History, markets, hierarchies and institutions

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Abstract: New institutional economies and the work of Coase, Williamson,
North and others today occupies a central place in thinking about the nature of
economic hierarchies institutions. This paper argues that it cannot offer a guide
to history of the real development of markets, hierarchies and institutions.
Those writers like MacIntyre and Sennett who focus on focus on social
embedding and the potential conflict between pure markets and social cohesion
offer a better basis for understanding of the real history of capitalism. But this
approach too needs extending if it is to be a guide to the real history of markets,
hierarchies and institutions.

Keywords: history; markets; new institutional economics; hierarchies;
economic institutions; social embedding; social cohesion.

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1 Introduction

In January 1786 the mayor of the borough of Lancaster in the UK issued an order
determining how the local market should function.

Whereas several Hucksters and Higglers have made a Practice of buying up
Fruit, Eggs, Butter and other Provisions in this market in order to sell the
same again to the great inconvenience and Detriment of the inhabitants of the
Town who ought first to have an Opportunity of supplying themselves from
the Market

Notice is therefore hereby given
THAT if any Huckster or Higgler shall in future presume to buy any of the above
mentioned Articles in the Market before the HOUR of 11 o’Clock in the
Forenoon, they will be prosecuted with the utmost Rigor of the Law. (sic)
To anyone whose understanding of the role of markets derives from modern economics such a rule will seem perverse. However, much we might sympathise with the plight of the poor, the hucksters and higglers of the time were merchants exploiting a market opportunity. A decade before, Adam Smith had laid down the basic idea that the interests of ‘society’ are best served by allowing the invisible hand of the market to do its work. While market imperfections may be a problem they are as nothing to the imperfections of political interference. This political interference may masquerade as being in the interests of the poor but in reality it is a mechanism by which some buyers and sellers are allowed privileges (rents) over others and to the ultimate detriment of everyone.

But to anyone familiar with economic history, the Lancaster ruling will seem of limited interest for another reason. It is, in an historical sense, banal. Such rulings and attempts to limit the role of the market were commonplace. They reflect two things which many historians take for granted. The first was the existence of an historical ‘moral economy’, shared by the rich as well as the poor. This drew on a belief that markets should not always rule and that their activities should be guided by principles other than those of supply and demand. We do not have to be naïve about this. It was often necessary for the poor to re-enforce this moral economy by reminding the rich that it mattered. This was one of the social functions of rioting of all kinds in the eighteenth century as change seemed to give a wider role to a seemingly more anonymous set of market processes. But the rich at this time often seemed to take the hint, or even take the view that it was best to pre-empt a riot by moving first to limit the scope of market forces. Nor should we see this as simply a factor in the past. In 2008 the rising price of food in some countries also provoked protests and riots that were in part built around a different sense of a moral economy to that of a market economy (Thompson, 1991). The second and more analytical issue that follows from this is that although market exchange has long existed, it has been historically structured by a wider set of relations. Societies in which markets have existed have not thereby been market societies. The separation and celebration of the market, its detachment and elevation above society as the determinant of society at large, is itself an historical construction of fairly recent vintage.

But today there are sharp divisions over the extent to which this is true and how we should analyse the history of the present. This paper explores the way in which what is called ‘the new institutional economics’ explains the evolution of the markets, the institutions that support them and the organisational forms within them. It first briefly considers the problem of markets and institutions. It then offers a basic exposition of how the new institutional economics emerged, its ambitions and the key assumptions on which it is built. The third section criticises these assumptions. The final section considers the apparent paradox that the policies drawn from this approach which insist on the superiority of the unfettered market may actually weaken the social and moral structures that markets need to operate.

2 The problem of markets and institutions

Neo-classical economic theorists have had a problem with both markets and institutions. They have tended to assume them. Markets have always existed or are a form which just develops naturally, almost by a process of spontaneous germination.
The neo-classical market is an act of God, not an act of man. It is a natural rather than artificial (…) The natural market is beyond the will of humans. It is a product of nature existing outside of history (…) But the spontaneous market, the natural market, is an assumption. It is not a unit of enquiry, something to be investigated. Instead it is something to be assumed, taken for granted (…) the market is taken as the only real circulation process and the market is simply assumed to exist. It is viewed as a self-generated phenomenon, a product of immaculate conception and virgin birth. (Dugger quoted Ankarloo and Palermo, 2004, p.421)

The historian Michael Postan wrote that ‘no society known to us, however remote in time or backward in development, was incapable of exchanging commodities within itself or with other societies’ (Postan, 1975, p.206). But these exchanges did not necessarily generate market organisation as we understand it today. Karl Polanyi, for example, argued that in pre-capitalist societies markets were ‘accessories of economic life’ (Polanyi, 1957, p.68). Such ‘propensity to truck, barter and exchange’ as existed was severely circumscribed.

The issue here is more than that of acts of exchange. Modern capitalism is based on generalised commodity production which operates not only at the level of production and exchange of goods but also the supply of the means of production – land, labour and capital. For this to happen ‘nature’, in the form of land, must be turned into property that can be bought and sold. ‘Capital’ must become a commodity. And above all ‘labour’ has to be turned into a commodity as wage labour. It is this generalised commodity production, which only emerges with the development of capitalism, which gives markets and competition their centrality today. Before this, as Polanyi put it,

Whether we turn to ancient city-state, despotic empire, feudalism, thirteenth century urban life, sixteenth century mercantile regime or eighteenth-century regulationsim – invariably the economic system is found to be merged in the social. Incentives spring from a large variety of sources, such as custom and tradition, public duty and private commitment, religious observance and political allegiance, judicial obligation and administrative regulation as established by prince, municipality or guild. (quoted McMylor, 1994, p.102)

But economists have been more concerned with analysing how an abstract market functions than in dealing with the question of what is a market and where does it come from? In a review of the sociology of markets John Lie argues that ‘the market … is the hollow core at the heart of economics’. We have market theories but fewer theories of markets (Lie, 1997, p.342). The best economists recognised this limitation in their work. Walras explicitly said that he would abstract from a whole series of issues to be better able to treat the mathematics of ‘the market’ and general equilibrium. He did not by this assume that what he was abstracting from was less important or unnecessary for a full understanding. Others have been less insightful (Kurian, 1993). But the issue is not merely of historical interest. After 1989 much early thinking on economic transition in the former Soviet bloc was based on the assumption that well functioning markets would develop naturally once society was released from the dead weight of the state, a view that was also evident in western policy in Iraq in 2003.

Economics no less has a problem with institutions. These too are assumed and therefore neglected. Economics is often described as the science of choice in which market analysis leads to the conclusion that the invisible hand produces a Pareto efficient solution to the economic problem which works to the advantage of all. With the restrictive assumptions of the general equilibrium model no better outcome can be
theorised. But there is a major theoretical and practical difficulty. This analysis neglects the endemic possibilities for opportunism which exist if life (even in theory) is thought of as a series of anonymous and transitory exchanges. This is famously captured in the prisoners’ dilemma where the individual pursuit of self-interest leads to an inferior solution rather than a superior one. It finds expression in a more populist sense in the idea that the pursuit of market solutions leads to a competitive race to the bottom. In these terms the interesting theoretical question is to ask, in Douglas North’s provocative formulation,

Why do people obey the rules of society … when an individualistic calculus would suggest cheating, shirking, stealing, assault and murder should be everywhere evident … Indeed a neo-classical world would be a jungle and no society would be viable.

The answer is that institutions, formal and informal exist and contain the self-destructive processes that might be predicted in the pure market model. The market can be thought of as in Figure 1. It is something which is nested, nurtured and to an extent constrained by a larger set of structures which determine the rules of the game and limit the brutality with which the game can be played.

Figure 1  Nested markets and the appeal of ‘Economics Imperialism’

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<th>Allocative markets and rational choice calculus</th>
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<th>States</th>
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<td>1. formal – constitutions, law, enforcement</td>
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<td>3. ideologies and ideas</td>
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But where do the structures and institutions that support markets come from and how do we explain them? An obvious answer is that they are non-market forms which need to be understood with the aid of politics, sociology, history and so on. Their development involved a struggle by social groups who wished to see more scope for the development of a market society. It also involved an ideological struggle – ideas had to be changed by undermining any older logic of paternalism and creating a new ideological pressure in which the market was taken as normal. Above all, the extension of the power of the market involved a fight to develop and use the power of the state. The Polanyi paradox (more apparent than real) is that ‘laissez-faire was planned’. ‘The road to the free market was opened and kept open by an enormous increase in continuous, centrally organised and controlled interventionism.’ Thus the nature of markets, the ways in which they are nested within bigger structures that are themselves the product of change, requires a broad historical understanding of the process of social and economic change. Markets, and their economics, are merely one aspect of the development of human society.
In these terms we can benefit from a theoretical division of labour and a narrowly conceived market based economics can only have a limited explanatory power within a specified domain. Today this argument is rejected by many economists and organisational theorists in favour of the idea that a combination of rational choice analysis and institutional economics can generate a social equivalent of what scientists call a ‘theory of everything’, ‘Institutions matter’. They are not only necessary to the functioning of the market economy, institutional differentiation plays a considerable role in explaining contrasting performance between economies. But institutions and institutional variations can be explained in economic terms. Economics then becomes the queen of the social sciences, colonising the other social sciences and history in a form intellectual imperialism – what has been called ‘economics imperialism’ (Fine, 2000). In terms of Figure 1, the tools used to analyse markets and the assumptions of individualism, self-interest and rational calculus that underpin them can be turned outwards to analyse the surrounding, nesting structures too.

In the resulting discussion the term ‘institution’ is not well defined but the ambition is considerable. First, the aim is to explain why different hierarchical organisational forms (which are to an extent both structures and actors – hence the dotted line), exist and, most notably today, the balance of firms and states. Second, it is to explain what lies behind the broader structures of constitutions, law, property rights, enforcement mechanisms etc. Third, it is to explain the supporting development of informal conventions, norms, codes of conduct, ideologies and ideas that help both condition and drive the market economy.

3 The new institutional economics

Institutional economics has a diverse background with significantly differing traditions, which are represented in Figure 2.

The Marx, Veblen, Commons tradition, supported by sociology and anthropology from outside of economics, was generally highly critical of neo-classical approaches for the ways in which they assumed what had to be explained and not least the market. (Indeed Veblen seems to have been the first to use the term ‘neo-classical’ and use it in a critical way.) But such approaches became marginalised in mainstream economics because they did lead to the kind of modelling that become increasingly popular from the 1950s. Neo-classical ‘new institutional economics’ largely rejects the older approach because, in their terms, it is too descriptive. Instead it draws directly on neo-classical economics to explain institutional change and evolution and not least the varying patterns of markets, firms and states (hierarchies) in and through history (Matthews, 1986).
Figure 3 illustrates some of the varieties of the new institutional economics. Each version shares the aim of colonising the social and has thus been often self-proclaimed as a form of ‘economics imperialism’ – “economic imperialism” is probably a good description of what I do’, said the economist Gary Becker (Swedberg, 1990, p.39). More, each version seeks to reduce the complexity of the social to a narrow set of determinants. As Fine puts it, ‘paradoxically as explanatory principles shrink from the social to the individual and from human behaviour to utility maximisation – so their potential range of explanation expands’ (Fine, 2000, p.13; for a more positive view see Allingham, 2002).

Figure 3  The logic of economics imperialism

<table>
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<tr>
<th>New Institutional Economics</th>
<th>Origins of the Social</th>
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<tr>
<td>Why things work</td>
<td>Why things don’t work – sub optimal outcomes (Colonisation of radical economics?)</td>
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<tr>
<td>Becker</td>
<td>Williamson</td>
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<td>‘As if markets’</td>
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<td>‘economies of everything’</td>
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<td>Crime addiction</td>
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<td>Social capital</td>
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<td>North</td>
<td>Stiglitz</td>
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<td>Property rights</td>
<td>Information imperfections</td>
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<td>Incomplete markets</td>
<td>Incomplete markets</td>
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<tr>
<td>Initial conditions</td>
<td>Path development</td>
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<tr>
<td>Multiple equilibria</td>
<td>Market failure especially in labour and financial markets</td>
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A generation ago Matthews wrote of the New Institutional Economics that ‘politically it is neutral – it has been invoked of both market pessimism and market optimism’. (Matthews, 1986) This is reflected in our division in Figure 3 between those who put more emphasis on why markets work and those who emphasise why markets fail. The first approach – seen by its critics as Panglossian – emphasises the success of markets in themselves but also the existence of a calculus which leads to the selection of better institutional frameworks and organisational forms over inferior ones. The second approach places more emphasis on the persistence of market failures – in Stiglitz’s phrase ‘information is always imperfect and markets are always incomplete’ – and the ways in which inefficient institutional and organisational frameworks can be perpetuated (Stiglitz, 2006, p.29).

But it is important to note that both approaches overlap and this is their weakness. Although they draw different conclusions from it, both market optimist and market pessimist accounts use the neo-classical framework, adapted to institutional analysis, and so tend to build their arguments on a similarly questionable methodological base. The pessimists in effect offer an internal critique which, whilst important, nevertheless remains compromised by key shared assumptions. Thus the oscillation between a pro-market and an anti-market position arises because, in Hodgson’s words, the basic approach ‘has no adequate theory of markets at all’. (Hodgson, 2000, p.321) This creates
a situation where even the pessimists tend to be pulled towards positions which assume that markets are preferable, if at all possible, and that we should prefer market enhancing solutions to state controls.

In the 1960s, Gary Becker made a crude beginning in this colonisation process of extending economics to the fields of the wider social sciences when he attempted to understand various social forms and social behaviours in terms of a market calculus (Nell, 1984). In Becker’s approach the aim has been to directly apply economics to as much of human social life as possible or to create ‘the economics of everything’. Becker asserts the centrality of rational choice mechanisms based on universalised utility maximisation. Becker proceeded by trying to expand the sphere of ‘the economic’ at the expense of the ‘social’. Thus apparently non-economic forms of behaviour like the family, crime and most notoriously addiction (‘A theory of rational addiction’) were shown to be a product of maximising behaviour – ‘individuals maximise welfare as they conceive it’. This approach was relatively unsophisticated in treating non-market forms as if they were market forms. Taken to its logical conclusion social forms appear to lose all specificity. One major example of this can be found in the theory of the firm where this approach can lead to the idea that the firm as a distinct organisation, analysed as a separate form, is questioned. Thus Alchian and Demsetz can argue that the firm ‘has no power of fiat, no authority, no disciplinary action any different in the slightest degree from ordinary market contracting’ (Alchian and Demsetz, 1972, p.777) The logic of commodification is taken to its extreme and every relationship is treated as if it were a commodity relationship whether it is an external or internal firm relationship. The boundaries separating the internal from the external become not only permeable but to a large extent inexplicable.

But solving a problem by dissolving it is not a very attractive way of proceeding. More interesting from our point of view are those accounts which accept that organisations and institutions matter and then try to explain time in terms of a rational calculus. The biggest influence here has been Oliver Williamson who by the late 1990s had, become, ‘the most cited economist of his generation’ (Ingham, 1996, p.244). Williamson’s project has been described by Baumol as ‘a systematic theoretical examination of those features of society’s economic activities that the market mechanism does not automatically run to perfection’ (Baumol, 1986, p.279). In these terms Williamson argues ‘ ... that the economic institutions of capitalism have the main purpose and effect of economising on transaction costs’ (Williamson, 1985, p.17; see also 1980, 1984,1994,1998, 2005).

Williamson’s point of departure is a focus less on production efficiency than governance efficiency, a concern which derives from transaction cost analysis and Ronald Coase’s classic paper (Coase, 1937). Transaction costs have been defined as ‘search and information costs, bargaining and decision costs, policing and enforcement costs’ (Dahlman, 1979). Market exchange is not free, it involves these types of costs every time a transaction is undertaken. Worse it creates opportunities for exploiting information gaps, (I don’t know everything I need to know), information asymmetries (I know more about things I control) and asset specificity (I have limited choice over what I can do with my assets). In these terms where weak markets or market imperfections create problems, it becomes rational to substitute hierarchy for the market.

A huge edifice has been built on these narrow foundations. Voluntary relations based on exchange and transaction costs explain the development of hierarchies and institutions as ways of dealing with transaction cost problems. The weaker (thinner) the market, the
more problematic the transaction costs, the more logical the use of hierarchy over market. But institutions have to be ‘efficient’ solutions to problems. In the long run only efficient institutions will survive. Competition between institutional forms and the market will undercut organisations when they begin to suffer from diseconomies. Similarly the stronger (thicker) the market relations, the less necessary the resort to hierarchy. Williamson argues that capitalism gravitates towards market organisation. There is an optimum degree of centralisation which cannot be exceeded on the long run. However in this analysis markets and institutions tend to be seen as substitutes for one another. The problem is market or firm or state rather than market and firm and state within a larger framework.

The more historically based work of Douglas North tries to go beyond this. North too stands in a tradition which uses elements of neo-classical rational choice theorising but he derives a more pessimistic argument from it. He is also concerned to systemically consider where the institutions that underpin the market come from. But for North, Williamson’s world is one possible one amongst many, a best case based on the experience of the ‘west’ and the USA where markets are built on secure property rights. As North and Thomas put it, ‘economic growth will occur if property rights make to worthwhile to undertake socially productive activity’ (quoted Lie, 1993, p.276). But ‘economic history is overwhelmingly a story of economies that failed to produce a set of economic rules of the game (with enforcement that can induce sustained economic growth)” (North 1991, p.98). North’s less Panglossian view has evolved over time and is more eclectic than that of Williamson. Because of this it has had less influence in terms of theoretical model building. But it does not break with the basic assumptions of the new institutional economics. This is also the case with the work of Joseph Stiglitz who also emphasises the scale of market failure and the frequently inefficient outcomes that result and the institutions and organisations which thrive on them.

As Figure 1 suggests this produces an interesting thrust in ‘economics imperialism’. The conventional radical criticism of economic theory is that it focuses on the systems successes and leaves out or minimises explaining its many failures. But North writes that history is the ‘endless struggle of human beings to solve the problems of co-operation so that they may reap the advantages not only of technology, but also all other facets of human endeavour that constitute civilisation’ (North, 1996, p.133). But since this endless struggle is as much the history of inferior rather than superior solutions both success and failure that can be explained by conventional economic analysis. Stiglitz has gone further suggesting that the radical critique of economics finds striking parallels in his own work on ‘information economics’.

But a parallel is not an equivalence. Despite his subsequent radicalisation and emergence as one of the most penetrating critics of neo-liberalism, he still seems to remain an insider. It is not clear, for example, how far he has moved from his 1993 declaration that in explaining economic change and its aberrations, limited share holder discipline over managers is a more relevant issue that ‘traditional concerns of the exploitation of workers by capitalists’, or his argument that hierarchy is a necessity since ‘there are good economic reasons beyond the exercise of power (whatever that much-used term means) for the existence of hierarchical relationships’ (Stiglitz, 1993, pp.110–111). This approach seemingly marginalises the huge literature on class, organisation and bureaucracy as institutional and collective forces and replaces them with the calculus of gain elaborated through principal-agent problems ‘which quite simply tries to reduce the complexity of social and economic organisation to the individual
propensities of the amoral maximisers’ (quoted Fine, 2000, p.23). A similar reduction can be found in the idea ‘social capital’ – said to be the most popular idea of the last decade and which has found a place in much new institutionalist writing. The idea of capital has been broadened over time to include ‘human capital’, ‘intellectual capital’ and now ‘social capital’ – as in Fine’s terms ‘anything that is “social” other than the market’. The presence, absence, adequacy etc of ‘social capital’ then becomes ‘a residual explanation for all outcomes … Everything can be interpreted through or as social capital’ (Fine, 2000, p.21).

4 The assumptions of the new institutional project

For the New Institutional Economics to have a semblance of success as an explanatory framework three major assumptions are necessary. The first building block is the assumption that individuals are rational economic maximisers, what Veblen (ironically) called lightening calculators of pleasure and pain. The second is that we can hypothesise a set of market relations in order to explain whether these individuals succeed or fail in co-operating to achieve their ends through markets or hierarchies. The third is that this is sufficient to allow us to explain all that we want to explain. Let us briefly consider each of these points in turn.

4.1 Methodological individualism

The new instutionalist economics shares a focus on what is called ‘methodological individualism’ with much wider economic theorising. The characteristic “new” institutionalist project is the attempt to explain the emergence of institutions, such as the firm or the state, by reference to a model of rational individual behaviour, tracing out the unintended consequences of human interactions. An initial institution-free “state of nature” is assumed. The explanatory movement is from individuals to institutions, taking individuals as given. This approach is often described as “methodological individualism”. (Hodgson, 1998, p.176)

But can individuals be taken as given? There is a huge debate about how individuals affect or are affected by the wider structures of society. The problem is that human beings are necessarily social beings. Humans can only exist in relation to one another. Therefore to explain the social as the outcome of individuals outside of society combining to create society makes no sense. This is not to say that the actions of individuals are completely determined – properly there exists a dialectical relationship between agency and structure. But in this interaction in the first instance the weight cannot be on the individual. As Heilbroner and Milber put it, ‘the recognition of the inextricably social roots of all behaviour leads to the view that macrofoundations must precede microbehaviour, not the other way round as modern economic thought perceives the issue’ (Heilbroner and Milber, 1995, p.8). In other words history and theory cannot be constructed as if there were once individuals whose preference structures were themselves not a product of history.

This problem is also apparent when we consider the idea of rational maximisation. Behavioural economics suggests that this may be a false assumption in any case because the human brain is a poor calculator and therefore prone to frequent, systematic error in
making choices. But even if we ignore the seriousness of this challenge it can be argued that the idea of the rational maximiser is itself an historical construction – what it does is to idealise theoretically an historically specific form of behaviour. This is not to deny the role of self interest in history – this would be foolish. But it is to question the way in which a relatively modern and limited (or impoverished) conception of what it is to be human is made the foundation of analysis. To sustain this argument we do not need an Arcadian vision of past ‘natural’ economies. In all class societies there is evidence of both exchange and what MacIntyre calls ‘the self aggrandising drive for power and money’. But it does not follow from this that humans in the past necessarily conceived of themselves as acting in terms of some individualised self-interest. In ‘pre-capitalist societies there was pressure on the individual to eliminate self interest from his consciousness to the point of making him unable, in many cases (but by no means all), even to comprehend the implications of his own action in terms of such an interest’ (MacIntyre quoted McMylor, 1994, pp.81, 100).

Hodgson emphasises that this unwillingness to locate the conception of the human as a utility maximiser historically is one of the features that distinguishes the new institutionalists from the first generation of institutionalists and it is a distinction that works to the first generation’s advantage. Early institutionalists emphasised the centrality of a socially conditioned habit and custom in human behaviour in general but also within capitalism. To the extent that utility maximisation existed within a framework of habit and custom, it had to be explained and not simply assumed.

The third problem with the individualistic calculus is the question of the distribution of resources and the extent to which social interaction is voluntary or coerced. Within the discussion of hierarchy there is often an explicit argument about the efficiency of inequality and social ordering. The division between leaders and followers needs to be understood, suggests Hermalin, as a voluntary exchange, ‘as economists we presume that followers follow because to is in their interest to do so’. The happy legitimation of inequality by assumption is obvious. But if interests are historically conditioned so too is our capacity to realise them. As Fine puts it, ‘whether or not we are able to realise our interests depends in part on the power they hold relative to other agents and the particular outcomes of the action’ (Fine, 2000, p.41). But what determines the unequal distribution of resources in the first place? Standard historical accounts do not derive this from some initially uneven distribution of human abilities (and in any case the problem would be to know which abilities mattered) but analyse it in terms of force and coercion. The sophistication of social organisation therefore is not necessarily a product of humans recognising that it is in their self-interest to cooperate and allow some a greater reward than others. They may have no choice in this – they may be the victim of an initial coercive act and their children subsequently born into unequal societies where coercion continues to play a role, even if veiled by the invisible hand. Hierarchy and organisation are therefore not necessarily a product of voluntary attempts to minimise transaction and production costs. They can equally be a product of, and a means to, continued domination and exploitation. There is a special irony here in the way that the new institutional economics attempts to use arguments whose roots lie ultimately in the idea of voluntary exchange to explain some of the most coercive forms in history from slavery to serfdom to capitalism itself. Williamson, for example, in rejecting explanations based on power and coercion in favour of choice, ends up with the argument that workers and employers each choose one another (and to be what they are) in terms of their respective efficiency properties (comparative advantages).
4.2 ‘As if’ markets

The second problem that needs to be addressed is where markets fit into this discussion. If there is a problem with the relationship between individuals and society there is no less of one between markets and institutions. We suggested at the start of this paper that markets should be thought of as being nested in institutional structures with firms and the state being both institutions and actors. If this nesting hypothesis is correct then markets cannot be given analytical primacy in explaining the structures within which they exist. To see markets as logically preceding institutions one must conceive of the market as some primordial thing. But just as individuals cannot exist without one another so markets cannot exist without institutions. Giving analytical primacy to the market and deriving institutions and organisational forms from it, as complements to the market and substitutes for its failures, is both historically and theoretically implausible. But this is essentially what those who espouse the main tenants of the new institutional economics do. This is most obviously the case for Oliver Williamson.

Williamson claims that we must assume for explanatory purposes that ‘in the beginning there were markets’ so we can then understand non-market forms as a deviation from this assumption. He also claims that this is a mere analytical convenience. It would equally be possible to start from the assumption of the universality of central planning and then look at existing forms as a deviation from this. This is, as Ankarloo and Palermo argue, not credible. The whole argument depends on the assumption of market calculus. The result is again a form of ‘as if history’ (Ankarloo 2002; Ankarloo and Palermo, 2004). Markets would exist if they could but, pace Williamson, transaction costs mean that other institutions become necessary as substitutes and evolutionary competition then ensures that they become fit for purpose to achieve an optimum balance of market, firm and state. Thus although these approaches appear to address the issue of history it is not real history that they are interested in. Rather they attempt to model a hypothetical calculus of non-market activity through theoretical time. This produces a pseudo history in the form of logically deduced jumps from static stages, ‘a fairy tale whose happy end is the present’ (Ankarloo and Palermo, 2004, p.427; see also Milonakis and Fine, 2007). This is then used to explain (or model) societies which, we have suggested, found many if not most of the assumptions made by the new institutional economists inconceivable.

We should extend this point in a more precise direction for one institution in particular creates a special problem, namely the state. Insofar as the state acts as a producer it can be seen as an hierarchical alternative to the market and the firm. But the state also provides the conditions for the existence of markets – it appears to act to some degree in the common interest of the (national) system.

The invisible hand which guides men to promote ends which were no part of their intention, is not the hand of some god or some natural agency independent of human effort; it is the hand of the law giver, the hand which withdraws from the sphere of the pursuit of self-interest those possibilities which do not harmonize with the public good. (Robbins, 1952, p.56)

But why? It is difficult to derive a satisfactory explanation of this if we stay within the confines of the approach we are discussing because both markets and hierarchies are supposed to be explained in terms of the self-interest of the actors. In these terms the state and state power is especially problematic. One way to deal with it is to assume that the state is a fictional individual – the ruler – whose actions are explained by a pursuit of a singular self-interest. Another way to deal with the problem is to conceive of the state
as a collection of individuals (or groups) concerned to compete against one another and outside forms for their own benefit albeit while claiming to act in the interest of society. While the first approach maintains the unity of the state as an actor, the second seems to dissolve it in a collection of actors and actions but neither can satisfactorily explain what might, in these terms, be thought of as the ‘altruism’ of ‘the state’ in creating system supporting structures.

4.3 Formal and informal ideologies

The third issue that needs to be addressed is whether the arguments offered provide a sufficient explanation for the operation of markets and in particular the extent to which they can cope with trust issues. Williamson and others in this tradition explicitly recognise this problem – indeed in one sense their analysis is an attempt to resolve theoretically the problem of the way that ‘self-interest seeking with guile’ creates the threat of endemic ‘mistrust and malfeasance’. In Milonakis and Fine’s phrase this involves a move from the principle of pricing to the ‘pricing of principle’.

It is often argued that a rational choice mechanism is at work here. Individuals co-operate because it is in their mutual self-interest. What appears as altruism and concern for others is really masked self-interest but its extent is sufficient for us to form social bonds. But if relationships are transient then any self-interest in them is limited. Granovetter gives as an example the tipping problem. Why, on a long journey should I tip a waitress who I have never met, will never see again, for a service that is already complete? Polanyi raised a sharper version of the same problem. What is to stop me pressing a button to get what I want today if the result is the death of some in China who I will never know or whose relations I will never meet? Moreover, since other institutions are required to mitigate the role of ‘guile and malfeasance’, then it seems self-evident that mutual self-interest alone cannot be the explanation of trust. The self-interest model contains too many incentives to exploit others to one's own advantage or to ignore the more distant members of society. The institutions which limit this include the state and law but even they are not adequate by themselves since they need to be supported by a sense of morality and wider ideologies. Moreover as Granovetter insists solutions in terms of state and law are not proper examples of trust but substitutes for it, limiting what would otherwise be Hobbes’ ‘war of all against all’ (Granovetter, 1985, p.489). They are also incomplete substitutes because if we are all engaged in a ‘war of all against all’ then the default mode is ‘dishonesty’ and there will be constant pressure to subvert them.

This problem takes its most extreme form when the market is viewed in terms of the competitive model. Here, as Hirschman, points out

> Large numbers of price-taking anonymous buyers and sellers supplied with perfect information ... function without any prolonged human or social contact among or between the parties. Under perfect competition there is no room for bargaining and negotiation, remonstration or mutual adjustment and the various operators that contract together here do not enter into recurrent or continuing relationships as a result of which they get to know each other well.

(Hirschman, 1982, p.1473)

Even if we do not assume the extremes of perfect competition the same problem appears the greater the level of commodification. The market sphere is what MacIntyre calls ‘a society of strangers, that is a society [based on] the bonds of mutual utility and of appeals to rights’. Weber made the same point, ‘the market community ... is the most impersonal relationship of practical life into which a human being can enter’.
Where the market is allowed to follow its own autonomous tendencies, its participants do not look towards the person, or each other, but only towards the commodity; there are no obligations of brotherhood or reverence, and none of those spontaneous human relations that are sustained by personal unions. (Weber quoted McMylor, 1994, pp. 78, 103, 120)6

But illegal and immoral behaviour is not the norm, nor is it distributed in the same way across society. Ideas of trust depend upon a sense of justice and fairness which are embodied in generalised moralities but these moralities do not appear to be derived from the market calculus.9

If self-interest cannot explain morals and ideas – what can? Hirschman suggests two other approaches. One is that integration within real capitalism arises from deviations from the market model. It is not perfect competition that integrates society but imperfect competition. This allows the sociological mechanisms of integration and cohesion. But if this is correct it also means that we cannot use market efficiency in the Pareto sense as a measure of the validity of a model of universal commodification or institutional change and development.10

A second solution is to see cohesion as being a product of something that comes from completely outside of the system. Thus Habermas argues that the ‘motivational structures necessary for bourgeois society are only incompletely reflected in bourgeois ideologies, capitalist societies were always dependent on cultural boundary conditions that they could not reproduce. They fed parasitically on the remains of tradition’ (McMylor, 1994, p.102). Hirsch similarly argued that ‘the social morality that has served as the understructure for economic individualism has been a legacy of the pre capitalist and pre-industrial past’. ‘The market’s moral framework is not sufficient (indeed has never existed in its own) to sustain non market elements’. (Quoted Hirschman, 1466).

5 Are markets weakening social cohesion?

This creates a problem. It has been argued that where possible we should prefer the market to the state – a view assisted by the collapse of the Soviet bloc. Where ‘hierarchy’ is necessary, whether as firms or states, these will work best if subject to as much external market discipline as possible, and internally to pseudo market incentive systems. And since individuals are motivated by self-interest it is important too that in hierarchies they be mobilised by this self-interest rather than a trust in what might be called ‘virtue’. No less, because of the argument that there are dangers of ‘aberrant’ behaviour mobilised through the political system, there has been support for ‘depoliticising’ as much economic decision making as possible by separating it from the political sphere and reducing the closeness of political oversight.

But this attempt to expand the role of the market creates an obvious problem in terms of the arguments we have made. What if the pursuit of markets actually weakens the structures within which markets operate? In terms of the new institutional economics this question makes little sense but if it is wrong, for the reasons we have suggested, then this issue seems to loom large. A situation might occur where, as Hirschman puts it, the apparent economic legitimacy of the market in terms of ostensible efficiency properties is bought at the expense of its ‘sociological legitimacy’. In the last two decades this type of argument has loomed large in the critique of the expansion of the market and, albeit perhaps implicitly, as a way of holding the line against the theoretical advance of the ideas involved in the new institutional economics style theorising.
The long historical debate on the market has always involved a discussion of the extent to which the market works in its own terms – how much market failure is there and how is this best dealt with it. But it has also involved a deeper discussion about the underlying nature of markets, even when they work as they are supposed to do. This deeper debate has involved a double critique emphasising on the one hand, the market as an alienating mechanism and, on the other, the market as an exploitative mechanism. Both types of argument can be found in the writings of Marx but neither originates with him. The two arguments can complement one another but in the end Marx gave emphasised the issue of exploitation in terms of the critique of capitalism and his call for action against it. Crudely, mobilised to political consciousness, opponents of capitalism would act against exploitation and be led on to deal with the issue of alienation. The arguments about social cohesion, however, can best be understood as drawing on the alienation strand in the market critique, a strand which then leads on to the issue of ‘sociological legitimacy’.

In the light of our earlier discussion it is easy to see possibly corrosive social consequences of marketisation. Those who celebrate the virtues of the market find that they can only do so from gated communities and trust and cooperation falls in society at large with the injunction to follow our self-interests and behaviour, as if every relationship is a commercial one. Thus the decline in the ‘social’ is far from being an unfortunate by-product of modern society; it is a direct result of the extension of market relations and thinking in modern capitalism. However, powerful though these arguments may be, they are also to a degree pessimistic too. The very fact that markets may be undermining social cohesion also creates the possibility that they may also undermine the institutions and organisations which might be sources of resistance as well.

It would be possible to take any number of examples here – the debate on trust, is an example (Ingham, 1996; O’Hara, 2004; Dasgupta, 2007). Another is the work of a writer like Richard Sennett (1998). Sennett suggests that from the eighteenth century onwards there has always been a sense of ‘the dark side of the market’ but the development of a more organised capitalism, for all its faults, did provide a basis for a degree of more personal stability and identity. The more recent emphasis on market flexibility, however, has increased the dependence on what Mark Granovetter once called ‘weak ties’ with negative results for both the individual and society. ‘Short term capitalism threatens to corrode … character, particularly those qualities of character which bind human beings to one another and furnishes each with a sense of sustainable self’ (Sennett, 1998, p.27). We no longer have a clear sense of what we value in ourselves, what we value in others and what we want others to value in us. Weak work identities, in particular, create the basis for weak social identities in general.

Such arguments can also be found in the work of the philosopher Alasdair MacIntyre who adds an interesting inflection of special relevance to those in management and business schools. MacIntyre argues that humans need a life built on virtue but that ‘the tradition of the virtues is at variance with central features of the modern economic order and more especially its individualism, its acquisitiveness and its elevation of the values of the market to a central social place’. As a result ‘the new dark ages are already upon us’ (MacIntyre, 1981, pp.254, 263).

MacIntyre too argues that ‘market relationships can only be sustained by being embedded in certain types of local non-market relationship, relationships of uncalculated giving and receiving, if they are to contribute to overall flourishing, rather than, as they so often do, undermine and corrupt communal ties’. MacIntyre therefore sees a conflict
between market imperatives and a decent life. He was already arguing in the 1970s and 1980s that the past barriers that prevented the full force of the market operating (and therefore insulated us from its corrosive effects) were breaking down. The result was an inversion of vices and virtues: virtues become vices and vices become virtues. Keeping one’s word is seen as a vice while breaking it is a positive sign of adaptability and flexibility. Worse, social relationships become manipulative and people become means to ends rather than ends in themselves. Since there is no common good over and above that produced by competitive self-interest, these ends become either personal or institutional aggrandisement. Obviously this produces enormous problems for the people at the bottom who are the major ‘means’ within the system. Free market economies, he argues, ‘ruthlessly impose market conditions that forcibly deprive many workers of the productive work, that condemn parts of this labour force in metropolitan countries and whole societies in less developed areas to irremediable economic deprivation, that enlarge inequalities and divisions of wealth and income, so organising societies into corrupting and antagonistic interests’ (Knight, 1998, p.249).

But this argument about social involution can be also given an interesting political inflection. Traditionally the ‘middle class’ has been seen as a bastion of support for capitalism and arguments that ‘we are all middle class now’ used to suggest that there is no constituency interested in a systemic change. We will leave aside the issue of what the term ‘middle class’ means. Our interest is rather the argument that this social involution has no less an impact on the ‘traditional middle class’ than it does on workers and employees. Professionals and managers, for example, have been argued to have become victims of the processes we have discussed.

As ‘professionalization’ developed in the last century a number of commentators attributed to professionals as a group a key role in moderating the impact of the market and sustaining the structures within which it worked. Independent professions were argued to form a barrier between the excessive power of the state and the excessive power of the market and so act as a force for community cohesion. Professional groups helped to generate a collective, non market, moral vision that put the social good rather than self-interest first. Typified by the activities of such groups as doctors and lawyers, the ‘true’ professions were thought to draw on a body of expert knowledge and use it in the service of ‘society’ as a whole. This helped to create the moral order within which the market operated but which was not reducible, as new institutionalist economics suggests, to it. Professional autonomy, the space in which they are allowed to work and practice, gave professionals the capacity, in the words of one early formulation, to ‘engender modes of life, habits of thought and standards of judgement which render them centres of resistance to the crude forces which threaten steady and peaceful evolution’ (quoted Johnson, 1973, p.14). In return society was expected to defer to professionals, show them a degree of respect and offer them a degree of trust.

In the two to three decades after World War II this idea of professionalism as a humanising force within capitalism and the market came under attack from those who saw professions being bureaucratised by both the state and big business. In a stronger version of this critique, professions, far from being centres of resistance, were deemed to be becoming ‘servants of power’. For others professions were and are power. According to this argument there is no independent way of establishing what a profession is. Rather some groups are able to establish a professional status and then deny it to others. Here process, discourse and power are all.
But from the 1980s the balance of the argument shifted and this latter argument merged with the sceptical market critique of professionalism as an ideology of self-interest. According to this view professionalism is the way in which organised groups are able to extract rents for themselves under the guise of serving others. So far from being an element of social cohesion at the service of society as a whole, professions are really little more than private corporations that need to be subjected to the disciplinary powers of the market.

The attempt to create a wider role for the market, therefore, involved an attack on the idea that professionals had a special role or capacity. In the UK, this resulted in numerous clashes with professional groups and bodies and especially in the public sector. If professions are merely self interested groups then everything they say and do must be viewed with suspicion. The relationship with the client, patient, student becomes a relationship with a customer. Professional prerogatives have to be subordinated to a superior managerial prerogative. There has also been a redefinition of professionalism away from any loyalty to an external ideal or authority, reflected in the not so subtle shift from the idea that a professional has a right and duty to say no to the idea that professionalism is a willingness to say yes.

But although presented as market strengthening, the attack on ‘professionalism as self-interest’ can be argued to have generated a whole series of negative and counter-productive trends. As one UK commentator put it,

“Our problem with the government’s approach to public service reform is that they trust no one. It’s a legacy of Thatcher and what is known as rational choice theory, which argues that no one can be trusted to act in anything other than their own interest. It was an arrow into the heart of professionalism and public service ethos. We cannot possibly care for each other, but instead operate as cold, calculating machines seeking to maximise our own utility.” (Lawson, 2008)

Deprofessionalisation then invites people to act just as ‘cold calculating machines seeking to maximise their utility’. But it then becomes ever more complex to limit the perverse consequences of this in terms of the loss of trust and cohesion. Several commentators have noticed that the attempt to generate pseudo market indicators and targets has actually begun to reproduce elements of the infamous Soviet ‘indicator problem’ that was apparent in the old USSR. Since one indicator was never sufficient to achieve the end, indicators and targets began to proliferate in all sorts of bizarre directions. The reduction ab absurdum of this perhaps came in the UK in the summer of 2008 when in the National Health Service – which had been a particular victim of the pseudo market target culture that flowed from this analysis – it was seriously suggested that nursing commitment should be additionally measured by a smile/fun indicator because, as the then government Health Secretary, put it, ‘if your experience involves nurses looking grumpy, or someone being rude, or not getting people there when you need them, then it ruins the whole experience’ (BBC News, 18 June 2008).

But it can also be argued that managers too have been far from free of the negative consequences of the policies they have often supported and implemented. MacIntyre, for example, argues that managers are forced to be the manipulators of people (sometimes in their own interest, sometimes in those of their company or organisation). They then end up in a deeply uncomfortable and unsatisfactory position. Managing involves attempting to control, a system which has no external goal – no telos. One way of solving this problem historically has been through the privileging of technique in
general and scientific management in particular. Goals are displaced. But a focus on technique is both a self-deceit and a social deceit. Techniques cannot live independently of ends. Worse capitalism and the market do not generate processes which humans can have the knowledge to allow scientific management even if it was desirable. Managers must therefore live a lie as an instrument themselves – a powerful instrument possibly, a well paid one probably but an instrument nevertheless.

Marx also pointed out that all humans including managers are subject to alienation but he took the view that those who commanded labour and capital were compensated for their ‘pain’. MacIntyre is less sanguine about the possibility of adequate compensation in terms of the human being. Subsequent analysis of the managerial dilemma offers some support for this. It is possible here to see perhaps an interesting way of reinterpreting the evidence of managerial stress that appears in survey after survey (e.g. Worrall and Cooper, 1997–2008). ‘Self harming managerial behaviour’ reflects the fact that managers become both victimisers and victims. They are caught in a bind in the work relationship from which they cannot break out so long as its terms are accepted.

The arguments of commentators like Sennett and MacIntyre remain, however, pessimistic and problematic. The two are connected. The logical problem derives from their unwillingness to locate their analysis in a political economy of capitalism and the market. If the market has existed for a long time then why has the issue of social cohesion become so important now? The answer that is often given is globalisation, heightened competition and so on which appear in the role an economic deus ex machina. This argument will be familiar to everyone. It then connects to the argument about agency and political pessimism. The pessimism of much criticism of the corrosive power of the market rests on the idea that its effects are to be lamented but not effectively challenged. The focus on a loose idea of ‘alienation’ at the expense of a more serious exploration of issues built around exploitation undercuts the possibility of social change. Part of the trick is that when the market is presented as a disembodied force it can appear, with the forces generated by it, as all-powerful. The market is the supra-historical force, which makes things happen. If writings in the spirit of the new institutional economics reflect the triumph of a neo-liberal agenda, the critique we have discussed can be seen as a more defensive argument against it generated at a time when in the narrowest of ‘economic terms’ the system appeared to be working. This is not to say that it is wrong but that it is not enough.

But it is equally possible to see that the shifting ideas and policies of the most recent decades as a product of a far more ‘classical crisis’ in which the balance has tipped in favour of capital and away from labour. This can certainly be read in the macro data of changing profit rates and the capital labour share in national income. This might suggest that we need to reconnect with what we suggested earlier were the two halves of Marx’s argument. Alienation and exploitation are not alternatives but complementary and related forces in capitalism.

The financial turmoil in the global system that broke in 2008 was unprecedented in its scale and, despite some claiming the benefit of hindsight, it was unseen by those who had supported the market thrust of the two to three decades before whether at the level of policy or in terms of the theorising that has been embodied in so much of the new institutional economics work. ‘What you, as the City of London, have achieved for financial services we, as a government, now aspire to achieve for the whole economy’,
the then British Chancellor and later Prime Minister Gordon Brown had argued. The possibility must at least be allowed for that one outcome of the crisis will not simply be a shift in ideas like those of the new institutional economics but a shift that is supported by a much more sceptical, rigorous, informed and committed critique of both market society and the market economy.

References


History, markets, hierarchies and institutions


Notes

1 Polanyi’s own account of this, especially in his most famous book, *The Great Transformation*, is not without its problems. His periodisation is somewhat crude and he tends to place too much emphasis on changes in the eighteenth and early nineteenth centuries in contrast to those from the sixteenth century onwards. He does not focus so much on the social struggles and, as I argued in an earlier paper with Rumy Husan, Polanyi does not by any means have an adequate or even barely adequate theory of the state (Haynes and Husan, 1998). This is a crucial defect given that he sees the state both as the institutional power that helps create the space for the market economy and then later comes to contain it. But the criticisms cannot detract from the central value of his understanding of the ways on which a market society is constructed as much by the deployment of the ‘visible fist’ as the ‘invisible hand’.

2 It is important to stress that the issue is not initially a debate over the balance of rationality and irrationality but where the structures supporting rational action come from and whether rational action is, in Weber’s terms, ‘instrumental-rational’ i.e. a rational evaluation of alternative means or ‘value rational’ – a way of rationally achieved normative ends (see Ingham, 1996).

3 It remains, however, a vigorous tradition (see Samuels, 1995).

4 Identifying and measuring actual transaction costs is a different matter. Even Williamson notes that they have been seen as ‘a vague and malleable concept … invoked as an all-purpose explanation for puzzling practices … an expansive concept’ (Williamson, 2005, p.4).

5 There is also a debate about ‘groups’ but the methodological individualists see groups as simple aggregates of self-interested individuals.

6 Most specifically in the assumption of universal markets this approach fails to deal with the peculiarity of wage labour and the labour market.

7 ‘Neo-classical economics gains much of its power and utility from the “as if” principle: We construct economic models as if …’ writes Sherwin Rosen (1997, p.147).

8 The appropriateness of the use of the term ‘choice’ in rational choice is problematic. The ‘utilitarian dilemma’ suggests that behaviour does not involve choice (except to be irrational) but rather determinate adaptation to objective circumstances.

9 ‘Trust is … both a cause and consequence of individual plans and purposes. The existence of such an order cannot be explained satisfactorily by arguing in one direction only, by starting from the abstract individual’ (Hodgson, 1989, p.254).

10 Schotter using game theory suggests that over time rules and codes may emerge as market imperfections that allow deficiencies in the games to be overcome. Market imperfections can therefore themselves be rational and necessary adjustments. But this is still modelled on an individualistic calculus (see Hodgson, 1989, pp.255–258).

11 Some commentators seek to diminish the sharpness of MacIntyre’s critique by arguing that virtuous practice can be housed in virtuous organisations without a need for a really fundamental change in market and business organisation (see Moore, 2002; Beadle and Moore, 2006).