Jens Beckert

BEYOND THE MARKET

THE SOCIAL FOUNDATIONS OF ECONOMIC EFFICIENCY

Translated by Barbara Harshav

PRINCETON UNIVERSITY PRESS

PRINCETON AND OXFORD

PUBLISHED BY PRINCETON UNIVERSITY PRESS, 41 WILLIAM STREET,
PRINCETON, NEW JERSEY 08540
IN THE UNITED KINGDOM: PRINCETON UNIVERSITY PRESS,
3 MARKET PLACE, WOODSTOCK, OXFORDSHIRE OX20 1SY
ORIGINALLY PUBLISHED IN GERMAN AS *GRENZEN DES MARKTES:*
DIE SOZIALEN GRUNDLAGEN WIRTSCHAFTLICHER EFFIZIENZ

LIBRARY OF CONGRESS CATALOGING-IN-PUBLICATION DATA

BECKERT, JENS, 1967– [GRENZEN DES MARKTES. ENGLISH]
BEYOND THE MARKET: THE SOCIAL FOUNDATIONS OF ECONOMIC
EFFICIENCY / JENS BECKERT; TRANSLATED BY BARBARA HARSHAV.
P. CM.
ORIGINALLY PUBLISHED AS: GRENZEN DES MARKTES.
INCLUDES BIBLIOGRAPHICAL REFERENCES AND INDEX.
ISBN 0-691-04907-6
1. ECONOMICS—SOCIOLOGICAL ASPECTS. 2. DECISION MAKING—SOCIAL ASPECTS. I. TITLE.

HM548.B43613 2002
306.3'4—DC21 2001058064

BRITISH LIBRARY CATALOGING-IN-PUBLICATION DATA IS AVAILABLE

THIS BOOK HAS BEEN COMPOSED IN BERKELEY BOOK MODIFIED TYPEFACE

PRINTED ON ACID-FREE PAPER. ∞

WWW.PUP.PRINCETON.EDU

PRINTED IN THE UNITED STATES OF AMERICA

1 3 5 7 9 10 8 6 4 2

BEYOND THE MARKET

PREFACE

THIS BOOK began in a seminar given by Robert Heilbroner and Ross Thompson at the New School for Social Research in the autumn of 1990. Titled "The Autonomy of Economic Life," the seminar examined the relationship of the economy and society as well as that of economics and other social sciences. Ever since then, I have been interested in these subjects. I am grateful first to Hans Joas, who supervised the work, encouraging the clarification of conceptual issues. In many respects, my thinking has been deeply influenced by the work of Hans Joas and our many conversations. I would also like to thank Heiner Ganssmann, Wolfgang Knöbl, Claus Offe, Harald Wenzel, and Dietrich Winterhager, who read the entire book or individual chapters and made helpful remarks. My thanks to the Studienstiftung des deutschen Volkes for financial assistance. I wrote most of the dissertation in the academic year 1994–95 as a Visiting Research Fellow in the Department of Sociology of Princeton University, where the ideal working conditions were an essential advantage for the progress of the book. For making this stay both possible and intellectually stimulating I should like to thank the department, particularly Paul DiMaggio and Viviana Zelizer. I am grateful to the Gottlieb Daimler and Carl Benz Foundation for a stipend during my year in Princeton. Volker Bien, Karin Goihl, and Anne-Christin Muth helped with literature and preparation of the final manuscript. Last but not least, thanks to my wife Farzaneh Alizadeh for all her support during the not always easy phases of the writing process. The book is dedicated to the memory of my father.

Berlin, July 1997

Note: For the English translation, the chapter on Durkheim has been slightly abridged, while some new material has been added to the chapter on Giddens and to the conclusions. The other parts of the manuscript remain unchanged, except for some corrections in the interest of legibility. Permission from Kluwer Publishers for using material from my article "What is sociological about economic sociology? Uncertainty and the embeddedness of economic action" (Theory and Society 25: 803-840) is gratefully acknowledged.

Cambridge, Mass., February 2002

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INTRODUCTION

ALTHOUGH sociology and economics have ignored one another for decades, developments in both disciplines during the past twenty years suggest that cautious rapprochements are beginning to crack the solid lines that have separated them. Catch phrases like those advanced by the American economist James Duesenberry (1960: 233)—that "economics is all about how people make choices; sociology is all about how they don't have any choices to make," are no more valid as a description of the relationship between the two fields today than they were when first pronounced.

Ever since the early 1970s, starting from criticism of the restrictive assumptions of the general equilibrium theory and developments in game theory, economics has clearly been opened to problems and subjects that had previously been ascribed essentially to the domain of sociology. These include developments in the economics of information, the transaction cost theory, principal-agent approaches, the new historical economy, and the incorporation of bounded rationality into game theory. No matter how varied these modeling strategies are, they all agree that more consideration should be given to psychological and social constraints, and that studies need to investigate how equilibrium models change when the heroic assumptions of information and structure of the standard models of economics are loosened.

Meanwhile, in the 1960s and 1970s, sociology moved away from functionalist and structuralist theoretical approaches and became increasingly devoted to approaches based on theories of action. Criticism of functionalism led especially to projects intended to make social structures and processes intelligible in reference to social action, without being tied to the rational-actor model for its behavioral typology. On this background, a renewed interest in socioeconomic problems has developed since the 1980s. In the 1950s and 1960s, economic sociology dealt with problems that were marginalized by economics. But the "new economic sociology" claims to be able to demonstrate on the ground of the substantial core areas of economic theory how economic functions can be understood better through sociological conceptualizations. Even though the objectives of the new economic sociology must be seen in the context of the repudiation of economic imperialism, it nevertheless reveals an opening to economics because sociology starts dealing with social phenomena that had long been considered the exclusive domain of economics.

In the mutual debate over the issues and approaches of each other's discipline, sociology and economics intersect. Thus, some of the modeling strategies, especially transaction cost theory and Douglass North's work in the field of economic history, were adopted with critical candor by economic sociology. In economic theory, those approaches also express at least a cautious opening to sociology. Historical data are included along with the possibility of "irrational" action on account of cognitive constraints, and the spread of inefficient equilibria on account of informational limitations, so that the field is partly dissociated from the assumption of universal efficiency of economic institutions.

While these developments in economics and the new economic sociology indicate an entente between the disciplines, they still remain separated from one another at the demarcation line of the rational-actor model. The central assumption of the maximization of utility has been both criticized and expanded by the theory of bounded rationality and by attempts to integrate altruistic behavioral motivations, yet the paradigmatic core of economics is defined by the action-theoretical notion of an individualized, universal maximizer of utility. Ever since the establishment of modern economics in the eighteenth century, the moral-philosophical justification for the behavioral model of *homo oeconomicus* has consisted of the expectation, expressed in the metaphor of the invisible hand, that action directed at self-interest leads to a desirable allocation of economic goods, both collectively and individually. Pursuit of private interest is the basis for the emergence of the common welfare. This link between behavioral expectations and institutional structure is also the basis of liberal economic policy: the demand for unlimited markets by removing trade barriers and restraining government regulation is justified normatively by the expected increase of wealth.

The new economic approaches developed as criticism of equilibrium theory with respect to its assumptions about market structures and the supply of information of market participants. They show that, often, under realistic premises, either no unequivocal equilibria exist or that stable equilibria with inefficient resource allocation develop. This results in market failure. But market failure calls into question the central link of economic theory between rational individual action, unlimited markets, and optimal distribution of economic goods; the claim of the superiority of rational individual action cannot be generally maintained under the more realistic assumptions. The close connection between self-interested action and economic efficiency becomes precarious.

In this book I try to explain how sociology can contribute to understanding the bases of economic efficiency. The decisive consideration here is that the discrepancy of the connection between rational action and efficient results asserted by economic theory forces the revision of the action theory that underlies the understanding of economic action. To substantiate this hypothesis, I shall demonstrate in the first part of the book why the emergence of efficient equilibria cannot be generally explained from the behavioral model of economic theory and, thus, that removing limits on markets does not per se lead to the increase of economic efficiency. Three central action situations can be identified for the functioning of the economy in which economically rational actors either achieve inefficient results or in which no rational strategy for the allocation of resources can be identified. These situations are cooperation, action under conditions of uncertainty, and innovation.

The critical discussion of the first part of the book raises two questions: how we can understand how actors in the three action situations arrive at efficient results, and how they make decisions when they cannot know what the optimal behavioral strategy is. The most important systematic starting point of a sociological concern with the economy is located in these two questions. They are central not only for determining the relationship between sociology and economics but also for the empirical understanding of economic structures and processes in market economies.

In the second part of the book, to get to an answer, I systematically examine conceptions of economic action in the tradition of sociological theory. Ever since sociology was founded, it has used both empirical and theoretical arguments against the economic theory of action and the notion of the emergence of social order from the behavior of actors pursuing their own self-interest. The discussions were linked both to the intensive debate with socioeconomic questions and often to the demand for the limitation of the market. Conceptions of economic sociology in sociological theory are particularly well suited for discovering designs for understanding the three action situations. They also fill a gap in the "new economic sociology," because the significance of considerations of economic sociology, especially in the classics of sociological thought, becomes more accessible in the field.

The choice and order of the concepts of economic sociology discussed are oriented toward the action situations in question. The projects of Émile Durkheim and Talcott Parsons prove to be especially fruitful for understanding cooperative relations but not for the problematics of uncertainty and innovation. On the other hand, Niklas Luhmann's systems theory is especially significant when acquiring the capacity to act under extremely contingent conditions. Yet understanding innovations demands a conception of creative action that can be derived from the new approaches of constitution theory; here works of Anthony Giddens are discussed as an example.

These studies represent debates with individual authors who all engage in the systematic debate of the assumptions of action theory for overcoming the specified limits of the economic model of action in explaining economic efficiency. Parallel to that, I pursue a second line of questioning:

how does consideration of the economy develop in the history of sociological theory? Whereas the debate with economics had a central significance for the founders of the discipline, in modern sociological theory it plays a much smaller role. This development also results in a shift between the four studies: in the investigations of Durkheim and Parsons, their conceptions of economic sociology are central; on the other hand, particularly in the last chapter on Giddens, the systematic aspect of action-theoretical considerations predominates.

Following the four studies, I shall compile the products of the analyses and discuss their significance for a theoretical underpinning of economic sociology, and also discuss the question of the social embeddedness of economic structures as a central condition of economic efficiency. A proper understanding of the significance of cultural, social, and cognitive structures for the efficiency of market economies can be achieved only when we go beyond the market as a universal institution for the allocation of economic goods and supersede the rational-actor model.

PART ONE
CRITIQUE

ONE

THE LIMITS OF THE RATIONAL-ACTOR MODEL AS A MICROFOUNDATION OF ECONOMIC EFFICIENCY

The most intellectually exciting question on our subject remains: Is it true that the pursuit of private interests produces not chaos but coherence and if so, how is it done?
—*Frank Hahn*

WHEN modern economics was founded in the late eighteenth century, two axioms that still constitute the paradigmatic core of the discipline were established: the action-theoretical assumption that actors maximize their utility or their profit in their actions; and the idea that decentralized economic processes exist in, or at least strive for, an equilibrium in which the independently acting economic subjects can achieve an optimal realization of their economic plans. Ever since Adam Smith, the theoretical concept of order expressed in the notion of market equilibrium and the action-theoretical concept of choices of actors as oriented to the optimization of utility or profit have been considered together: the concept of order has its microeconomic base in the rational model of action; the "magic" connecting limb is the metaphor of the invisible hand.[1] Later on, the first theorem of welfare theory was formulated from this postulate, which says that, given a sufficient number of markets, the competitive action of all producers and consumers, and the existence of an equilibrium, the allocation of resources is Pareto-optimal in this equilibrium: none of the actors can enhance his utility by a change in the allocation of goods without impairing that of at least one other actor.

It can hardly be denied that a sturdy paradigmatic core for scholarly research is inherent in the two axioms and their connection: if the order of preferences is known, the normative premise of the maximization of utility on the basis of any set of preferences allows the anticipation of choices of the actors and their mathematical modeling; the concept of homeostasis refers to the socially desirable consequences of action oriented toward self-interest with the immense moral philosophical significance of the connection of a morally indifferent motive of action and a morally desirable result of action.[2] The optimality of the allocation situation in the equilibrium legitimates the market as the central economic institution with a capacity for universal approval.

The axioms of rationally acting actors and macroeconomic processes of equilibrium encountered both passionate critics and defenders. Ever since the action model of *homo oeconomicus* was introduced into economic theory, it has been subject to constant criticism. Its validity has been challenged not only by the Historical School in Germany, but also by the American institutionalists and now by an enormous literature from various disciplines that cannot be ignored.[3] The criticism argues both on an epistemological and an empirical level: an objective glance at the action of actors in economic situations demonstrates at once that they often do not follow the prescriptions of the model of the maximization of utility. As defined by the theory, "irrational" action is so prevalent in economic contexts that it does not seem admissible to exclude it simply as a deviation from the theoretical system for understanding economic processes. Actors do not maximize their utility but rather make allocation decisions at variance with the theoretical forecasts, by acting inconsistently or choosing suboptimal means to achieve stated goals. In the formulation of his first economic principle that every actor is guided only by self-interest, Edgeworth (1881:16) understood clearly that this was not a realistic description of action: "The concrete nineteenth century man is for the most part an impure egoist, a mixed utilitarian." The concept of forming macroeconomic equilibrium did not fare any better: the idea of an economic development evolving through the market, largely liberated from crises and social frictions, was soon rejected as an ideology by both Auguste Comte and Karl Marx; and the most highly respected alternative to orthodox economics of the twentieth century, Keynsian economics, has its core in the proof of a stable disequilibrium.[4] Finally, criticism of economic theory also turned against the postulate of the morally desirable consequences of action oriented purely toward self-interest. Durkheim (1984) saw economic relations oriented too much toward interest and too little toward morality as a definite cause of social anomie. Karl Polanyi (1944) analyzed the (necessarily abortive) attempt in the nineteenth century to establish a pure market society where exchange relations were no longer linked with principles of reciprocity or redistribution as a cause of the development of fascism in Europe. These lines of argument have been continued today, among others, by the American sociologist Amitai Etzioni (1988), who regards altruistic action orientations in economic contexts as a prerequisite for the market economy's ability to function.

The criticism of orthodox economic theory presented in this chapter does not proceed from the empirically observed discrepancy between theoretically deduced prescriptions of action and factually observed decision-making. For reasons that are explained later, the development of empirical weaknesses of economic theory is not regarded as a convincing starting point for a criticism. The strength of economic theory resides in the *normative* postulation of the connection between the action model of *homo oeconomicus* and a model of order derived from it in which efficient allocation equilibria prevail. Normative here means that recommendations for action can be derived from the theoretical models that imply how actors have to act if they want to optimize their individual utility, while the invisible hand of the market at the same time produces an equilibrium with optimal allocation of resources. A criticism of orthodox economic theories should begin with this strong point of the connection of models of action and order and should show why the normative claims of the theory are untenable. Considered systematically, there are exactly two action problems on which economic theory as a normative theory can founder: if, using the rational-actor model, strategies are recommended that lead to Pareto-inferior results; and if, because of the structure of the situation, it is not possible to identify an optimal manner of action. It can then be asked for the conditions under which actors can choose "irrational" strategies of action, which lead to *superior* results, and for the social mechanisms to steer action that are relevant for decision making under conditions in which an optimal strategy cannot be derived only from an ordering of preferences under the postulate of maximization of utility.

The three sections of this chapter are intended to examine these two limits of the economic paradigm as a prescriptive theory. Three action situations are discussed in which actors are confronted with the two systematic limits just mentioned: cooperation, action under conditions of uncertainty, and innovation. The discussion of the three action situations demonstrates that economic theory cannot *generally* derive efficient results from utility-maximizing action, but rather, under specific conditions, this theoretical model of action leads to Pareto-inferior equilibria or does not permit any derivation of an unambiguous strategy of action. According to the thesis that follows from this, we can imagine social order in the economy as defined by an efficient allocation of resources only if the actions of the actors are also integrated into nonmarket mechanisms of coordination. The achievement of efficient results of economic action requires the "social embeddedness" (Granovetter 1985) of actors, which either leads to deviation from the pursuit of rational individual strategies or actually enables actors to act in extremely complex or novel situations. These requirements are not consistent with the economic action model of universal maximization of utility, even though the line of criticism followed here does not call into question the at least intentional rationality of the actors as *homines oeconomici* but, rather, casts doubt solely on the efficiency of an action in line with the premises of the economic theory of action under specified conditions.[5]

In the first section of the chapter, using the cooperation problem in economic contexts, I examine the hypothesis of dispensing with rational action as a prerequisite for achieving efficient equilibria. The question of how rational actors can cooperate when noncooperation is the dominant strategy can be deduced from the prisoner's dilemma discussed in game theory. Empirically, it is easy to refer to examples of clearly irrational action of the actors, which can be seen in the cooperation that actually does take place (Marwall and Ames 1981). Instead of relying solely on these empirical observations, in this section I argue critically with such approaches in game theory that try to reconstruct cooperative action as rational strategy and thus solve the problem posed by the prisoner's dilemma within the theoretical premises of the economic theory of action. From this discussion I conclude only that cooperation cannot be explained comprehensively as the pursuit of a self-interested strategy of maximization.

In the second section, by means of the problem of uncertainty, I deal with the impossibility for actors to identify the optimal choice due to the complexity of the structure of the situation or due to cognitive limitations. The problem inserted into economic theory by uncertainty, unlike risk, consists of the fact that actors acting intentionally rational can no longer weigh the costs and benefits connected with various alternatives and thus *per definitionem* cannot make an optimal decision.[6] The theory founders again in its prescriptive function. Here, too, I argue with the modeling strategies developed in economic theory that claim to overcome the problem posed by uncertainty within the premises of the economic model of action.

The third and last section of the chapter concerns the aspects of innovation and learning. The neoclassical theory is designed as a static theory that starts from a fixed technology. Dynamic models regard technological change as an external shock, from which the economy moves back to an equilibrium. Innovative processes are understood very badly in orthodox economic theory as endogenous phenomena, and to this day Schumpeter's proposals for an economic theory of innovation are the starting point for modeling techniques that depart critically from neoclassical theory. From the perspective of the actor, investments in innovations cannot be derived rationally due to strategic uncertainty with respect to the action of other actors and the uncertainty of the utility of an innovation.

At the end of the chapter, we should be able to identify the three areas of cooperation, uncertainty, and innovation as central elements of economic processes at which the economic model of order as a normative theory encounters the limits cited. All three action situations refer to the limits