about what works. Innovation increases as the latest information and trends create a large-scale learning system in which many potential users share knowledge.

Innovation is stunning among Emilia Romagna's hundreds of thousands of tiny, networked companies. As so many have observed about this region, it reflects a vital dynamic that simultaneously integrates vigorous competition and cooperation—co-opetition—among many independent players.

These lessons have a timeless quality. They apply both on grand scales and on intimate ones.

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[i] Jessica Lipnack and Jeffrey Stamps, *The TeamNet Factor: Bringing the Power of Boundary Crossing Into the Heart of Your Business* (Essex Junction, VT: Oliver Wight, 1993.

[ii] The rise of small business networks was the "hot news" that many business writers and reviewers picked out of *The TeamNet Factor.*

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[iv] There was enormous disparity in social services between the north and the south. For example, Emilia-Romagna had one child-care center per 400 children; Campania, in the south, had 300 percent fewer, one per 12,560 children.

[v] For the detailed analysis of Emilia-Romagna's "good government," reporting the study's composite index of institutional performance, see *Making Democracy Work,* p. 76.

[vi] The third map, "Civic Community in Italian Regions," is map figure 5.1, p. 134. Copyright © 1993 by Princeton University Press. Reproduced by permission of Princeton University Press.

[vii] Social capital has been a research topic and a concept under development for more than a decade, especially in sociology. See Ronald S. Burt, *Structural Holes: The Social Structure of Competition* (Cambridge, MA: Harvard University Press, 1992), for an excellent treatment. We use Putnam's formulation here.

[viii]For a superb three-part series on problems in the fishing industry, see "Troubled Waters: Fishing in Crisis," by Cohn Nickerson, whose first article, "Stripping the Sea's Life," *The Boston Sunday Globe,* April 17, 1994, jumped from p. 1 to p. 24, where it had the headline "Greed, Mismanagement Ravage Fisheries."

[ix] The observation that cooperation becomes increasingly rational and practical is from *The Evolution of Cooperation,* by Robert Axelrod (New York: Basic Books, 1984).

[x] The quote on defection is from Robert Sugden, as quoted in *Making Democracy Work,* p. 178 (see note 1).